Competitiveness and Private Sector Development

Competitiveness in South East Europe

A POLICY OUTLOOK

2016



OECD

Competitiveness and Private Sector Development

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A POLICY OUTLOOK

BETTER POLICIES FOR BETTER LIVES

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Please cite this publication as:
OECD (2016), *Competitiveness in South East Europe: A Policy Outlook*, Competitiveness and Private Sector Development, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264250529-en

ISBN 978-92-64-25051-2 (print)
ISBN 978-92-64-25052-9 (PDF)

Series: Competitiveness and Private Sector Development
ISSN 2076-5754 (print)
ISSN 2076-5762 (online)

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Preface

In the aftermath of the global financial and economic crisis, all countries are confronted with the need to address structural reform challenges to boost competitiveness. Recovery has been sluggish in developed and emerging economies alike. In this challenging setting, the way forward – particularly for small, open economies – is to implement reforms to improve the conditions for investment and private sector development, so the economy can grow, more jobs can be created and all citizens can enjoy greater opportunities and well-being.

South East Europe (SEE) is a region of middle-income economies that lies on the doorstep of the European Union (EU), the largest trading block in the world. The region had made great strides in liberalising investment and improving its business climate. As a result, it experienced annual growth rates in excess of 5% between 2000 and 2008. Following a double-dip recession in 2009 and 2012, growth has been slowly recovering, though it is still far short of pre-crisis levels. The impact on jobs has been dramatic: employment rates dropped by 7 percentage points between 2008 and 2012 and had clawed back only 2 points by 2014. The region still has much ground to make up, with per capita GDP still at about one-third of the EU average.

The SEE economies have made competitiveness a priority as they strive to boost economic growth and the well-being of their citizens. Policy makers from across the region have drawn up an ambitious agenda for *integrated, smart, sustainable and inclusive growth*, underpinned by *governance for growth*. That agenda is set out in the South East Europe 2020 Vision, adopted at the Ministerial Conference that took place at the OECD in 2011. In 2013, the South East Europe 2020 Strategy translated the SEE 2020 Vision into a comprehensive strategy with specific headline targets.

The region's economies have also committed to enhancing their focus on competitiveness in the context of their efforts to meet EU accession criteria. In particular, measures to improve growth and competitiveness are at the centre of the Economic Reform Programmes (ERPs) that economies of the region committed to preparing on an annual basis. The ERPs require the economies to make an in-depth, evidence-based diagnostic of the obstacles to greater competitiveness and growth. It is in this context that the OECD can offer relevant and effective expertise in support of reforms.

This first edition of *Competitiveness in South East Europe: A Policy Outlook* supplies quantitative and qualitative information on 15 key policy dimensions of the SEE 2020 Strategy. It offers indicators that will enable SEE policy makers and citizens to compare their economy's performances with each other's and, where possible, with those of the European Union. These 15 policy dimensions encompass a wide scope of key areas in national competitiveness – including public governance, regulation, investment, the environment and education.

The report acknowledges regional progress in all dimensions and describes the benefits of a more strategic approach to policy making, including through more effective whole-of-government co-ordination. In this regard, it stresses the need for more effective involvement of stakeholders in policy design and implementation, particularly the private sector.

Competitiveness in South East Europe: A Policy Outlook, which is part of the OECD's long standing partnership with South East Europe, benefited from close co-operation with governments and regional policy networks. While the OECD contributed the expertise of its Secretariat and various Committees, the governments of South East Europe provided qualitative self-assessments and statistical data. The report also builds on good practices from OECD economies that have addressed similar issues and provides evidence-based perspectives to inform policy making in the region.

I would like to thank all those who have contributed to this publication. It provides a strong basis for implementing the mandate of the 2015 OECD Ministerial Council Meeting to further strengthen the Organisation's South East Europe Regional Programme. *Competitiveness in South East Europe: A Policy Outlook* seeks to become a key resource for regional policy makers, citizens and researchers in the design, the development and the implementation of better policies for better lives.



Angel Gurría

OECD Secretary-General

Foreword

This first edition of *Competitiveness in South East Europe: A Policy Outlook* offers quantitative and qualitative assessments of key policy dimensions related to competitiveness in six economies from South East Europe – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia. It provides assessment frameworks for evaluating current policy and institutional performance, and for regional benchmarking and comparison with EU and OECD good practices.

The 15 policy dimensions in this report encompass a wide range of policy areas that are critical to economic growth. **Investment Policy and Promotion** attracts foreign and direct investment to increase job creation and technology transfer. **Trade Policy and Facilitation** reduces barriers to trade to facilitate cross-border economic activities and the flow of ideas. **Education and Competences** builds the human capital needed to develop a modern economy. **Research, Development and Innovation** are key to the shift towards knowledge-based economies. **Digital Society** uses information and communication technology to ease market frictions, reduce transaction costs and improve productivity. The **Cultural and Creative Sectors** are valuable in and of themselves, stimulating innovation through creativity and exerting a positive effect on social and territorial cohesion. **Transport** contributes to domestic and international economic integration, helping countries take their place in global value chains as it takes increasingly less time to move goods and people. **Environmental Policy** addresses sustainability objectives by ensuring that critical input factors remain available over time through improved resource efficiency and diversified product portfolios. **Access to Finance** lays the foundations of growth by enabling businesses to start, grow and innovate. **Tax Policy** strikes a balance between raising the revenue required to deliver public services and relieving the burden on enterprises and individuals. **Competition Policy** seeks to prevent unfair competition through government regulations that foster an internationally competitive business environment. **Employment Policy** makes labour markets more inclusive and efficient in addressing post-crisis and demographic challenges. **Health Policy** contributes to economic growth through greater labour productivity, demographic change and higher educational attainment. The quality of **Effective Public Services** – be they political, institutional or legal – has a causal link with a nation's overall level of socio-economic development. **Anti-corruption Policy** improves government efficiency as a whole, limits resource misallocation and builds trust.

The report greatly benefitted from close co-operation between SEE governments, regional policy networks and the Organisation. We express our gratitude to the OECD directorates which contributed their expertise in fields of knowledge covered by the

* 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.

15 policy dimensions, the SEE government officials who provided qualitative self-assessments and statistical data, and the regional policy networks which supplied expert understanding of the SEE economies.

Acknowledgements

The report is the outcome of the European Commission's initiative to develop a tool for monitoring the key policy dimensions related to competitiveness in the six South East European economies.

The work was conducted by all six economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro, and Serbia. Special thanks go to the many government representatives who have been actively involved and whose support and dedication have made the development of this report possible.

The work was co-ordinated by the OECD South East Europe Regional Programme in collaboration with the Regional Cooperation Council (RCC) (Sanjin Arifagic, Dragana Djurica, Nand Shani, Maja Pinjo-Talevska and Mladen Dragasevic) and 16 regional expert organisations and networks.

The regional expert organisations and networks include the CEFTA Secretariat (Renata Vitez and Umut Ergezer), the ERI SEE Interim Secretariat / Centre for Education Policy (Jasminka Cekic Markovic, Nevena Adzic and Vanja Ivosevic), the Electronic South East Europe Initiative (Nera Monir-Divan), the Energy Community Secretariat (Violeta Kogalniceanu), the Global Water Partnership (Dimitris Faloutsos and Anna Maria Papaioannou), the Network of Associations of Local Authorities (Natasha Ilijeva Acevska and Ranka Bartula-Musikic), the Regional Anti-Corruption Initiative (Radu Cotici and Kiro Cvetkov), the RCC Task Force for Culture and Society (Milena Filipovic), the Regional Environmental Centre (Gordana Kozhuharova), the Regional School of Public Administration (Goran Pastrovic), the South East Europe Centre for Entrepreneurial Learning (Efka Heder and Maja Ljubic), the SEE Health Network, the South East Europe Transport Observatory (Mate Gjorgjievski), the Regional Rural Development Standing Working Group (Boban Ilic and Katerina Spasovska), the Western Balkans Research and Innovation Strategy Exercise Facility, the World Health Organization European Office for Investment for Health and Development (Chris Brown, Andrea Bertola and Antonella Biasiotto).

The RCC and the 16 regional expert organisations and networks played an integral part in developing the assessment framework on which this publication is based, collecting data, liaising with SEE governments and reviewing draft versions of the publication.

The report was written under the guidance of Marcos Bonturi, Director for Global Relations, OECD, Anthony O'Sullivan, Deputy Director for Global Relations, OECD, and Marzena Kisielewska, Head of Division, OECD South East Europe Regional Programme.

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The report was reviewed and enriched with further input by the OECD Centre for Entrepreneurship (Miriam Koreen, Virginia Robano, Marco Marchese, Lucia Cusmano and Kris Boschmans), the OECD Centre for Tax Policy and Administration (David Bradbury, Bert Brys, Jacques Sasseville, Evelyn Lio, Michael Hewetson, Korstiaan Kool and Ubaldo Gonzalez), the OECD Directorate for Financial and Enterprise Affairs (Olga Savran, Andrija Erac, Rusudan Mikhelidze), the OECD Directorate for Education and Skills (Richard Yelland, Andrew McQueen, Margarita Kalamova, Caitlyn Guthrie, Daria Jarczewska and Kathrin Hoeckel), the OECD Directorate for Employment, Labour and Social Affairs (Mark Keese, Andrea Bassanini, Anton Nivorozhkin and Ian Forde), the OECD Environment Directorate (Ziga Zarnic), the OECD Public Governance and Territorial Development Directorate (Keit Kasemets, Wojciech Zielinski and Rachel Holloway), the OECD Trade and Agriculture Directorate (Evdokia Moïsé, Ronald Steenblik, Ada Ignaciuk and Silvia Sorescu), the International Transport Forum (Mario Barreto and Jari Kauppila) and the European Training Foundation (Anthony Gribben and Kristien Van den Eynde).

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

The independent assessments were conducted with the support of local consultants: Juela Haxhiymeri (Albania), Edin Jahic (Bosnia and Herzegovina), MDA (Kosovo), Igor Nikoloski (the Former Yugoslav Republic of Macedonia), CEED Consulting (Montenegro) and Mila Marinkovic (Serbia).

The following persons also contributed significantly to the success of the project: Elena Miteva, Anita Richter, David McBride, Florence Bernard, Marie Carr, Véronique Quenehen (OECD South East Europe Regional Programme), Antonio Fanelli and Marie-Estelle Rey (OECD Global Relations Secretariat), Milan Konopek, Margarita Kalamova, Sarah Perret, Anne-Christelle Ott, Lisa Eifert, Claudia Kempe, Amra Salihovic (formerly OECD South East Europe Regional Programme), Alexandre Berlin (Honorary Director, European Commission), Richard Alderslade (Independent Public Health Consultant), Christian Hartmann (Joanneum Research),

Ulrike Damyanovic, Anastasia Fetsi, Anthony Gribben, Cristina Mereuta and Kristien Van den Eynde (European Training Foundation).

This document has been produced with the financial assistance of the European Union. The views herein can in no way be taken to reflect the official opinion of the European Union. The production of the document also benefitted from the financial assistance of the Central European Initiative.

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Abbreviations and acronyms

ALB	Albania
BGR	Bulgaria
BIH	Bosnia and Herzegovina
EST	Estonia
HRV	Croatia
KOS	Kosovo
LTU	Lithuania
LVA	Latvia
MKD	Former Yugoslav Republic of Macedonia
MNE	Montenegro
ROU	Romania
SRB	Serbia
SVK	Slovak Republic
SVN	Slovenia

AEO	Authorised economic operator
AIDA	Albanian Investment Development Agency
ANCC	Albanian National Centre of Cinematography
ATS	Accreditation Body of Serbia
B2B	Business-to-business
B2C	Business-to-client
BAN	Business angel network
BERD	Business expenditure on R&D
BLA	Bilateral agreement
CABs	Conformity assessment bodies
CCA	Climate change adaptation
CCIs	Cultural and creative industries
CCSs	Cultural and creative sectors
CEER	Centre for environment-friendly energy
CEFTA	Central European Free Trade Agreement
CEN	European Committee for Standardization

CENELEC	European Committee for Electrotechnical Standardization
CIRT	Computer incident response teams
CoE	Centre of excellence
CRI	Centre for research-based innovation
CRM	Customer relationship management
CSDH	Commission on Social Determinants of Health
CVTS	Continuing Vocational Training Survey
DILC	Department for International Legal Cooperation
EA	European co-operation for Accreditation
EA MLA	EA Multilateral Agreement
EBRD	European Bank for Reconstruction and Development
ECA	Ecological Compensation Area
ECAA	Common Aviation Area Agreement
ECAA	European Common Aviation Area Agreement
ECEC	Early childhood education and care
ECOFIN	Economic and Financial Affairs Council
ECS	Energy Community Secretariat
EDIF	Export Development and Investment Fund
EEIS	Estonian Educational Information System
EFTA	European Free Trade Association
EIF	European Investment Fund
EMIS	Educational management information system
ENs	European Standards
EPFTC	Regulation of standard fixed-term contracts
EPL	Employment protection legislation
EPRC	Regulation of open-ended contracts
EPT	Regulation of temporary contracts
EPTWA	Regulation of temporary work agency employment
EQF	European Qualifications Framework
ERISEE	Education Reform Initiative of South Eastern Europe
ERP	Economic Reform Programme
eSEE	Electronic South East Europe
ETCS	European Train Control System
ETF	European Training Foundation
FDI	Foreign direct investment
FIPA	Foreign Investment Promotion Agency of Bosnia and Herzegovina
FP7	Seventh Framework Programme

FSA	Financial Services Authority
FTA	Free trade agreement
GATT	General Agreement on Tariffs and Trade
GERD	Gross domestic expenditure on research and development
GRECO	Group of States against Corruption
GVA	Gross value added
GVCs	Global value chains
GWP	Global Water Partnership
HEI	Higher-education institute
HEIA	Health equity impact assessment
HERIC	Higher Education and Research for Innovation and Competitiveness Project
HIA	Health impact assessment
HIS	Health information system
HRM	Human resource management
HSC	High State Control
IAF	International Accreditation Forum
ICSID	International Convention for the Settlement of Investment Disputes
ICT	Information and communication technology
IHR	International health regulations
INTOSAI	International Organisation of Supreme Audit Institutions
IPF	Investment promotion and facilitation
IPP	International Property Protection
IPR	Intellectual property rights
ISIS	Programme for the implementation of Single European Sky in South East Europe
ISS	Institute for Standardization of Serbia
ITF	International Transport Forum
ITS	Intelligent transport systems
IWRM	Integrated water resource management
KBRA	Kosovo Business Registration Agency
KIBO	Korea Technology Finance Corporation Act
KIESA	Kosovo Investment and Enterprise Support Agency
KOTEC	Korean Technology Credit Guarantee Fund
LLL	Lifelong learning
LPI	Logistics Performance Index
LSCI	Liner Shipping Connectivity Index

MAP	Multi-annual plan
MFI	Micro-finance institution
MFN	Most-favoured-nation
MIPEX	Migrant Integration Policy Index
MLA	Mutual legal assistance
MMF	Multilateral Monitoring Framework
NALAS	Network of Associations of Local Authorities
NCDs	Non-communicable diseases
NECC	National Entrepreneurship and Competitiveness Council
NGO	Non-governmental organisation
NHP	National health policy
NQF	National Qualifications Framework
NSBs	National standards bodies
NTBs	Non-tariff barriers
OGP	Open Government Partnership
OSS	One-stop shop
PACA	Project against Corruption in Albania
PARIS	Programme of Accounting Reform and Institutional Strengthening
PBMC	Performance-based maintenance contract
PCT	Patent Co-operation Treaty
PEM	Pan-Euro-Mediterranean
PES	Public employment services
PFI	Policy framework for investment
PIAAC	Programme for the International Assessment of Adult Competencies
PISA	Programme for International Student Assessment
PPO	Public Procurement Office
PRO	Public research organisation
PSP	Private sector participation
RAI	Regional Anti-Corruption Initiative
RBMP	River basin management plans
RCC	Regional Cooperation Council
RCC TFCS	RCC Task Force on Culture and Society
REBIS	Regional Balkans Infrastructure Study
REC	Regional Environmental Center
REI	Research excellence initiative
RESPA	Regional School of Public Administration
RIA	Regulatory impact assessment

RIS	River information services
RPSEE	Regional Programme for Cultural and Natural Heritage in South East Europe
RTA	Regional trade agreement
SAA	Stabilisation and Association Agreement
SAEK	Support to Anti-Corruption Efforts in Kosovo
SAI	Supreme audit institution
SAO	State Audit Office
SAP	Stabilisation and Association Process
SBAN	Serbian Business Angel Network
SCPC	State Commission for Prevention of Corruption
SEE	South East Europe
SEECEL	South East Europe Centre for Entrepreneurial Learning
SEEHN	South-Eastern Europe Health Network
SEETO	South East Europe Transport Observatory
SES	Single European Sky
SIEPA	Serbian Investment and Export Agency
SMEs	Small and medium-sized enterprises
SPS	Sanitary and phytosanitary
STP	Science and Technology Park
STRI	Service Trade Restrictions Index
SWG	Standing Working Group
TEN-T	Trans-European Transport Network
TEU	Twenty-foot equivalent unit
TFA	Trade Facilitation Agreement
TNA	Training needs analysis
TTO	Technology transfer offices
ULCs	Unit labour costs
UNCAC	United Nations Convention against Corruption
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
VC	Venture capital
VET	Vocational education and training
VTS	Vessel tracking system
WCO	World Customs Organization
WEF	World Economic Forum
WFD	Water Framework Directive

WGI	Worldwide Governance Indicators
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WISE	Western Balkans Research and Innovation Strategy Exercise
WTO	World Trade Organization
WTTC	World Travel and Tourism Council

Executive summary

Future economic development and the well-being of citizens in South East Europe (SEE) increasingly depend on greater economic competitiveness. To underpin the drive to improve competitiveness and foster private investment an integrated policy approach is needed. This first edition of *Competitiveness in South East Europe: A Policy Outlook* (hereafter referred to as the "*Competitiveness Outlook 2016*") seeks to help policy makers in Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia assess their progress towards their growth goals and benchmark them against i) the good practices adopted by OECD countries and ii) the performance of their regional peers.

This *Competitiveness Outlook 2016* addresses 15 policy dimensions critical to competitive economies that draw on the South East Europe 2020 Strategy (SEE 2020), a regional growth strategy drawn up by the Regional Cooperation Council and adopted by SEE governments in 2013. The qualitative assessments presented herein use scoring frameworks to enable regional comparisons. The participatory assessment process brought together regional policy networks and organisations, policy makers, independent experts and the private sector to create a balanced view of performance.

Main trends

At the beginning of the 21st century, a protracted growth period which saw GDP rise 5% a year enabled the economies of South East Europe covered in this report to narrow their development gaps with the EU and OECD countries. By 2008, their average PPP GDP per capita was 30.5% of the EU average, up from 23.4% in 2000.

However, the global economic crisis and its aftermath saw their average GDP growth slump to an annual 0.8% between 2009 and 2014. Four economies suffered a marked double-dip recession, while Albania and Kosovo experienced a slow-down in growth. Unemployment rates are among the highest in Europe – in 2013, average unemployment was 24%, compared to 10.8% in the EU. Those trends show that strategic policy action is needed to promote future sources of economic growth, if the six economies are to meet the SEE 2020 per capita GDP target of 39.7% of the EU average by 2020.

Cross-cutting challenges

While each of the 15 policy dimensions has its own particular obstacles, a number of cross-cutting challenges emerge. All SEE economies could consider addressing them as part of their efforts to increase their economic competitiveness.

- A **strategic approach to policy making** helps governments make more efficient use of scarce resources in pursuit of their policy goals. Examination of progress towards SEE 2020 objectives in the economies' comprehensive policy strategies reveals wide disparities in policy dimensions.
- Effective policy implementation is hindered by **limited capacity and skills shortages among civil servants**.

- Ministries and implementing agencies **lack co-ordination mechanisms** in many policy areas, which detract from the effectiveness of policy development and execution.
- Most dimensions lack robust **statistical data and monitoring systems,** which restricts scope for evidence-based policy making.
- Despite legislative requirements for forward planning and co-operation between government and parliament, legislation is often rushed through, so by-passing valuable **cross-policy stakeholder consultations**.
- The pervasiveness of the **informal sector** (which accounts for up to 30% of employment in some economies) impinges on tax revenues, the fairness of competition and vulnerable population groups. Measures to coax informal businesses and workers into formality are often limited in scope.
- Autonomous agencies, staffed by skilled professionals, should implement policy in accordance with pre-defined, objective criteria. The lack of **autonomy and professionalism** persists in the region.
- **Sub-national governments** are often underfunded and rely heavily on central government, which impairs their autonomy and ability to implement policy.

Main recommendations by policy dimension

The comprehensive analyses of the 15 policy dimensions in the *Competitiveness Outlook 2016* give rise to recommendations. Some are listed below. Considering them could help the SEE economies prioritise policy action as they look to the future:

- **Investment Policy and Promotion.** Investment promotion strategies could be implemented more extensively. Similarly, investment promotion agency services could be more comprehensive, particularly when they address linkages between foreign investors and local SMEs. Foreign investors' access to land could be eased.
- **Trade Policy and Facilitation.** Non-tariff barriers to trade (particularly barriers arising from the application of sanitary and phytosanitary measures) could be further reduced and barriers to trade in services addressed in priority sectors.
- **Education and Competences.** The quality and relevance of work-based learning could be improved to equip students with skills and competences relevant to the labour market. In that regard, the teaching profession could be an area of focus, with policies to recruit better candidates, improve remuneration and provide continuous training opportunities for teachers.
- **Research & Development and Innovation.** The governance of RDI policies could be improved so that the work of all the relevant actors is fully co-ordinated. Incentives and support for collaboration between business and academia could be built into RDI policies and private sector R&D expenditure promoted.
- **Digital Society.** The provision of broadband services could be further developed through closer co-operation with the private sector. The development and use of e commerce needs to be fostered by analysing and removing non-legal barriers, such as the lack of information on the potential of e commerce and the high cost of adopting ICT solutions.

- **Cultural and Creative Sectors.** Public-private co-operation could be promoted in the strategic planning of cultural tourism. SEE economies could benefit from integrated approaches to the use of cultural and creative sector policies as development vehicles. Such approaches would foster evidence- and consultation-based strategic policy making in cultural tourism, and in the audiovisual and creative sectors.
- **Transport.** Transport infrastructure development strategies and investment priorities should be aligned with the Core Network Corridors and the Regional Core Network, and focus particularly on the development of multi-modal nodes. Further efforts – to establish sustainable management and maintenance systems, for example – are needed to make existing infrastructure more efficient.
- **Environmental Policy.** Agri-environmental measures could be strengthened and policies to increase sustainable irrigation developed. SEE economies could also advance the water-energy-food nexus approach and intensify efforts to adopt climate change adaptation strategies.
- **Access to Finance.** Investment readiness programmes could be developed to help enterprises better understand and access different financing opportunities. Cadastres, credit and moveable asset registries should also be regularly updated to help support banks in assessing borrowers' credit-worthiness (so facilitating firms' ability to access capital).
- **Tax Policy.** The SEE tax authorities' policy analysis staff and funding capacity could be strengthened and current efforts to modernise and introduce electronic tax filing and payment procedures intensified (to ease and guarantee tax compliance).
- **Competition Policy.** Competition authorities could consider intensifying enforcement as a matter of priority. Guidance for stakeholders on enforcement practices could be improved by publishing explanatory documents.
- **Employment Policy.** Further active labour market policies could be promoted – e.g. youth employment schemes, self-employment programmes and targeted training opportunities for the long-term unemployed. The capacity of public employment services could be enhanced so that they are better able to implement active labour market policies.
- **Health Policy.** The development of effective national health policies is essential in all SEE economies. Health systems will require significant strengthening to achieve universal health coverage.
- **Effective Public Services.** Strategic human resource management seeks to match public servant staffing levels and skills sets with government policy goals. Governments would benefit from implementing their strategies on human resource management.
- **Anti-corruption Policy.** To ensure the effective implementation of anti-corruption instruments, the human and financial resources of anti-corruption institutions could be strengthened. Further efforts to streamline and centralise the network of communication and competence sharing between different anti-corruption institutions could ensure more efficient co-ordination in the fight against corruption.

Methodology and assessment process

Introduction

This *Competitiveness Outlook 2016* is a tool the economies in South East Europe may use to monitor and evaluate progress in policies that support competitiveness. It enables them to benchmark their policy frameworks regionally and assess gaps with respect to international best practice.

The *Competitiveness Outlook 2016* assesses the state of play in policy design, implementation, monitoring and evaluation. It measures convergence towards the headline targets of the South East Europe 2020 Strategy (SEE 2020), a comprehensive growth strategy adopted by South East European governments in 2013. It seeks to help policy makers set strategic priorities for boosting competitiveness and to further improve private sector development. The *Competitiveness Outlook 2016* also engages governments in policy dialogue and facilitates the sharing of experience with each other and with regional expert organisations and networks in the region.

The OECD developed the *Competitiveness Outlook 2016* in partnership with a number of regional expert organisations and networks that supplied their expertise.[1]

The South East Europe 2020 Strategy, a policy road map for SEE countries

The Regional Cooperation Council (RCC) is the co-ordinator of the SEE 2020 Strategy. It describes the strategy as embodying "the shared vision of the SEE economies". What is that vision? "[T]o improve living conditions in the region and bring competitiveness and development back in focus." Or, translated into figures, "to open up to 1 million new jobs by 2020" (RCC, 2013).

How will the region realise its shared vision? By working towards an "increase of total regional trade turnover by more than double from EUR 94 to 210 billion, the rise of the region's GDP per capita from current 36% to 44% of the EU average, and the addition of 300 000 highly qualified people to the workforce" (ibid.).

The SEE 2020 Strategy is centred on five interlinked growth pillars:

- **Integrated Growth** promotes regional trade and investment linkages through policies that are non-discriminatory, transparent and predictable.
- **Smart Growth** facilitates committing to innovation and competing on value-added rather than labour costs.
- **Sustainable Growth** aims to raise the level of competitiveness in the private sector, develop infrastructure and encourage greener, more energy-efficient growth.
- **Inclusive Growth** emphasises skill development, job creation, inclusive labour market participation, and health and well-being.

- **Governance for Growth** focuses on the capacity of public administration to strengthen the rule of law, reduce corruption, improve the business environment and enhance public service delivery.

Each pillar sets one or two headline targets as detailed in Table 0.1.

Table 0.1. **SEE 2020 Strategy pillars and headline targets**

Pillar	Integrated Growth	Smart Growth	Sustainable Growth	Inclusive Growth	Governance for Growth
Headline Target(s)	Increase SEE intra-regional trade in goods by more than 140% Increase overall annual FDI inflows to the region by at least 160%	Increase GDP per person employed by 32% Add 300 000 highly qualified people to the workforce	Increase net enterprise creation (i.e. number of new businesses per year) from 30 107 to 33 760 Increase exports of goods and services per capita from the region from EUR 1 780 to EUR 4 250	Increase the overall employment rate as a percentage of the population over the age of 15 from 39.5% to 44.4%	Improve government effectiveness as measured by the World Bank Governance Index from 2.33 to 2.9 by 2020

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Methodology

The methodology is based partly on previous work by the OECD in South East Europe, notably the *Investment Reform Index* (IRI), first published in 2006, then again in 2010. The methodology is designed to provide an evidence-based, objective assessment and elicit broad buy-in from key stakeholders. It is made up of two components: the assessment framework and a participatory assessment process.

The assessment framework

The *Competitiveness Outlook 2016* assesses policies in 15 policy dimensions built on the SEE 2020 Strategy's five growth pillars (Table 0.1). Table 0.2 shows how policy dimensions relate to each pillar.

Each of the 15 policy dimensions comprises three to five sub-dimensions that capture the critical elements of policy development in the policy dimension of which they are part. The sub-dimensions are, in turn, made up of 336 indicators, both quantitative and qualitative.

Qualitative indicators

Qualitative indicators assess whether policy settings, processes and institutions exist and, if so, the extent to which they have been adopted, implemented, monitored and regularly updated. The indicators are assigned a score according to the level of policy development in the policy area they measure. They distil complex qualitative information into numbers to facilitate the measurement of progress in implementing reform and the comparison of performance in the SEE economies.

Table 0.2. **SEE 2020 Strategy pillars and corresponding *Competitiveness Outlook 2016* policy dimensions**

SEE 2020 Strategy pillar	*Competitiveness Outlook 2016* policy dimension
I. Integrated Growth	1. Investment Policy and Promotion 2. Trade Facilitation and Promotion
II. Smart Growth	3. Education and Competences 4. Research, Development and Innovation 5. Digital Society 6. Cultural and Creative Sectors
III. Sustainable Growth	7. Transport 8. Environmental Policy 9. Access to Finance 10. Tax Policy 11. Competition Policy
IV. Inclusive Growth	12. Employment Policy 13. Health Policy
V. Governance for Growth	14. Effective Public Services 15. Anti-corruption Policy

Source: Adapted from RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective,* www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Qualitative indicators score performance on a scale from 0 to 5. While each indicator has its own specific components, they all share a general structure based on observed pathways of policy development:

- **Level 0.** There is no framework (e.g. law, institution, project, initiative) that addresses the policy topic concerned.
- **Level 1.** There exists a draft or pilot framework and there are signs of government activity to address the policy area concerned.
- **Level 2.** A framework that specifically addresses the policy area concerned is solidly in place. The government or parliament (where applicable) has officially approved it.
- **Level 3.** Level 2 plus some concrete indications that the policy framework is effectively being implemented.
- **Level 4.** Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly.
- **Level 5.** Level 4 plus continuous corrective monitoring of the framework and independent impact evaluation are part of a systematic practice of adjusting policy to meet the standards of international best practice. Level 5 comes closest to the good practices identified by OECD standards.

The scores assigned to each indicator are the result of a participatory analytical process. It consists of two parallel assessments – a self-assessment by the government, co-ordinated by the regional expert organisations and networks, and an independent assessment by local consultants (see the section, "The assessment process", below).

Table 0.3 shows an example of how the six general performance levels are tailored to a specific qualitative indicator – in this instance, the qualitative indicator "expropriation" from the Research, Development and Innovation Dimension. For a full list of all qualitative indicators and their scoring levels, readers are invited to visit www.oecd.org/investmentcompact.

Table 0.3. **Example of expropriation qualitative indicator scoring levels**

Level 0	Level 1	Level 2	Level 3	Level 4	Level 5
No national law or constitutional provision against expropriation. No recourse possible for foreign investors.	Drafting in progress of law or constitutional amendment to regulate expropriation and provide prompt, adequate and effective compensation.	Law or constitutional amendment providing guarantees against expropriation approved. Expropriation and regulatory expropriation are possible only in strictly defined circumstances and followed by prompt, adequate, and effective compensation.	Level 2 plus: Any expropriation order is reviewed based on the law by an independent authority that reviews public interest, due process and fair compensation.	Level 3 plus: government periodically reviews law or acts upon complaints and adjusts accordingly.	Clear law and administrative practices guarantee against expropriation. Due process, public interest motivation and fair market compensation have always been adhered to during expropriations. If international arbitration available, disputes over expropriation and arbitral awards are adjudicated and regularly enforced.

A score for each of the 15 policy dimensions is arrived at by calculating the simple average of the indicator scores in a given policy dimension. Indicators are not weighted because the importance of each indicator is different to different stakeholders. Average scores should therefore be interpreted with caution and taken only as rough estimates of policy development. They should not be used for ranking of any kind.

Quantitative indicators

Quantitative indicators are input factors pertinent to the assessment of policies, policy making, institutional conditions and policy outputs that can be quantified – e.g. public or private spending in the policy field in question, the number of times a certain event takes place, the number of bills passed and the number of agreements ratified. Quantitative indicators complement qualitative indicators by supplying quantifiable information on the performance of policy settings, processes and institutions, and on the economies' progress towards SEE 2020's headline targets.

The assessment process

The *Competitiveness Outlook 2016* draws on the results of two parallel evaluations – government self-evaluations and independent ones. Both took place through the second half of 2014 and the first half of 2015, with a cut-off date of 30 June 2015, after which new policy developments were not taken into account.

Self-assessments used input collected from the agencies and ministries involved in the various policy dimensions. The self-assessments in each policy dimension were co-ordinated by the regional expert body that acted as the co-ordinator of the policy dimension concerned.

As for the independent assessments, they were conducted by the OECD. They used input from a team of local experts who collected data and information and conducted interviews with key stakeholders and private sector representatives.

The final scores are a consolidation of the results of the two assessments, enhanced by further OECD desk research, country missions and consultations with government representatives. Meetings with stakeholder were then held in each of the economies to examine and compare the assessments.

The meetings were typically attended by between 30 and 50 stakeholders – representatives from ministries and government agencies, international donor organisations, civil society, the academic community, NGOs and the private sector.

The meetings cleared up discrepancies between the two assessments, plugged information gaps and dispelled misjudgements before coming up with draft scores for the qualitative indicators. Drawing on the information culled from the stakeholder meetings, the OECD then consulted with the regional expert bodies to determine the final results.

The results were presented and discussed at a meeting in Paris between OECD experts and their peers from South East European organisations and networks.

The *Competitiveness Outlook 2016* assessment was carried out in three phases:

1. Design phase (January 2014 – June 2014)

   In consultation with regional expert organisations and networks, the OECD drew up the methodology and assessment framework. In March 2014, a regional workshop was held where OECD experts came together with these regional expert bodies to discuss the methodology and assessment framework.

2. Evaluation phase (July 2014 – December 2014)

   The SEE economies carried out self-evaluations of their policy frameworks through assessment questionnaires, co-ordinated by the regional expert bodies.

   At the same time, the OECD carried out independent assessments with the support of local experts. It also conducted stocktaking missions and held country workshops to support the data collection exercise. It used desk research and follow-up with relevant stakeholders to address information gaps and inconsistencies.

3. Consolidation phase (January 2015 – April 2015)

   A series of stakeholder meetings were held in each of the six economies between February and March 2015 to consolidate and reconcile findings from the self-evaluation and independent assessments. In cases of disagreement on indicator scores, the OECD gathered further evidence to determine a final score. A meeting with all regional expert organisations and networks was held in March 2015 to discuss the draft results and assessment scores.

The OECD finally prepared the report for publication. The preparation involved two rounds of revision with the regional expert organisations and networks, South East European governments, and extensive consultation within the OECD. The publication was launched at a high-level conference at the OECD headquarters on 26 February 2016.

The value of the *Competitiveness Outlook 2016*

The principal added value of the *Competitiveness Outlook 2016* is its holistic approach to policies that foster competitiveness. It gives policy makers a single window through which to assess progress across various policy areas. The evaluation framework seeks to:

- independently and rigorously assess competitiveness-related policy settings and reforms against international best practice
- provide guidance for policy reform and development

- create a process that enhances the quality of pro-competitiveness policy development
- facilitate the prioritisation of government and donor activities in support of competitiveness.

While a number of other indices and benchmarking reports assess the business environment in the SEE economies, the *Competitiveness Outlook 2016*'s evaluation framework offers a different approach to addressing policy issues that relate to competitiveness. The chief differentiating factors are:

- the focus on a specific region where history, culture and geography allow particularly meaningful benchmarking between economies
- the tripartite participatory approach to evaluation and measurement that brings together governments, the private sector and the OECD
- the comprehensive evaluation of pro-competitiveness policies grouped into 15 policy dimensions informed by the SEE 2020 Strategy
- guidance on how to improve existing policy frameworks through good practices and policy recommendations
- the inclusion of existing work conducted by other organisations such as the World Bank's *Doing Business* reports, the EBRD's *Transition Report* and the European Commission's progress reports.

The methodology has both strengths and limitations, as Table 0.4 shows.

Table 0.4. **Strengths and limitations of the *Competitiveness Outlook 2016***

Strengths	Limitations
– The analysis draws on original data collected by the OECD with existing data collected by other organisations. – A participatory assessment process enables stakeholder dialogue on policy, joint learning, and agreement with identified strengths and shortcomings to help build consensus for future reform. – The common scoring framework facilitates public-private consultation and encourages action. – Scoring by policy dimension helps public officials communicate more effectively on policy progress and areas where further reform is necessary. – Dimensions and indicators are in line with the priorities of the SEE 2020 Strategy. – Good practice examples and policy recommendations offer ways forward. – Country contexts and other, wide-ranging, factors that affect competitiveness and policy development underpin the analysis and supplement the scores.	– The *Competitiveness Outlook 2016* does not cover all aspects of competitiveness, choosing instead to focus on the areas covered by the SEE 2020 Strategy. – The *Competitiveness Outlook 2016* gauges only whether policies are in place, implemented and monitored. – National statistics on and in the SEE region are limited. – As the same set of indicators is applied to all economies in the region, certain economy-specific characteristics may not be fully reflected in the scoring.

Note

1. The regional expert organisations and networks include the Regional Cooperation Council (RCC), the CEFTA Secretariat, the Education Reform Initiative of South Eastern Europe (ERI SEE)/Centre for Education Policy, the Electronic South East Europe (eSEE) Initiative, the Energy Community Secretariat (ECS), the Global Water Partnership (GWP), the Network of Associations of Local Authorities (NALAS), the Regional Anti-Corruption Initiative (RAI), the RCC Task Force for Culture and Society, the Regional Environmental Centre (REC), the Regional School of Public Administration (RESPA), the South East Europe Centre for Entrepreneurial Learning (SEECEL), the SEE Health Network, the South East Europe Transport Observatory (SEETO), the Regional Rural Development Standing Working Group (SWG), the Western Balkans Research and Innovation Strategy Exercise (WISE) Facility, and the World Health Organization (WHO) European Office for Investment for Health and Development.

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Chapter 1.

Investment policy and promotion in South East Europe

Investment policy refers to a government's foreign or domestic investment framework, while investment promotion denotes activities designed to attract investment to an economy. This chapter on the Investment Policy and Promotion Dimension focuses on three sub-dimensions in its assessment of investment performance and policy development. The Transparency and Treatment of Investors Sub-Dimension examines to what degree foreign and domestic investors have equal rights through a reliable and transparent investment environment. The Investment Promotion and Facilitation Sub-Dimension assesses government policies and activities to promote the economy to investors through measures such as aftercare services, client relationship management and foreign direct investment incentives. The Intellectual Property Rights (IPR) Sub-Dimension gauges IPR protection legislation and enforcement.

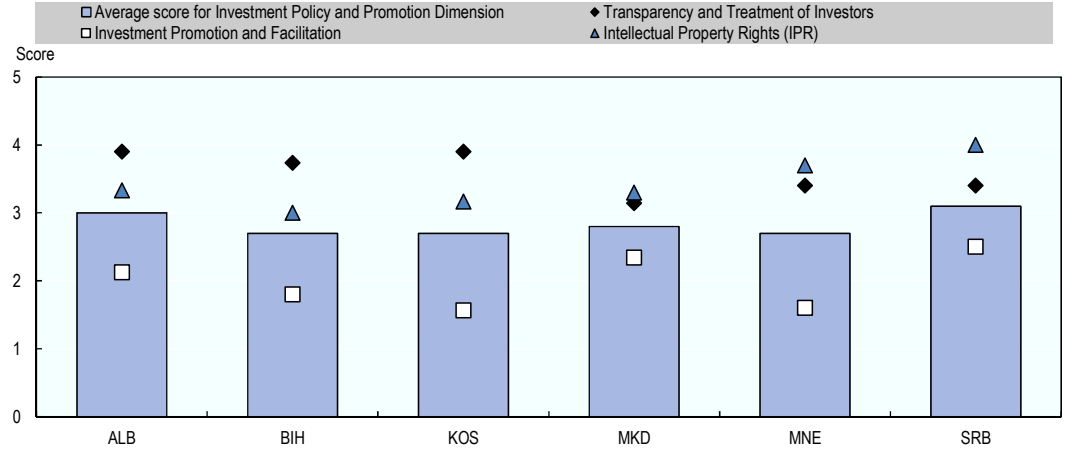
Main findings

As the OECD *Policy Framework for Investment* states, the non-discrimination principle, openness to foreign investment, the protection of investors' property rights and mechanisms for settling investment disputes are core policy issues. They underpin efforts to create a quality investment environment for all (OECD, 2015). Attracting foreign and fostering domestic investment expand an economy's productive capacity, so contributing to job creation and economic growth. In addition, foreign direct investment (FDI) plays an important role in transferring technology and expertise, boosting labour productivity and improving access to international markets (ibid.).

While foreign, domestic and greenfield investment in South East Europe (SEE) have consistently exceeded the EU average as a percentage of GDP since 2007, the gap has narrowed in recent years, due mainly to the double-dip financial crisis.

All SEE economies have an average score of around 3 in the Investment Policy and Promotion Dimension. The score signifies that all SEE economies have largely operational investment policy and promotion frameworks. However, monitoring and readjustment practices still need to be engaged. They are stronger in the sub-dimensions, Transparency and Treatment of Investors and Intellectual Property Rights, than in the Investment Promotion and Facilitation Sub-Dimension, where the Former Yugoslav Republic of Macedonia and Serbia are the most advanced.

Figure 1.1. **Investment Policy and Promotion: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have seen recent improvements in investment policy and promotion.

SEE economies have taken positive steps towards treating foreign and domestic investors equally. In addition, they periodically review their national treatment legislation and adjust it accordingly.

SEE economies have strengthened foreign investors' access to industrial land. Generally, foreigners are allowed to own or lease industrial land in SEE for 30 to 99 years. Bosnia and Herzegovina and Kosovo also periodically review their legislation based on investor feedback and adjust it accordingly. By doing so, they facilitate new and expand on-going investment.

SEE economies have made progress in facilitating business operations. They have strengthened public-private sector dialogue by further involving and consulting the private sector prior to making relevant legislative changes. They have also continued facilitating the recruitment of foreign personnel, be they employees or board members. Moreover, most economies in the region allow investment-related capital transfers.

SEE economies have taken steps to better protect intellectual property rights. They have all enacted IPR-related legislation and ratified the major international IPR conventions. There is also emerging evidence that they are enforcing IPRs more effectively in the region.

Challenges

Despite their achievements, the SEE economies still face a number of challenges that prevent them from attracting all potential investment.

Investment promotion and facilitation strategies as well as investment promotion agency (IPA) operational objectives are not fully implemented. All SEE economies have put an investment promotion agency (IPA) in place with a clear mandate to implement the national investment promotion strategy. However, most IPAs are still in the process of establishing key services such as one-stop shops (single windows for all business administrative procedures) and linking foreign investors with local small and medium-sized enterprise (SME) supplier bases.

The design and promotion of FDI incentive schemes are not fully developed. Few SEE economies have FDI incentive schemes based on a formal cost-benefit analysis. Those economies with FDI incentive schemes in place do not generally publicise them well – through IPA websites, for instance.

Strategic investor targeting is still an emerging practice. While all SEE economies do conduct some investor targeting, the systematic practice of identifying potential investors with suitable profiles and addressing investment promotion and communication campaigns at them is yet to be established.

Aftercare services are currently limited. However, all SEE economies collect investor feedback on an ad hoc basis or are in the process of defining aftercare services in their investment promotion strategic plans.

Access to agricultural land remains comparably difficult for foreign investors. Foreign investors are generally allowed to purchase or lease farm land. However, administrative procedures for doing so are often more burdensome for foreign than for domestic investors. Indeed, some SEE economies may restrict foreign ownership of certain types of land – to ensure food self-sufficiency or control inflation, for example. Laws should clearly state any such restrictions (OECD, 2010).

IPR awareness raising is not a systematic practice. Although most SEE economies have operational IPR information services, they do not yet regularly undertake IPR awareness-raising activities, such as campaigns to promote understanding of IP or capacity-building programmes on how to file for IP protection.

Recommendations

Measures addressing identified challenges can facilitate increased investment.

Further advance the implementation of investment promotion strategies and IPA services. To increase investment, SEE economies could further improve the implementation, evaluation and revision of their investment promotion strategies. Most IPAs would benefit from more clearly allocated budgets and greater operational independence. They also stand to gain from continuous monitoring of their investment promotion practices.

Set up one-stop shops (OSS) to help foreign investors overcome regulatory hurdles. All SEE economies seek to assist foreign investors in negotiating regulatory hurdles and investing in the economy. To that end, a useful initiative might be to establish one-stop shops across all SEE economies. Foreign investors could thus stop at a single window to obtain the permits and support required to establish their business operations rather than having to deal with multiple government bodies.

Strengthen practices for linking foreign investors with the local supplier base. SEE economies could establish FDI-SME linkage programmes to help foreign investors adapt to local markets and support the domestic supplier base. One particular measure could be to create supplier databases and advertise them to new and established investors.

Further enhance communication with potential and established investors through a customer relationship management (CRM) mechanism. IPAs could introduce new CRM mechanisms or expand existing ones in order to proactively manage relations with potential investors and thereby offer enhanced services. Accordingly, they would systematically document all interaction with and information about investors and make systematic use of such knowledge.

Ease foreign investors' access to land. Clearly defined land ownership rights would help encourage new and expand current investment. Furthermore, better access to land for foreign investors could act as an incentive to sustainable land management practices.

Intensify IPR awareness-raising activities. The introduction and systematic enforcement of measures to raise awareness of IPR would increase foreign investors' confidence and encourage them to develop and bring innovative technologies to SEE economies. SEE economies could consider setting up dedicated IP help desks as one practical and user-friendly way of further supporting IPR enforcement.

Overview

Investment policy refers to a government's foreign or domestic investment framework, while investment promotion denotes activities designed to attract investment to an economy or region. The quality of investment-related policies determines, by and large, investment promotion and facilitation (OECD, 2015). The analytical framework presented in this chapter builds on the OECD's Policy Framework for Investment (PFI), a comprehensive and systematic approach to improving conditions conducive to investment (ibid.). Covering a broad range of issues for policy makers, the PFI also assesses such determinants as the treatment of foreign investors, the transparency of the legal framework governing investment and the protection of property rights.

A solid investment policy and promotion framework plays an important role in attracting FDI (OECD, 2011). FDI triggers technology spillover, fosters the creation of human capital, contributes to international trade integration and helps create a more

competitive investment environment. It also enhances enterprise development, so contributing to economic growth. Beyond strictly economic benefits, FDI also helps improve environmental and social conditions in the host country through the transfer of cleaner technologies and more socially responsible corporate policies (OECD, 2002). Furthermore, it provides transition countries with much needed sources of finance to build more competitive industries (OECD/The World Economic Forum, 2011). Finally, it increases capital stocks, thus increasing labour productivity (OECD, 2015).

Box 1.1. **Investment Policy and Promotion Dimension in the SEE 2020 Strategy**

The Investment Policy and Promotion Dimension is part of the Integrated Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The pillar's central objective is to foster integrated growth through the promotion of regional trade, investment linkages and policies that are non-discriminatory, transparent and predictable – all regarded as factors in the region's further integration in the European and global economy. One of two headline SEE 2020 Strategy targets in this pillar is annual FDI inflows to the SEE region by 2020 that are 160% greater than in 2010. The Integrated Growth Pillar informs the key components of the Investment Policy and Promotion analysis in this publication.

The SEE 2020 Strategy also sets specific investment policy and promotion objectives:

- increased trade facilitation through the use of transparency tools and simplified trade-related procedures
- improved investment policy and promotion co-ordination
- better investor and investment protection
- freer movement of experts, professionals and skilled labour
- stronger protection for trademarks throughout the region
- closer alignment of efforts to improve the business environment and promote business climate reforms.

By removing trade and investment barriers through effective co-ordination between government policies and by aligning efforts with the Governance for Growth Pillar, the integrated growth agenda as a whole will contribute to improving the business climate in the SEE region.

The official SEE 2020 Strategy Co-ordinator for the Investment Policy and Promotion Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and enhance regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Analysis of investment policy and promotion in SEE reveals significant links with other policy areas. For example, a well-functioning legal system can be an important determinant of investment by securing property rights and enforcing contracts (Palumbo et al., 2013). Furthermore, efficient legal procedures prevent breaches of contract and influence firms' investment decisions (Chemin, 2012). This chapter is particularly related with the following chapters:

- **Chapter 4. Research, development and innovation** capacity and investment can be mutually reinforcing. Investment may lead to the transfer of technology and human capital, which heightens competitiveness. Effective R&D and innovation

policies can be a powerful driver of investment, as businesses are attracted to economies which lead the way in certain technologies. They seek to take advantage of positive spillover effects to become more competitive on a global scale (OECD/The World Economic Forum, 2011).

- **Chapter 15. Anti-corruption policy** can play an effective part in attracting FDI. Countries where there is little corruption are found to draw larger inflows of FDI (Castro and Nunes, 2013).
- **Chapter 2. Trade policy and facilitation** and investment mutually reinforce each other to increase cross-border activity (OECD, 2002). There is a growing realisation that a sound investment framework increases FDI and furthers the integration of economies in the world economy through trade growth and greater participation in global value chains (GVCs).
- **Chapter 10. Tax policy** and administration can influence investment decisions and prompt follow-up investments from successful, established investors.

Investment Policy and Promotion Dimension assessment framework

This chapter proposes an analysis of investment policy and promotion in the SEE region. It does not seek to be exhaustive, but considers three broad sub-dimensions based on the Integrated Growth Pillar of the SEE 2020 Strategy:

- Transparency and Treatment of Investors

  How clear and predictable is the investment framework to foreign investors? Are they treated on an equal footing to their domestic peers?

- Investment Promotion and Facilitation

  Are investment promotion and facilitation practices properly established? What are they and are they supported by adequate resources?

- Intellectual Property Rights

  How well is the intellectual property of foreign investors protected by the provisions and enforcement of IPR legislation framework and is there IPR awareness raising?

Figure 1.2 shows how the sub-dimensions and their constituent indicators make up the Investment Policy and Promotion Dimension assessment framework.

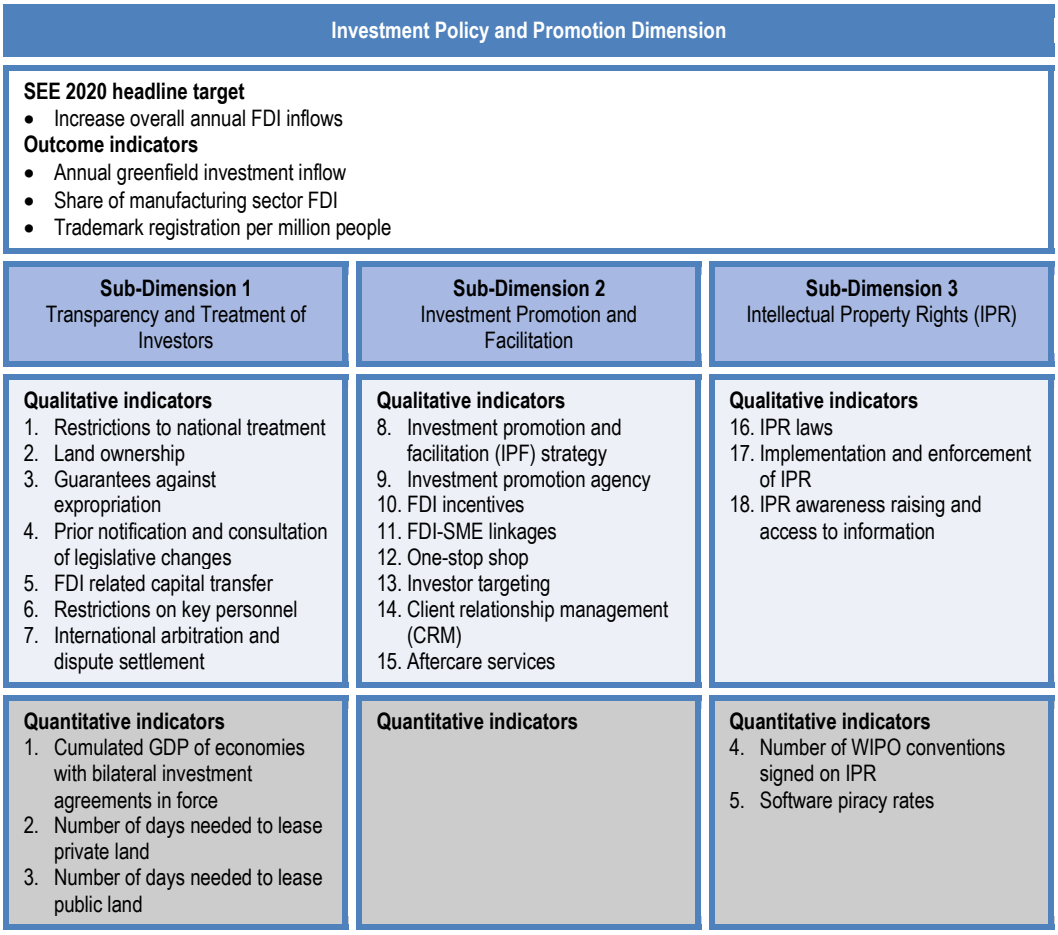
Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional Cooperation Council (RCC) collected qualitative and quantitative data on the Investment Policy and Promotion Dimension.

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.[1]

FDI performance in SEE economies

Levels of FDI inflows have stagnated in recent years across the SEE region. However, taken as a percentage of GDP, FDI in the SEE region has regularly exceeded the EU average since 2007, thanks to SEE's closer trade ties with the EU and its lower per capita incomes. Businesses from more developed economies, such as those of the EU, can take advantage of differences in unit labour costs (ULCs) by investing productive capacity in nearshore markets.

Figure 1.2. **Investment Policy and Promotion Dimension assessment framework**



Montenegro is the SEE economy with the highest annual FDI inflows as a percentage of GDP, although they have declined in recent years. Most of its FDI goes into tourism infrastructure. While such investment has helped develop the tourist trade, two important contributors to service exports – job quality and average salaries – remain at low levels.

Albania has the second highest FDI to GDP ratio. It has shown strong resilience and maintained FDI growth rates throughout the crisis. They have been especially firm in the extractive sector (Bank of Albania, 2014). The post-crisis macroeconomic situation has had a worse effect on FDI/GDP ratios in the Former Yugoslav Republic of Macedonia and Serbia, where they have declined in recent years. However, they are showing the first signs of recovery (UNCTAD, 2015a).

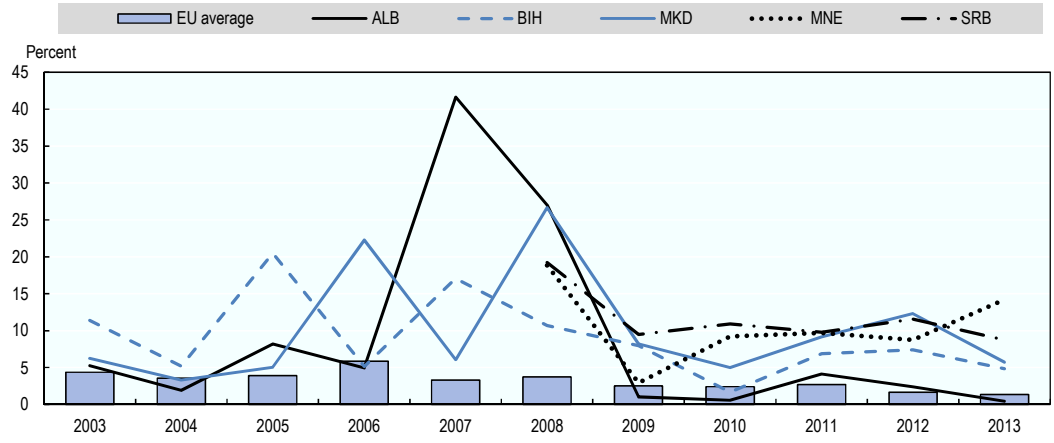
Overall, resource-seeking FDI has been very robust – especially in Montenegro (tourism) and Albania (mineral resources) – while efficiency-seeking FDI, which dominates in the other three economies, has stagnated.

Foreign and domestic greenfield investment is a robust driver both of economic and employment growth and – through technology spillover – of innovation (Begović et al., 2008). Between 2003 and 2013, annual greenfield inflows as a percentage of GDP exceeded the EU average in most SEE economies. However, since the 2008 financial crisis, the average ratio of the SEE region's greenfield investment flows to GDP fell from 33% in 2007 to 7% in 2013. This downward trend is consistent with the pattern in the EU

as well. In Albania, for example, large projects in the manufacturing and electricity sectors saw the value of greenfield projects rise steeply in 2006 and 2007, only to fall in the aftermath of the global crisis (UNDP, 2012). The SEE economies have not yet regained the ratios of greenfield investment to GDP they boasted in 2008. Montenegro is the sole exception, with greenfield investment flows tripling in 2013 from their low point in 2009.

Figure 1.3. **Annual greenfield investment flows**

Percent of GDP



Note: Data for Kosovo not available. Data for Montenegro and Serbia available from 2008.

Source: Adapted from UNCTAD (2015a), *World investment report 2015: Reforming international investment governance*, www.unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1245; UNCTAD (2015b), *UNCTADStat* (database), http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx.

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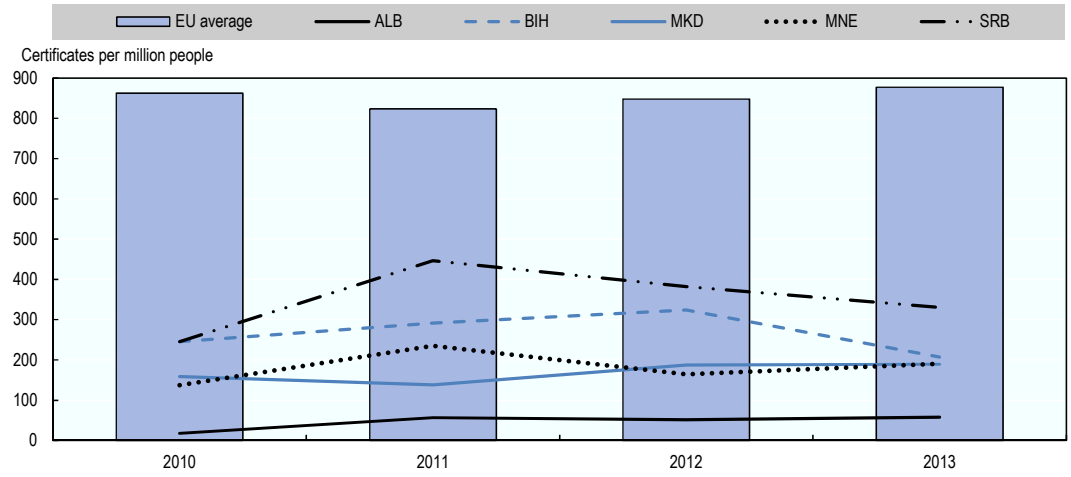
The manufacturing sector has substantial weight in most SEE economies and accounts for a significant share of regional exports. Yet FDI flows into the manufacturing sector followed a downward trend across SEE between 2010 and 2013. In Bosnia and Herzegovina, for instance, they dropped from 26.7% to 8.3% and in the Former Yugoslav Republic of Macedonia from 52.9% to 33.8% over the same period. Albania, too, experienced a similar trend.

In 2014, however, FDI flows into the manufacturing sector substantially increased in the region. The increase was driven partly by Bosnia and Herzegovina where, after years of decline, manufacturing FDI as a share of total FDI rose to 30.8% in 2014.

The number of registered International Organization for Standardization (ISO) certificates is a measure of integration in global value chains and investment resilience. Certificates work as guarantees that a certain product, service, or system meets specific requirements and standards. They enable cross-border trade to enter the global economy, ensure that business operations are efficient and increase companies' productivity. Across the SEE region, the number of ISO 9001 certificates registered per million inhabitants is lower than in the EU. Serbia has the highest rate, while Albania, the Former Yugoslav Republic of Macedonia and Montenegro have the lowest. ISO certification rates increased across SEE in 2010-13, peaking in 2011 at an average of 300 certificates per million people, but have stagnated since.

Figure 1.4. **Registered ISO 9001 certificates**

Certificates per million people



Note: Data for Kosovo not available.

Source: Adapted from ISO (2013), *ISO Survey 2013* (database), www.iso.org/iso/iso-survey; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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The available data suggest that FDI, greenfield investment and manufacturing FDI are below their full potential in SEE. Innovation spillover and intellectual property protection also show room for improvement.

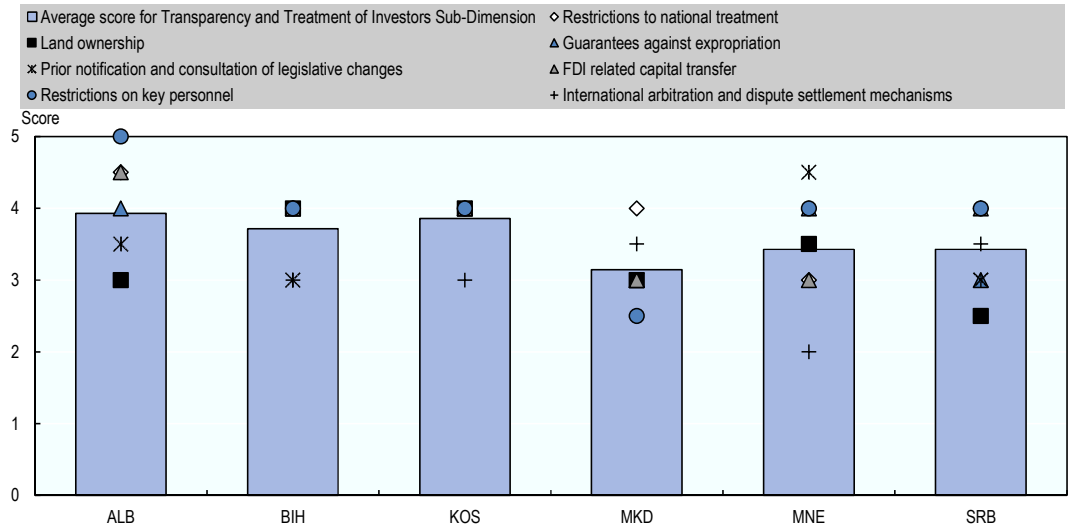
Why, though, are SEE economies not realising their full investment potential and what levers do SEE governments have at hand for improving investment performance?

Transparency and Treatment of Investors Sub-Dimension

A reliable, stable investment environment, in which the property of foreign investors is secured, is a prerequisite for FDI. Cumbersome administrative procedures cost time and money and heighten the investment risk, especially if they lack transparency (OECD, 2015). Transparency remains a key concern of investors worldwide (ibid.). Foreign investors need to be certain that their investments are treated no less favourably than those of their domestic peers. When investment procedures – for starting a business or settling commercial disputes, for example – are transparent and straightforward, they boost foreign investors' confidence and enable them to make better informed investment decisions (ibid.). The Transparency and Treatment of Investors Sub-Dimension includes seven qualitative indicators that analyse foreign investors' rights, access to land and operations enabling policy framework.

Creating a transparent business environment and affording equal treatment to foreign and domestic investors alike have been priorities across the SEE region. On average, the SEE region scores 3.6 out of 5 in the Transparency and Treatment of Investors Sub-Dimension. In other words, economies have established and implemented frameworks and carry out a certain degree of monitoring (Figure 1.5). SEE economies have generally transparent investment procedures and treat foreign and domestic investors in the same way.

Figure 1.5. **Transparency and Treatment of Investors: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The areas in which the economies are most advanced are national preference and admittance of key personnel, while the one where there has been the least progress is international arbitration and dispute settlement mechanisms.

Comparison with the 2010 OECD Investment Reform Index reveals a positive overall trend in several SEE economies. Albania, Kosovo and Bosnia and Herzegovina claim the highest average scores in the Transparency and Treatment of Investors Sub-Dimension. Their good showing reflects their recent progress in investment as they bid to raise FDI levels.

SEE economies have strengthened safeguards of foreign investors' rights

The sound safeguard of foreign investors' rights fosters a predictable, secure investment environment conducive to FDI. Before investing in a country, foreign investors consider existing investment agreements that protect other foreign businesses. Key factors in the protection of foreign investors' rights include the equal treatment of foreign investors, the protection of their ownership rights and the presence of dispute settlement mechanisms to solve commercial disputes, such as arbitration (OECD, 2010).

The **restrictions to national treatment** indicator assesses whether foreign investors are treated in the same way as domestic ones. Foreign investors look for jurisdictions that offer fair and equal treatment, as it signals a government's commitment to non-discrimination and a degree of predictability, both of which reduce investment risk (ibid.).

The **guarantees against expropriation** indicator evaluates whether a legal framework protecting the property of foreign investors has been established. While foreign investors value protection against expropriation, they also seek those jurisdictions that offer prompt, adequate and effective compensation for any expropriation that may occur (ibid.).

The **international arbitration and dispute settlement mechanisms** indicator assesses whether an economy has ratified international conventions on arbitration-related matters and whether it has dispute settlement mechanisms in place. The ability to resolve disputes efficiently has been shown to be fundamental in investment decisions (OECD, 2015).

Table 1.1. **Transparency and Treatment of Investors Sub-Dimension: Foreign investors' rights indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Restrictions to national treatment	4.5	4.0	4.0	4.0	3.0	4.0
Guarantees against expropriation	4.0	4.0	4.0	3.0	4.0	3.0
International arbitration and dispute settlement mechanisms	3.0	3.0	3.0	3.5	2.0	3.5

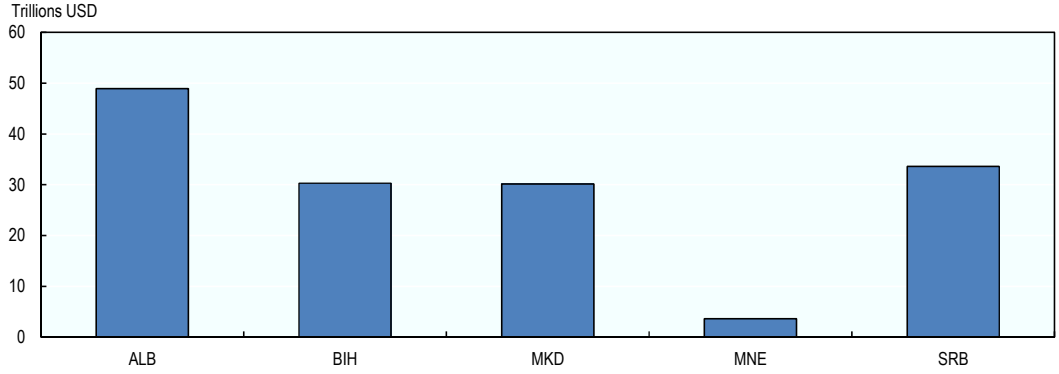
Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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In line with such considerations, a quantitative indicator, cumulated GDP of economies with bilateral investment agreements in force (Figure 1.6), evaluates whether SEE economies have signed FDI protection agreements with sizeable foreign economies (e.g. France, Germany and the United States).

Figure 1.6. **Cumulated GDP of economies with bilateral investment agreements in force, 2013**

Trillions USD



Note: Data for Kosovo not available.

Source: Adapted from UNCTAD (2015b), *UNCTADStat* (database), http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx; United Nations Conference on Trade and Development (2013), *Investment policy hub* (webpage), http://investmentpolicyhub.unctad.org/IIA.

StatLink http://dx.doi.org/10.1787/888933321192

Generally, SEE economies fare well when it comes to indicators that measure the protection of foreign investors' rights. In that regard, a number of significant patterns may be observed across the region.

SEE economies have shown strong commitment to safeguarding foreign investors' legal rights. They have, for instance, all signed investment agreements and seek to treat foreign and domestic investors equally. Furthermore, the expropriation of foreign

investors' property is permitted only in strictly defined circumstances, generally followed by prompt, adequate and effective compensation. Finally, dispute settlement mechanisms are generally in place.

Albania, Bosnia and Herzegovina, and Kosovo boast comparatively well-established legal frameworks for safeguarding the rights of foreign investors. In the three economies, foreign investors enjoy the same treatment as their domestic peers. Furthermore, bilateral investment agreements with more advanced economies have come into force in Albania and Bosnia and Herzegovina. As for the expropriation of foreign investors, the three economies allow it only in very specific and defined circumstances and follow it up effectively with adequate, speedy compensation.

The Former Yugoslav Republic of Macedonia and Serbia have also taken measures to protect foreign investors' rights. Both economies treat foreign and domestic investors equally. Furthermore, they have dispute settlement mechanisms in place which strengthen their governments' commitment to the rule of law.

As a sign of their determination to meet their investment treaty obligations, the Former Yugoslav Republic of Macedonia and Serbia have fully ratified and implemented such international arbitration agreements as the New York Convention and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). Albania and Bosnia and Herzegovina, too, have ratified and implemented both agreements. By approving the Law on Foreign Investment, Kosovo has also advanced the implementation of regulations in both the New York and ICSID conventions.

Montenegro has taken positive steps to protect the rights of foreign investors. It allows them to purchase agricultural land, for instance, and guarantees them adequate, prompt and effective compensation in the event of expropriation.

Montenegro has signed comparably few investment agreements and recently introduced national preferences (in the fishery, insurance and air traffic sectors, for example). Furthermore, it has a limited number of dispute settlement mechanisms in place and, despite ratifying both the New York and ICSID conventions, it has not yet started monitoring them.

The Former Yugoslav Republic of Macedonia and Serbia are yet to institutionalise certain practices that protect the rights of foreign investors. For example, the Former Yugoslav Republic of Macedonia and Serbia have not yet reviewed their legal framework for provisions guaranteeing foreign investors against expropriation.

SEE economies continue facilitating foreign investors' access to land

Secure land rights are a prerequisite for a sound investment environment (OECD, 2010). There may be circumstances in which economies do not allow foreign investors to own certain types of land – to ensure food self-sufficiency or limit inflation, for example. However, such restrictions should be clearly set out in law (OECD, 2010), particularly as well-established land ownership rights can encourage new and continuing investment. Moreover, they also incentivise sustainable land management (OECD, 2015). Foreign investors always consider whether a host country's law entitles them to purchase land and property and how cumbersome the requisite administrative procedures are.

Accordingly, the **land ownership** indicator measures whether foreign investors are allowed to purchase or lease agricultural and industrial land and property. Clearly defined, secure land rights encourage foreign investors to invest in an economy, while the number of days it takes to lease private and public land is a measure of how easy it is for investors to access land.

Table 1.2. **Transparency and Treatment of Investors Sub-Dimension: Foreign investors' access to land ownership indicator scores**

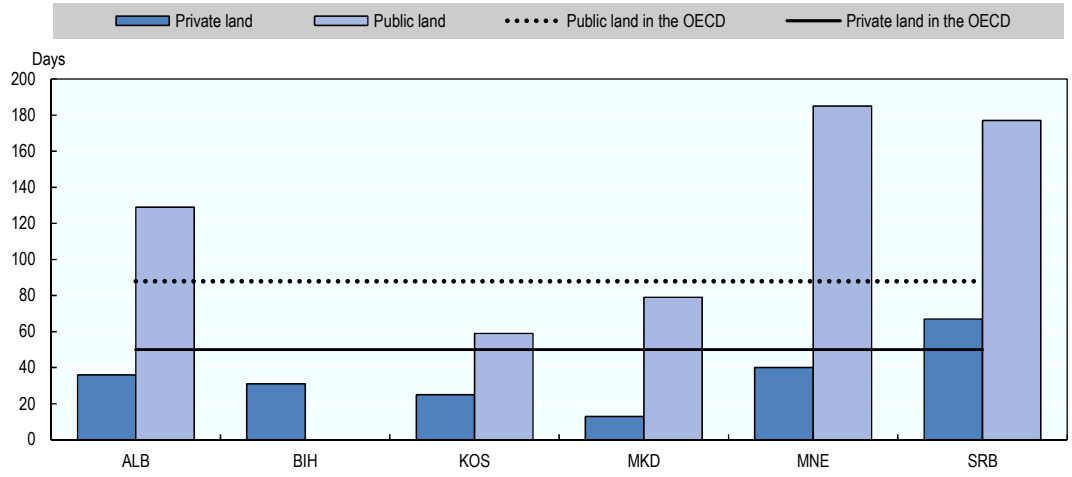
	ALB	BIH	KOS	MKD	MNE	SRB
Land ownership	3.0	4.0	4.0	3.0	3.5	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322784

The World Bank report, *Doing Business 2014*, includes the number of days that it takes to lease private and public land.

Figure 1.7. **Days needed to lease private and public land, 2013**



Note: Data for number of days needed to lease public land in Bosnia and Herzegovina not available.

Source: World Bank (2013), *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises*, http://dx.doi.org/10.1596/978-0-8213-9984-2.

StatLink http://dx.doi.org/10.1787/888933321207

SEE economies generally allow foreign investors to purchase or lease agricultural and industrial land. They have comparatively transparent procedures to that end and a number of good practices have emerged.

Bosnia and Herzegovina, Kosovo and Montenegro all allow foreign investors to buy land, which includes agricultural and industrial land as well as real estate. Furthermore, the number of days it takes to lease private land is less than the OECD average in all three economies. The number of days to lease public land in Kosovo is less than the OECD average. In addition, as emphasised in *Doing Business 2014* (World Bank, 2013), Montenegro has streamlined its property registration formalities.

Albania and the Former Yugoslav Republic of Macedonia have also taken positive steps to facilitate foreign investors' access to land and, in both economies, the number of days needed to lease private land is lower than the OECD average. The same is true of public land in the Former Yugoslav Republic of Macedonia. That being said, the actual process of leasing or purchasing land in both economies remains comparatively difficult.

Albania, for its part, allows foreign investors to buy land on the condition that they do so at no less than three times the market price.

In Serbia, too, there are still obstacles. It does not yet allow foreign investors to purchase farmland, for example, while the number of days it takes to lease private and public land is higher than the regional and OECD averages. As for registration procedures, they have become more expensive in Serbia than in the rest of the region, as World Bank reports in *Doing Business 2014*.

SEE economies have made their policy frameworks more conducive to on-going business operations

Once a foreign enterprise has made its initial investment, the policy framework that governs business operations in the host country will determine whether it can do business sustainably and continue to invest. Factors that help sustain on-going business operations include ease of recruitment from abroad, the involvement of businesses in any legislative changes that may affect them and the ability to transfer profits. OECD analysis shows that these elements are fundamental to investment decisions (OECD, 2010).

The **restrictions to key personnel** indicator gauges the degree to which investors can hire foreign staff, be they ordinary employees or board members. No or few such restrictions encourage investment, as businesses generally try to reduce risk by employing experienced personnel, especially when making major investments (OECD, 2015).

The **prior notification and consultation of legislative changes** indicator evaluates to what extent governments inform and talk to the private sector when they plan to make changes to legislation that affects the business environment. The economies that do notify and consult generally produce laws that factor in investors' interests and help foster a more stable investment environment (OECD, 2010).

Finally, the **transfer of FDI-related capital** indicator assesses whether and to what extent laws, regulations and international commitments provide for the transfer of investment capital, which includes profits, dividends and proceeds from the sales of investments. Profit remittance is a key concern in most investment decisions (OECD, 2010).

Table 1.3. **Transparency and Treatment of Investors Sub-Dimension: Operations enabling policy framework indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Restrictions on key personnel	5.0	4.0	4.0	2.5	4.0	4.0
Prior notification and consultation of legislative changes	3.5	3.0	4.0	3.0	4.5	3.0
FDI related capital transfer	4.5	4.0	4.0	3.0	3.0	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322798

SEE economies generally perform well when it comes to sustaining on-going business operations and investment. A number of significant patterns emerge across the region:

- SEE economies have continued to facilitate the recruitment of foreign personnel, whether employees or board members.
- Public-private sector dialogue is also well established, with governments involving and consulting the private sector prior to making legislative changes that affect it.
- Most economies allow investment-related capital transfers.

Kosovo has a well-established holistic legal framework – part of its efforts since 2008 to establish a functioning market economy. It also allows foreign workers, including managerial staff, to take up employment. Furthermore, the government systematically consults private businesses and other stakeholders prior to making legislative changes that affect them. Indeed, Article 32 of the Regulation of Rules and Procedure No. 09/2011 specifically states that ministries must publish proposed legislative changes for public comment and that they should seek the views of non-governmental organisations substantially affected by the changes. Finally, foreign investors may, freely and without delay, remit profits and transfer to another country any proceeds from investment in Kosovo.

Albania, Bosnia and Herzegovina, Montenegro and Serbia have no general restrictions on the number of foreign employees or on their duration of employment. Indeed, all four economies make it easy for foreign nationals to come to work. Albania and Montenegro also systematically consult stakeholders prior to relevant legislative changes. Finally, all four economies permit foreign investors to transfer abroad all funds related to their investment.

Bosnia and Herzegovina and Serbia still conduct consultations on an ad hoc basis with a narrow selection of stakeholders. However, both economies actively promote prior notification and consultation among stakeholders.

The Former Yugoslav Republic of Macedonia does not use certain business-facilitation measures as standard practice. As in other SEE economies, foreigners wishing to work there need to apply for long-stay visas or temporary residence permits. Furthermore, application procedures are reported to be cumbersome and may be a sizeable barrier to the employment of foreign personnel. Finally, the government still notifies and consults only some stakeholders prior to legislative reform and does so on an ad hoc basis.

The way forward in transparency and treatment of investors

As SEE economies look to the future, they might bear in mind a number of policy interventions to further improve the treatment of investors.

The Former Yugoslav Republic of Macedonia and Serbia could consider periodically reviewing their expropriation-related legislation and adjusting it if necessary.

The Former Yugoslav Republic of Macedonia could simplify procedures and requirements for employing foreign personnel. It could also introduce legislative provisions that would facilitate the transfer of investment-related capital. In addition, it could publicise restrictions on the transfer of FDI-related capital, then monitor the law and make any necessary adjustments.

Albania and the Former Yugoslav Republic of Macedonia could periodically collect feedback from foreign investors and adjust legislation accordingly in order to simplify administrative barriers to land access.

Serbia could consider making it easier for foreign investors to purchase agricultural land and further ease the administrative procedures for leasing private and public land.

Bosnia and Herzegovina and Serbia could make pre-reform notification and consultation standard practice, while involving a broader cross-section of stakeholders from the private sector. They could do so by drawing on the OECD Background Document on Public Consultation (2006), as it contains a number of detailed recommendations for consulting stakeholders. The recommendations include systematically assessing whether a legislative change impacts the private sector and drawing up guidelines for the ensuing dialogue with stakeholders from the investment and business community.

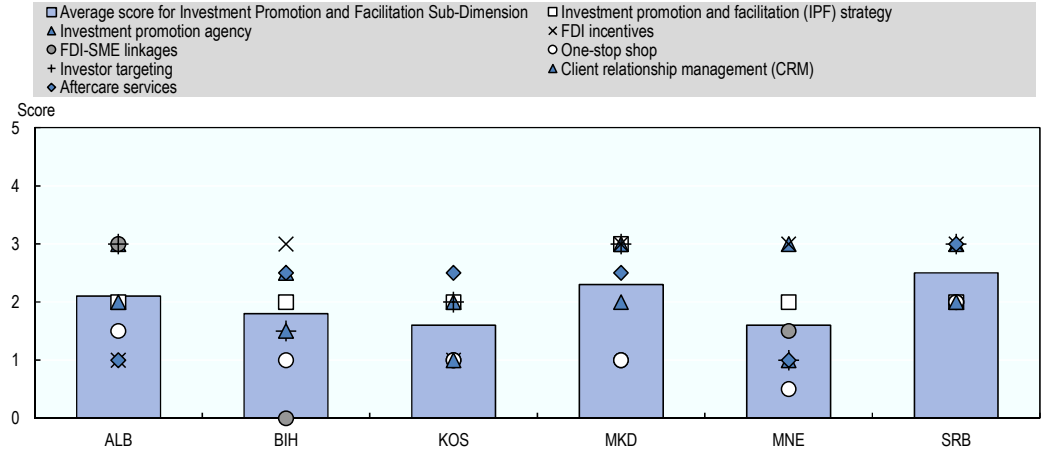
Kosovo and Montenegro could consider facilitating foreign investment through more bilateral investment agreements. Montenegro could also further implement and begin monitoring the legislation and regulations set forth in the New York Convention and ICSID, especially with regard to the enforcement of arbitration awards. It might also monitor its dispute settlement arrangements more closely.

Finally, all SEE economies could consider streamlining the investment regulatory framework to an even greater extent so as to further improve the business environment in the region, as advocated in the joint conclusions of the Economic and Financial Affairs Council (Council of the European Union, 2014).

Investment Promotion and Facilitation Sub-Dimension

It is essential that any economy wishing to draw investors promotes itself as an attractive FDI destination and takes action to facilitate procedures and foster an investment-friendly environment (OECD, 2010). Figure 1.8 shows the SEE economies' scores in the Investment Promotion and Facilitation Sub-Dimension.

Figure 1.8. **Investment Promotion and Facilitation: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The Investment Promotion and Facilitation Sub-Dimension comprises eight qualitative indicators (Table 1.4). They assess the overall investment policy and facilitation framework (IPF) and investment promotion services.

Table 1.4. **Investment Promotion and Facilitation Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Investment promotion and facilitation (IPF) strategy	2.0	2.0	2.0	3.0	2.0	2.0
Investment promotion agency	3.0	2.5	2.0	3.0	3.0	3.0
FDI incentives	1.0	3.0	1.0	3.0	3.0	3.0
FDI-SME linkages	3.0	0.0	1.0	1.0	1.5	2.0
One-stop shop	1.5	1.0	1.0	1.0	0.5	2.0
Investor targeting	3.0	1.5	2.0	3.0	1.0	3.0
Client relationship management (CRM)	2.0	1.5	1.0	2.0	1.0	2.0
Aftercare services	1.0	2.5	2.5	2.5	1.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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As the scores indicate, all SEE economies have investment promotion and facilitation frameworks in place, though not all have taken action so far. The greatest progress has come in the drawing up of IPF strategies and the setting up of functional investment promotion agencies. In contrast, some of the more advanced investment promotion and facilitation practices are yet to be instituted.

Analysis does in fact reveal a number of regional patterns and good practices, although there is still room for improvement. Albania, the Former Yugoslav Republic of Macedonia and Serbia score an average mark of over 2, indicating that they have fully adopted their frameworks and entered the initial stages of implementation.

SEE economies have the main IPF infrastructure in place

A comprehensive IPF infrastructure is the basis for establishing effective investment promotion and facilitation practices to attract FDI (Table 1.5). It includes an effective strategy, a well-funded and well-staffed investment promotion agency (IPA) that implements it and, ideally, a single point of contact for all administrative procedures that investors are required to go through in order to start business operations.

The **IPF strategy** indicator measures to what extent governments have developed and implemented a strategy to promote and facilitate investment. An effective IPF strategy – with clear objectives, mechanisms, responsibilities and action plans – is the foundation of IPF infrastructure and successful practices. Building on that foundation, the IPA indicator evaluates whether a government agency that implements the IPF strategy is up and running. Generally, a single implementing agency is more effective than multiple government bodies with different investment promotion and facilitation duties.

A well-funded, well-staffed **IPA** is considered a key factor in effectively implementing an investment promotion and facilitation strategy (OECD, 2015). Finally, the **one-stop shop** qualitative indicator ascertains whether governments have introduced single windows where foreign investors may obtain all the permits required to start business operations. Streamlined permitting procedures co-ordinated by a single body speed up procedures, improve transparency and reduce investment risk.

Table 1.5. **Investment Promotion and Facilitation Sub-Dimension: Framework indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Investment promotion and facilitation (IPF) strategy	2.0	2.0	2.0	3.0	2.0	2.0
Investment promotion agency	3.0	2.5	2.0	3.0	3.0	3.0
One-stop shop	1.5	1.0	1.0	1.0	0.5	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322818

Across the SEE region, efforts to build an effective IPF infrastructure have yielded progress, but advanced IPF infrastructure is yet to come.

All SEE economies have developed and adopted IPF strategies and set up investment promotion agencies with financial and personnel resources allocated to implementing the measures in the economies' strategies. Some economies have made progress in cutting the number of government contacts handling investment formalities, but one-stop shops are still to be introduced.

Serbia has developed and adopted an IPF strategy and the Serbian Investment and Export Agency (SIEPA) is implementing the measures it sets out. SIEPA also helps foreign investors overcome regulatory hurdles by offering administrative support in the investment phase and beyond.

Albania and the Former Yugoslav Republic of Macedonia have also made sound progress towards a comprehensive IPF infrastructure. The former, for example, recently approved the Law on Strategic Investments, which aims to promote and attract investments in strategic industries such as energy, transport and tourism. Albania also ratified the Law on Concessions and Public Private Partnership to further facilitate investments realised through public-private partnerships. The Former Yugoslav Republic of Macedonia, for its part, approved the implementation of a comprehensive IPF strategy, the National Programme for Stimulating Investments 2011-2014. Both economies have comparatively well-funded, well-staffed IPAs in place – the Albanian Investment Development Agency (AIDA) and InvestMacedonia. Both have also taken initial steps to support foreign investors through all the administrative procedures needed to set up business operations, although they have not yet put in place one-stop shops and investors still have to stop at numerous administrative windows.

As for Bosnia and Herzegovina, Kosovo, and Montenegro, they are still working towards a comprehensive IPF infrastructure. All three economies have developed and adopted IPF strategies. Over 20 municipalities in Kosovo have taken measures to steer foreign investors through administrative procedures. However, the municipalities do not offer a full service portfolio yet.

The Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA) and the Kosovo Investment and Enterprise Support Agency (KIESA) are not yet implementing the full range of measures in their governments' strategies. Both governments, however, have indicated that more resources might be forthcoming to support the implementation of their IPF strategies.

When it comes to one-stop shops that handle all formalities, however, Bosnia and Herzegovina, Kosovo, and Montenegro have not yet taken steps in that direction.

SEE economies perform a range of investment promotion activities

Once the economies have set up effective IPF infrastructures, their next step is to attract and incentivise investors by promoting themselves as profitable destinations that facilitate investment. IPF practices include selecting and interacting with potential investors who have suitable profiles, organising investment promotion events, offering foreign investors adequate incentives to invest, and linking them with local supplier bases.

To support these efforts, SEE economies might introduce customer relationship management (CRM) systems to help IPAs interact with potential investors more effectively. Finally, aftercare services that seek to retain investors and support them in any business expansion can also be an effective tool to increase FDI (OECD, 2010).

The **investor targeting** indicator measures whether and to what extent IPAs screen potential investors in order to identify suitable ones and target their approach. Screening and targeting practices make IPAs more efficient as they focus their resources on identified investor profiles. As for the **FDI incentives** indicator, it gauges whether SEE economies grant investors adequate fiscal, financial or regulatory incentives to attract and retain them. It also measures whether incentives have been developed in accordance with careful cost-benefit considerations and whether incentive schemes are publicised and information is publicly communicated.

Another investment promotion activity involves bringing together foreign investors and host economy SMEs. The **FDI-SME linkages** indicator gauges whether SEE economies have established practices for supporting foreign investors in building local supplier bases. Linking investors with supplier SMEs is mutually beneficial. The **customer relationship management** indicator assesses whether IPAs use a structured and informed approach in interacting with potential investors. With a clearly defined CRM strategy and adequate software to document all interaction, IPAs can make their investor communication more effective.

Finally, the **aftercare services** indicator measures the support offered to investors once they have set up their business operations. Such services can help enhance foreign investors' satisfaction and prompt them to expand their activity.

Table 1.6. **Investment Promotion and Facilitation Sub-Dimension: Promotion services indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
FDI incentives	1.0	3.0	1.0	3.0	3.0	3.0
Investor targeting	3.0	1.5	2.0	3.0	1.0	3.0
FDI-SME linkages	3.0	0.0	1.0	1.0	1.5	2.0
Client relationship management (CRM)	2.0	1.5	1.0	2.0	1.0	2.0
Aftercare services	1.0	2.5	2.5	2.5	1.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322829

As the indicator scores in Table 1.6 show, all SEE economies are starting to take action to promote and facilitate investment. Half of them hold investment promotion and matchmaking events, frequently targeting specific countries or sectors. SEE economies generally offer foreign investors incentives, based in part on cost-benefit considerations.

All also run business-linkage activities to help foreign investors build local supplier bases. Finally, most IPAs do keep track of their communication and interaction with investors, although they have yet to put in place integrated CRM systems.

The Former Yugoslav Republic of Macedonia and Serbia have comparatively well-established investment promotion practices. For example, they post publicly available information on investment incentives on their IPA websites, although they have not yet run cost-benefit analyses of their incentives to assess whether they are effective. Both economies also systematically conduct investment promotion campaigns. They also frequently hold follow-up conversations with established investors to collect feedback on ways to further improve the investment environment. In addition, Serbia's SIEPA has a local supplier and foreign investor database to facilitate business linkages. The Former Yugoslav Republic of Macedonia foresees measures to connect and secure co-operation between foreign investors and local SMEs in its Master Plan for Competitiveness.

Albania, too, has made solid progress in developing IPF activities. It runs regular investment promotion campaigns to attract new investors, for example. The number of such events that the Albanian Investment Development Agency (AIDA) has held in recent years rose from 4 in 2010 to 18 in 2014. Furthermore, the Albanian government is drafting legislation to design FDI incentives based on cost-benefit analysis and will ensure information on the incentives is made available to the public. Albania's investor-supplier linkage programmes are making headway, too, and it has already run a linkage pilot programme. Finally, Albania also holds follow-up conversations and meetings with foreign investors as part of its aftercare service, although it does not yet seek feedback on a systematic basis.

Bosnia and Herzegovina and Kosovo, too, follow up investors to gain post-investment feedback as part of their aftercare service provision.

Bosnia and Herzegovina, Kosovo and Montenegro have yet to make certain investment promotion and facilitation activities standard practice. For instance, all three could target investors and conduct investment promotion campaigns on a more regular basis.

Kosovo and Montenegro have taken only their first steps towards linking foreign investors with local supplier and are yet to develop CRM practices. Furthermore, while Montenegro publicises FDI incentive schemes and information on eligibility for such schemes on the website of the Montenegrin Investment Promotion Agency (MIPA), Kosovo is still to establish this practice. Cost-benefit analysis of FDI incentives could be developed further in both economies.

The way forward in investment promotion and facilitation

As SEE economies look to the future, they might consider a number of policy interventions to further strengthen their IPF infrastructure. For instance, Bosnia and Herzegovina and Kosovo could pursue the implementation of their IPF strategies and strengthen IPA resources.

Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro could strengthen support for foreign investors as they attend to investment formalities by reducing the number of administrative ports of call and moving towards a one-stop shop.

Albania and Serbia could further advance implementation of their IPF strategies.

As SEE economies look to the future, they might consider making their investment promotion and facilitation efforts even more effective through a number of measures. For instance, Bosnia and Herzegovina and Kosovo could consider implementing FDI-SME linkage practices to help investors build a local supplier base, from which the domestic economy would also benefit.

SEE economies could take into consideration the joint conclusions of the Council of the European Union, which emphasise the importance of giving SMEs targeted support and improving their access to finance in order to foster economic activity (Council of the European Union, 2014).

Furthermore, Bosnia and Herzegovina, Kosovo and Montenegro could develop more advanced CRM systems so that IPAs optimise their communication and interaction with investors.

Bosnia and Herzegovina, Kosovo and Montenegro could benefit from the recommendations for better investment promotion and facilitation practices outlined in the *OECD Policy Framework for Investment* (2015). Recommendations include:

- undertaking investor targeting activities to identify potential investors with suitable profiles
- tailoring investment incentive schemes
- developing good aftercare and policy advocacy services.

Box 1.2. **CzechInvest, an example of good practice in investment promotion**

Setting up an effective investment promotion agency to promote and facilitate FDI can be an effective tool for increasing investment. In line with that objective, the Czech Ministry of Industry and Trade established in 1992 CzechInvest as the national investment promotion agency.

Since its establishment, CzechInvest has helped to attract new investment projects, especially in selected priority sectors such as the automotive and the aerospace industry, IT, software development and clean technology.

CzechInvest boasts a wide-ranging service provision for attracting FDI and expanding domestic investment. It also promotes inward investment into the Czech Republic through numerous promotion events worldwide. In this context, it also provides potential investors with information on the business climate, investment environment and investment opportunities in the Czech Republic. Furthermore, CzechInvest acts as the single interface for most investment procedures and provides businesses directly with permits required to set up business operations. CzechInvest‘s service portfolio also includes consultations on how to most effectively handle investment procedures and the attribution of investment incentives. Finally, the agency’s investment facilitation strategy also includes aftercare services, business expansion assistance and business linkage practices.

Despite a fall in inward FDI to the Czech Republic in the aftermath of the financial crisis in 2011, CzechInvest successfully mediated investment projects worth USD 1.9 billion. In 2013, the figure rose to USD 2.4 billion for 108 projects.

Given its fine results, CzechInvest regularly serves as a model for the establishment of effective IPAs in Central and Eastern Europe, the Russian Federation and Central Asia.

Source: Ecorys (2013), *Exchange of good practice in Foreign Direct Investment promotion*, www.ec.europa.eu/DocsRoom/documents/4669/attachments/1/translations/en/renditions/native.

In addition, Albania could consider posting FDI incentive eligibility criteria and procedures on AIDA's website so that they may be freely consulted.

Albania could further develop the provision of aftercare services such as follow-up conversations and meetings with investors to gain feedback on the business environment.

The Former Yugoslav Republic of Macedonia could consider further strengthening FDI-SME linkage practices to help investors build local supplier bases with domestic SMEs and further strengthen the domestic economy.

Intellectual Property Rights Sub-Dimension

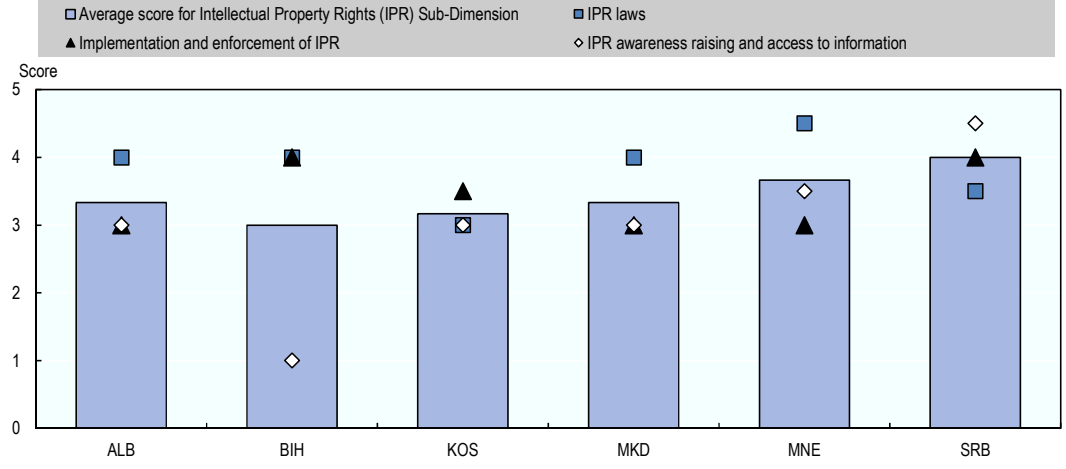
Many foreign investors regard intellectual property rights (IPR) protection as a key requirement for investing in research and development and creating innovative products and processes (OECD, 2015). Good practices in protecting the intellectual property of foreign investors include establishing effective, adequately resourced bodies for intellectual property protection adhering to international IPR conventions and enforcing laws to protect intellectual property (OECD, 2010). Furthermore, for IPR to be effective, economic actors need to be aware of the IPR legislation in place and to know that it is systematically enforced (ibid.).

The Intellectual Property Rights Sub-Dimension includes three qualitative indicators analysing the overall intellectual property rights framework and intellectual property right information access and promotion.

While this chapter focuses on the protection of IPRs, Chapter 4 complements it with a detailed assessment of how IPR legislation is conducive to innovation.

Figure 1.9 shows the SEE economies' scores in the Intellectual Property Rights Sub-Dimension and the indicators that constitute it.

Figure 1.9. **Intellectual Property Rights (IPR): Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321220

SEE economies fare comparatively well in the field of intellectual property rights (IPR). The average scores point to a fair environment for investors in knowledge-intensive sectors. Generally, SEE economies perform better in IPR protection and enforcement than in IPR awareness raising and access to information (Figure 1.9).

Analysis of IPR reveals a number of good practices, while the potential for improvement persists in areas like raising awareness. With well-established IPR frameworks and monitoring systems in place, Serbia and Montenegro emerge as the regional leaders in the protection and enforcement of intellectual property.

SEE economies have progressed in establishing effective IPR frameworks

An effective IPR framework can determine the willingness of foreign technology holders to invest in a country (OECD, 2015). Factors that contribute to an intellectual property framework conducive to FDI include comprehensive legislation and effective enforcement mechanisms. OECD analysis shows that they are fundamental to investment decisions (OECD, 2010).

The **intellectual property rights laws** indicator gauges whether SEE economies have adopted legislation that affords comprehensive protection to different forms of IPR. This is a critical requirement since extensive IPR legislation gives foreign investors the confidence to share technology, thereby stimulating further innovation in an economy which increases productivity and growth (OECD, 2015).

The **implementation and enforcement of IPR** indicator measures whether an effective IPR enforcement body is up and running. If protection is to be effective, however, legislation must be comprehensive with adequate infrastructure and resources to implement it.

Table 1.7. **Intellectual Property Rights (IPR) Sub-Dimension: Framework indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
IPR laws	4.0	4.0	3.0	4.0	4.5	3.5
Implementation and enforcement of IPR	3.0	4.0	3.5	3.0	3.0	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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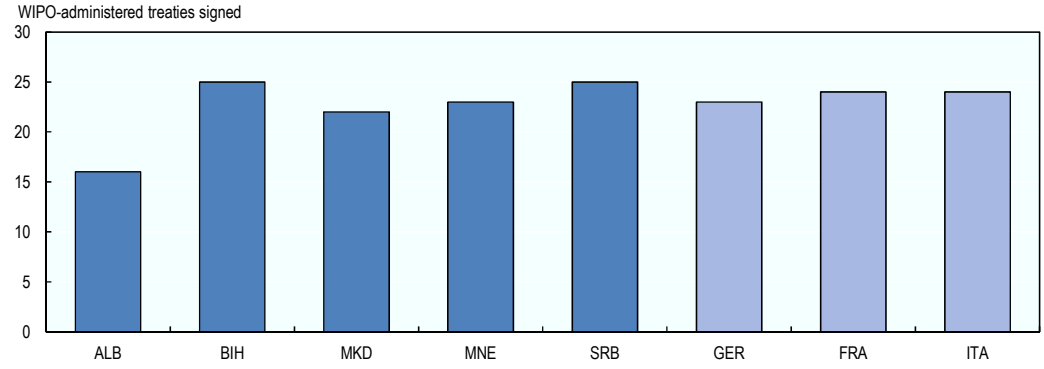
The indicator, number of WIPO-administered treaties signed (Figure 1.10), denotes the number of international IPR agreements to which an economy is a signatory and assesses how much it adheres to international IPR standards. Compliance matters to investors who regard it as a guarantee that their intellectual property is protected.

Finally, the software piracy rates indicator measures the proportion of installed software that is pirated (Figure 1.11). High piracy rates may point to weaknesses in intellectual property protection.

Generally, SEE economies perform well on measures of effective IPR frameworks. A number of significant patterns have emerged across the region.

SEE economies protect various forms of intellectual property, such as patents, trademarks, industrial designs and geographical indications. Furthermore, most have signed a good number of international IPR agreements. However, at twice the average EU rate, software piracy in the region remains an issue.

Figure 1.10. **Number of WIPO-administered treaties signed, 2015**

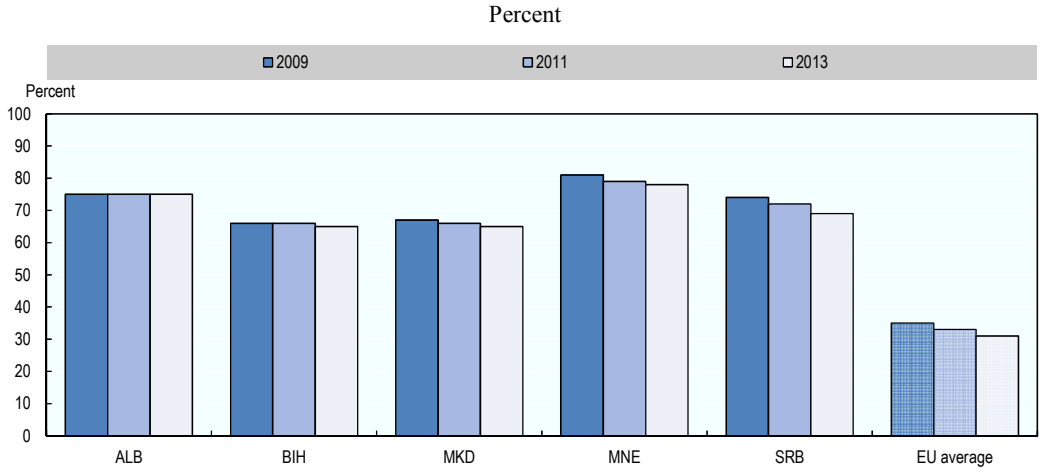


Note: Data for Kosovo not available.

Source: World Intellectual Property Organization (2015), *WIPO-Administered treaties* (webpage), www.wipo.int/treaties/en.

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Figure 1.11. **Software piracy rates, 2009, 2011 and 2013**



Note: Data for Kosovo not available.

Source: BSA (2014), *The compliance gap: BSA global software survey*, http://globalstudy.bsa.org/2013/downloads/studies/2013GlobalSurvey_Study_en.pdf.

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Bosnia and Herzegovina, Montenegro and Serbia boast comprehensive IPR legislation that protects various forms of IPR, e.g. patents and trademarks. All three economies are also parties to international agreements, such as the Patent Co-operation Treaty (PCT), the Madrid System for the International Registration of Marks and the Hague Agreement Concerning the International Deposit of Industrial Designs.

Indeed, both Bosnia and Herzegovina and Serbia have signed more international IPR accords than EU member countries such as France, Germany and Italy. Both economies also have well staffed and funded IP enforcement bodies which adjudicate IPR-related disputes. They both monitor the enforcement of their IPR legislation.

Albania, the Former Yugoslav Republic of Macedonia and Kosovo and have made solid progress in establishing and implementing an effective IPR framework. They have, for example, widened the scope of their IPR legislation in recent years.

Albania and the Former Yugoslav Republic of Macedonia are signatories to international IPR agreements, such as the PCT, the Madrid System for the International Registration of Marks and the Hague Agreement Concerning the International Deposit of Industrial Designs. Finally, it has been reported that governments of both economies could increase resources to support their IPR enforcement bodies.

Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro are still to monitor IPR enforcement.

As SEE economies look to the future, they could consider a number of policy interventions to further strengthen their IPR framework. Albania and the Former Yugoslav Republic of Macedonia could increase their IPR enforcement bodies' resources. Kosovo could consider regularly reviewing and adjusting IPR laws to pre-empt any potential shortcomings. All SEE economies could consider monitoring the enforcement of IPR legislation on a systematic basis to ensure that intellectual property is even better protected.

SEE economies all seek to raise awareness of IPR

If IPR practices are to be effective, economic actors need to know that IPR legislation is in place and that it is systematically enforced. Ways to raise awareness of IPR include dedicated help desks and user-friendly information outlets on protected patents.

The indicator, **IPR awareness raising and access to information**, considers whether a government takes action to raise awareness of IPRs. Action may be, for example, IPR awareness-raising campaigns or capacity-building programmes in processing intellectual property applications.

Table 1.8. **Intellectual Property Rights (IPR) Sub-Dimension: Awareness raising indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
IPR awareness raising and access to information	3.0	1.0	3.0	3.0	3.5	4.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322842

SEE economies score comparatively well when it comes to raising awareness of IPR and enhancing access to information. IPR information services are generally operational, most economies carry out awareness-raising measures and governments hold IPR information sessions – on the use of the intellectual property system, for example.

Montenegro and Serbia have comparably well established IPR awareness-raising practices. The Montenegrin Intellectual Property Rights Office, for example, regularly maintains and updates its website to keep the public informed of changes in IPR legislation. Furthermore, Serbia has put in place a dedicated IPR help desk to offer economic actors guidance and answer queries on IPR.

Albania, the Former Yugoslav Republic of Macedonia and Kosovo have made sound progress in their IPR awareness-raising activities and have developed IPR information systems, for example.

However, all three economies are still to establish dedicated IPR help desks to provide guidance to foreign investors and other economic actors.

Bosnia and Herzegovina is yet to make IPR awareness-raising activities standard practice. Despite offering some information on IPR, Bosnia and Herzegovina is still to run IPR awareness-raising campaigns.

As SEE economies look to the future, they might consider a number of policy interventions to further raise awareness of IPRs among economic actors. Bosnia and Herzegovina could further advance the development of an IPR information service, for instance through further developing its structure and organisational format. Albania, the Former Yugoslav Republic of Macedonia and Kosovo could consider setting up dedicated IRP help desks to support economic actors and keep them up to date with IPR legislation.

Box 1.3. **IP Australia, an example of good practice in intellectual property protection**

For many foreign investors, particularly those in knowledge-intensive industries, the protection of intellectual property is a key requirement for investing in a country. If IPR practices are to be effective, investors and businesses need to be aware of the host country's IPR legislation and to know that it is always enforced. To that end, governments set up IPR information services. IP Australia is the Australian government agency administering intellectual property rights and legislation related to patents, trademarks, designs and plant breeder's rights. It is a listed entity within the Australian Department of Industry and Science.

IP Australia undertakes a number of IPR awareness-raising activities, such as processing patent applications, conducting IP hearings and maintaining IP registers. It works with IP offices in Australia and international IP organisations, as well as with business groups, trade associations and government bodies to ensure the effectiveness of Australia's IP system. It holds regular meetings with its national stakeholder groups to raise IPR awareness.

Through its large portfolio of activities, IP Australia provides substantial information on IPRs, contributing to IPR awareness raising across Australia. Through its website, it supplies detailed information on the different kinds of IP that can be filed. IP Australia also provides access to searchable patent, trademark, design and plant breeder's rights databases. It ensures that information is practical, user-friendly and tailored to private sector actors. Finally, IP Australia runs targeted IP programmes for SMEs, exporters, creative industries, the vocational and education sector, and schools.

With its comprehensive set of IPR awareness-raising activities and private sector focus, IP Australia is perceived as one of the most advanced agencies in the field. It substantially contributes to the protection of IPRs in Australia, where IPR protection is among the strongest there is.

Source: IP Australia (n.d.), *IP Australia* (webpage), www.ipaustralia.gov.au.

Conclusions

SEE economies have demonstrated that they are making headway towards a sound, predictable investment framework that is conducive to foreign and domestic investment alike. Indeed, foreign and domestic investors are widely treated on an equal footing and investment procedures are increasingly transparent. SEE economies have also institutionalised a growing number of investment promotion and facilitation practices and

instituted measures to protect and enforce intellectual property rights. All economies have, for instance, enacted IPR legislation and ratified international IPR agreements.

Nevertheless, the SEE region's economies still face a number of challenges. They include granting foreign investors greater access to land and, in accordance with the New York and ICSID conventions, advancing the implementation and systematic monitoring of legislation and regulations – for instance with respect to the enforcement of arbitration awards. Further progress in rolling out investment promotion and facilitation practices, such as FDI-SME linkage programmes and one-stop shops would also be beneficial. A final positive move would be to foster awareness of IPRs through more extensive IPR information services – e.g. dedicated help desks to advise economic actors on IPR legislation and provide them with information.

Addressing those challenges would enable the region to build an investment framework that increasingly attracts investors and, in turn, fosters further FDI and domestic investment.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 2.

Trade policy and facilitation in South East Europe

Open, predictable and transparent trade policies facilitate cross-border economic activities and idea flows. This chapter on the Trade Policy and Facilitation Dimension focuses on three sub-dimensions in its assessment of trade performance and policy development. The Trade Policy Development Sub-Dimension analyses government capacities for designing, implementing and evaluating trade policy that incorporates institutional co-ordination and public-private consultations. The Trade Liberalisation Sub-Dimension examines international agreements and domestic laws to determine how open an economy is to trade in goods and services. The Trade Facilitation Sub-Dimension describes the extent to which non-tariff barriers – technical barriers, sanitary and phytosanitary measures, administrative barriers, and non-automatic import licences – hinder trade.

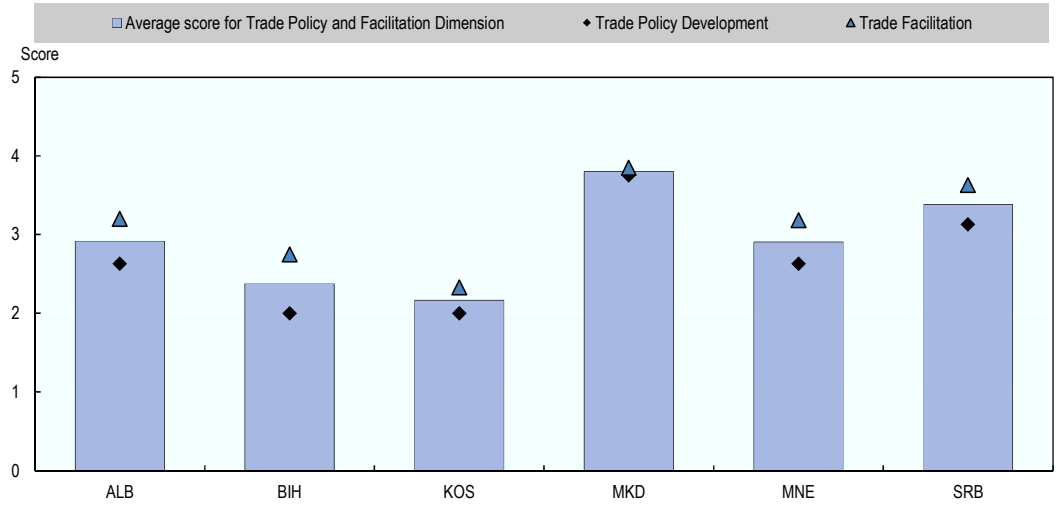
Main findings

Effective trade policy enables national competitiveness by facilitating cross-border economic activities and idea flows. Measures to liberalise trade can improve allocative efficiency and provide access to larger markets, allowing for increased economies of scale and, thereby, lower costs (Melitz, 2003). An effective free-trade policy encourages more domestic and foreign direct investment (FDI) (OECD, 2005). Furthermore, transparent trade policies facilitate trade and access to global value chains, which are highly effective means of integrating into the world economy and connect to modern technologies and skills (OECD, 2015; OECD/World Bank, 2015).

The global economic and financial crisis was associated with the most dramatic decline in world trade in recent history. In South East Europe (SEE), total trade fell to its lowest point in 2009, a decline of 20.5% from its peak in 2008. Since then, it has gradually recovered, increasing by 23.2% across the region in 2013. Generally robust institutional and legal frameworks for trade supported the recovery in trade flows.

The Former Yugoslav Republic of Macedonia leads the region in trade policy and facilitation with a score of just under 4, reflecting its advanced trade policy implementation. Albania, Montenegro and Serbia all score around 3, which signifies that they have established frameworks that they implement but do not yet monitor. Bosnia and Herzegovina and Kosovo, with scores just over 2, have still to make their frameworks operational. Across SEE economies, development in the Trade Facilitation Sub-Dimension has slightly out-paced in Trade Policy Development. The Trade Liberalisation Sub-Dimension describes the measures that the SEE economies have taken to integrate into the world trading system.

Figure 2.1. **Trade Policy and Facilitation: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have advanced in developing policies that facilitate trade.

All SEE economies have taken positive steps towards integration into the world trading system. All SEE economies are signatories of the Central European Free Trade Agreement (CEFTA). Albania, the Former Yugoslav Republic of Macedonia and Montenegro are also WTO members. Trade integration with the EU is facilitated through the Stabilisation and Association Process (SAP). Average applied most-favoured nation (MFN) tariffs are broadly in line with world and OECD averages and average customs duties on capital goods are close to EU levels. SEE economies have abolished quantitative restrictions on imports and exports for economic reasons.

All SEE economies have strengthened trade policy institutional frameworks. All SEE economies have designated a single body to co-ordinate trade policy formulation and implementation, usually in the form of an inter-ministerial committee or working group. Although formal instruments for consultation with civil society are in place, broader participation of the private sector and civil society is not consistent.

Challenges

The SEE economies still face barriers to trade despite their progress.

Non-tariff barriers (NTBs) are still a constraint. Economies from the region have been more successful in reducing technical barriers to trade and implementing trade facilitation measures than in addressing barriers related to sanitary and phytosanitary (SPS) measures.

Regulatory barriers restrict trade in services. Restrictions on the movement of people are the most significant. Constraints on foreign ownership in legal, accounting, auditing, architecture and engineering services also pose a problem. Finally, a lack of regulatory transparency and burdensome administrative requirements restrict trade in the construction services sector.

Trade measure impact evaluations are sporadic and often limited to specific sectors. Few government bodies have a clear mandate or budget to systematically conduct comprehensive impact assessments. Furthermore, high-quality statistical trade data are scarce and government bodies have only limited access to and familiarity with quantitative and qualitative trade analysis tools.

Recommendations

In response to the challenges identified above, a number of strategic steps are needed to further develop infrastructure to facilitate increased trade flows.

Further reduce non-tariff barriers to trade, especially as regards SPS measures. Efficient customs enquiry points, simplified and harmonised documentation, and automated, streamlined customs procedures and processes facilitate trade. Implementing risk-based inspection practices reduces the time and cost of importing and exporting. Priority areas include the transposition of EU technical legislation and participation in European standardisation activities with a focus on information and notification systems.

Address barriers to trade in services. In professional and construction services, restrictions to the free movement of people – i.e. foreign experts, professionals and skilled labour – have room for improvement. For instance, professional services sectors would benefit from introducing clear, transparent systems of licensing and streamlining the mutual recognition of foreign qualifications. In the construction sector, expert quotas, limits on durations of stay and labour market tests could be addressed.

Strengthen trade policy formulation. SEE economies could consider developing monitoring and evaluating trade policy measures. Analytical and econometric skills could be strengthened and existing inter-ministerial capacities for impact measurement improved. High-quality statistical trade data collection could be reinforced. Moreover, civil society consultation mechanisms would benefit from creating specific advisory or economic councils and committees.

Overview

Effective trade policy enables national competitiveness by facilitating cross-border flows of economic activities and ideas. It encourages more domestic and foreign direct investment (OECD, 2005). If undertaken unilaterally, or as part of binding multilateral and preferential trade and investment agreements, trade liberalisation measures provide access to bigger markets, which enables larger economies of scale and efficiency gains. Greater access to markets also brings greater competition from international firms in domestic markets, which leads to increased competition and improved allocative efficiency (OECD, 2015).

Open, predictable and transparent trade policies are thus necessary if countries are to stay competitive in a world where global value chains (GVCs) are a dominant feature of trade. Each step in the whole process of producing goods – from raw materials to finished products – is increasingly carried out wherever the necessary skills and materials are available at competitive costs and quality. Similarly, trade in services is essential to the efficient functioning of GVCs. When production is fragmented and goods and services cross borders many times, tariffs, non-tariff barriers and other restrictive measures impact not only foreign suppliers but also domestic producers (OECD/WTO/World Bank, 2014). Fast and efficient customs and border procedures and well functioning transport, logistics, finance, communications and other business services are particularly important. Open trade and investment regimes, with streamlined and efficient customs procedures, help ensure inputs are competitively priced and trade costs reduced (OECD, 2015).

The Trade Policy and Facilitation Dimension is closely linked with other policy fields analysed in this publication.

- **Chapter 1. Investment policy and promotion**, in particular foreign direct investment (FDI), is dependent on an open, liberal trade regime with trade facilitation measures in place. Academic literature agrees that a country's openness to trade is more likely to be positively correlated with FDI than any other explanatory variable (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).
- **Chapter 7. Transport** and 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. Furthermore, research suggests countries with better logistics performance tend to specialise more in manufacturing GVCs. Delays, which are 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 12. Employment policy** and trade are highly interdependent. 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 contain 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).

Box 2.1. **Trade Policy and Facilitation Dimension in the SEE 2020 Strategy**

Trade Policy and Facilitation is a key element of the Integrated Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Integrated Growth Pillar is to promote regional trade and investment linkages through non-discriminatory, transparent and predictable policies that will enhance the flow of goods, investment, services and people within the region.

SEE 2020 sets the following main trade-related headline targets:

- boost total SEE trade in goods and services from EUR 94.4 billion to EUR 209.5 billion by 2020
- reduce SEE trade deficit from 15.7% to 12.3 % of GDP by 2020
- increase SEE intra-regional trade in goods by more than 140.0% by 2020.

Furthermore, SEE 2020 focuses on a number of free trade actions: fully liberalise trade in agricultural products; address distortive sanitary and phytosanitary (SPS) measures; remove unnecessary technical barriers to trade; employ regional transparency tools to systemise detection of trade irritants; eliminate non-automatic input licences that contravene WTO and EU regulations; modernise customs interconnectivity; and reduce trade in services restrictions.

The Central European Free Trade Agreement (CEFTA) Secretariat in Brussels is the official co-ordinator of the Trade Policy and Facilitation Dimension. The CEFTA 2006 Agreement is an innovative and ambitious free trade agreement that provides for the liberalisation of trade in industrial products and agricultural goods. It also incorporates provisions on free trade in services, as well as clauses on investment promotion and protection, provisions on government procurement and dispute-resolution mechanisms.

Source: RCC, (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Trade Policy and Facilitation Dimension assessment framework

This chapter analyses aspects of the underlying framework for trade policy and facilitation in South East Europe. It does not seek to be exhaustive, however. It confines itself to assessing three broad sub-dimensions based on objectives in the Integrated Growth Pillar of the SEE 2020 Strategy. The three constituent sub-dimensions are:

- Trade Policy Development

  What capacities do governments have for designing, implementing and evaluating trade policy and strategy?

- Trade Liberalisation

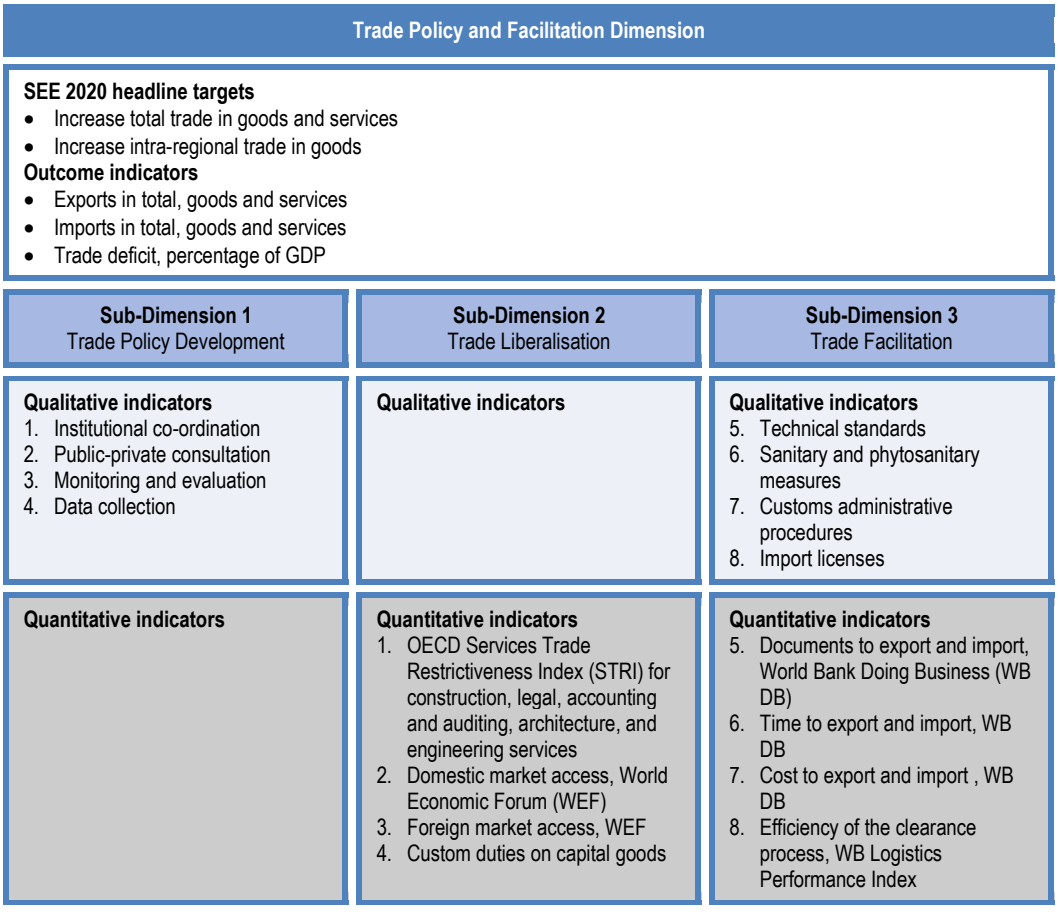
  To what extent is trade in goods and services liberalised? How well integrated in the multilateral trading system are the SEE economies?

- Trade Facilitation

  To what extent do non-tariff barriers – technical barriers, sanitary and phytosanitary measures, administrative barriers and non-automatic import licences – hinder trade?

Figure 2.2 shows how the sub-dimensions and their constituent indicators make up the Trade Policy and Facilitation Dimension assessment framework.

Figure 2.2. **Trade Policy and Facilitation Dimension assessment framework**



Each sub-dimension is assessed through quantitative and qualitative indicators collected by the secretariat of the Central European Free Trade Agreement (CEFTA), with the support of the OECD.

Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

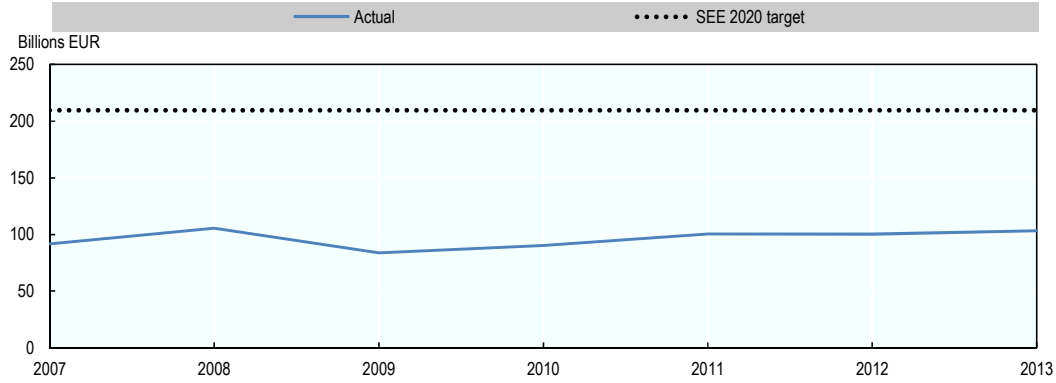
Trade policy and facilitation performance in SEE economies

Three quantitative outcome indicators are used to assess the trade performance of the SEE economies in recent years. These indicators are total SEE trade in goods and services (EUR billions), the SEE trade balance (as a percentage of GDP) and intra-regional trade in goods (EUR billions). Some complementary quantitative indicators are also used to gauge trade trends in the region.

The global crisis has had a subduing effect on the value of total trade in goods and services in the SEE region (Figure 2.3). It peaked in 2008 before falling 20.5% to its lowest point in 2009. From 2009 to 2011, it picked up steadily to approach its 2008 level. From 2011 to 2013, however, it levelled out.

Figure 2.3. **Total SEE trade in goods and services**

Billions EUR



Note: The data in USD have been converted to EUR using yearly average exchange rates. Data for Kosovo not available.

Source: Adapted from World Bank (2015a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Across the region, exports of goods make up a larger and faster-growing share of all exports than services (Figure 2.4). In 2013, they accounted for 65% of aggregate exports, against 35% for services. From 2009 to 2013, the average annual growth rate in regional exports of goods was 15%, while in services it was 4%.

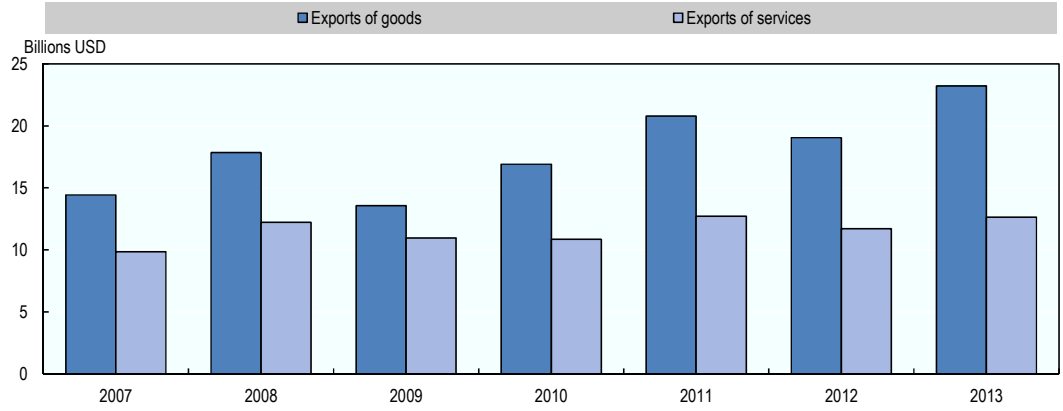
At 26%, the contribution of trade in services to SEE regional GDP lags behind the EU, where it accounted for 41% in 2013. As for the individual SEE economies, indicators show wide differences.

In Bosnia and Herzegovina, trade in services makes the smallest contribution to GDP and has the lowest growth rate – it increased by only 1% from 13% in 2005 to 14% in 2013. Albania and Montenegro boasted the most dynamic increases in trade in services, increasing its share of GDP from 35% in 2005 to a figure comparable with the EU average of 41% in 2013. Examination of the composition of trade in services in the SEE region reveals the dominance of travel, transport and telecommunications. Travel accounts for the largest share of trade in services in Albania and Montenegro (approximately 59% in 2013), while in Bosnia and Herzegovina it is transport (37%

in 2013). As for telecommunication services, they are more important for the Former Yugoslav Republic of Macedonia (around 15%) than for the rest of the SEE economies.

Figure 2.4. **SEE regional exports of goods and services**

Billions USD



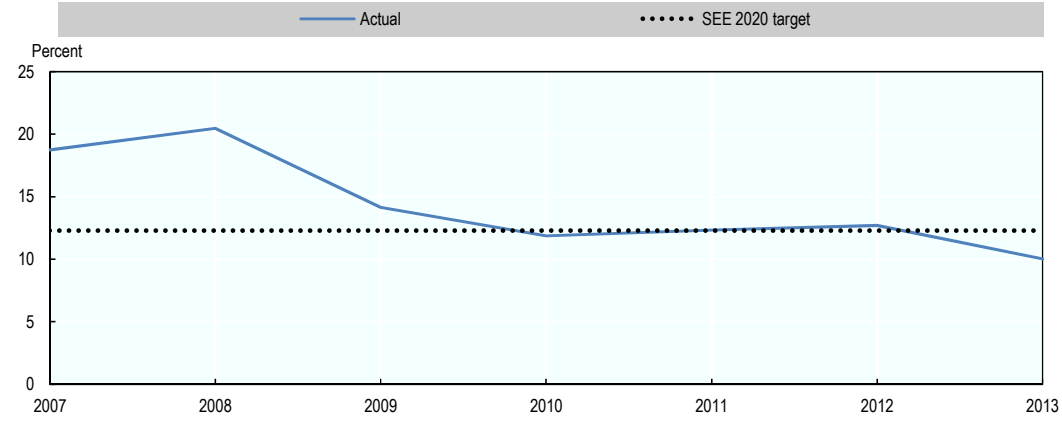
Source: World Bank (2015a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321270

The SEE trade deficit has narrowed almost continuously since 2008, reflecting a steep fall in consumer goods imports due to reduced demand in the wake of the crisis (Figure 2.5). The deficit in fact halved from just over 20% in 2008 to 10% in 2013.

Figure 2.5. **SEE trade deficit**

Percent of GDP



Source: World Bank (2015a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

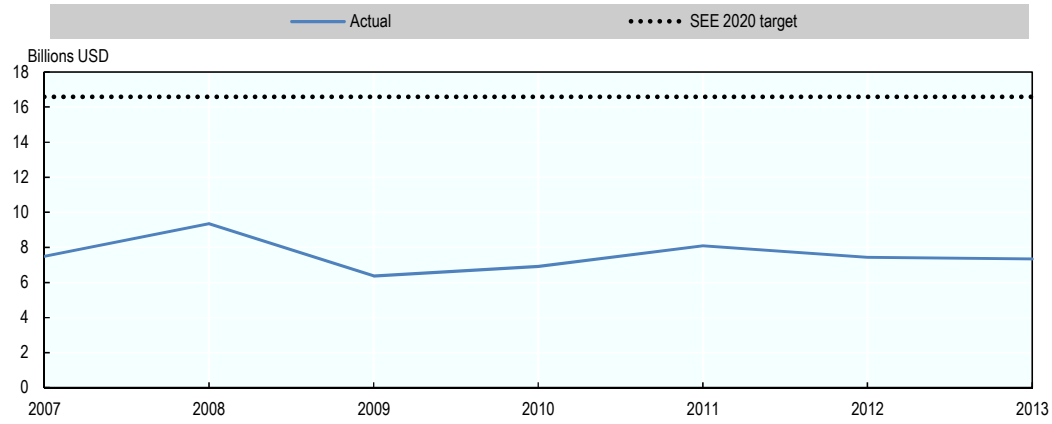
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The SEE economies have thus met the SEE 2020 goal of reducing the deficit to 12.3% of GDP. As they recover, the deficit may widen, however, with consumer goods imports rising in response to consumer demand and to potential new FDI prompting greater equipment imports. Once investment produces a beneficial impact on exports in

the medium to long term, though, its negative impact on deficits will diminish. Total intra-SEE trade has not regained its peak level of 2008. From a low point in 2009, it made up about half the ground to its 2008 peak by 2011, but has fallen away slightly since then. The SEE 2020 target of a 140% increase in intra-SEE trade between 2010 and 2020 will be a challenge for the simple reason that it will require sustained annual growth of 12% until 2020.

Figure 2.6. **Total intra-SEE trade**

Billions USD



Source: UN (2015), *UN Comtrade Database* (database), http://comtrade.un.org/data.

StatLink http://dx.doi.org/10.1787/888933321296

Trade Policy Development Sub-Dimension

Over the last decade, global trade policy has steadily broadened its scope beyond simply 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.

Firstly, trade policy makers and negotiators need to regularly co-ordinate different ministries, government agencies and institutions when formulating and implementing trade policy. Secondly, they need to consult a broad range of private and civil society actors, including non-governmental organisations (NGOs), to facilitate transparency and inclusive in policy development. And thirdly, governments need to monitor and evaluate 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.

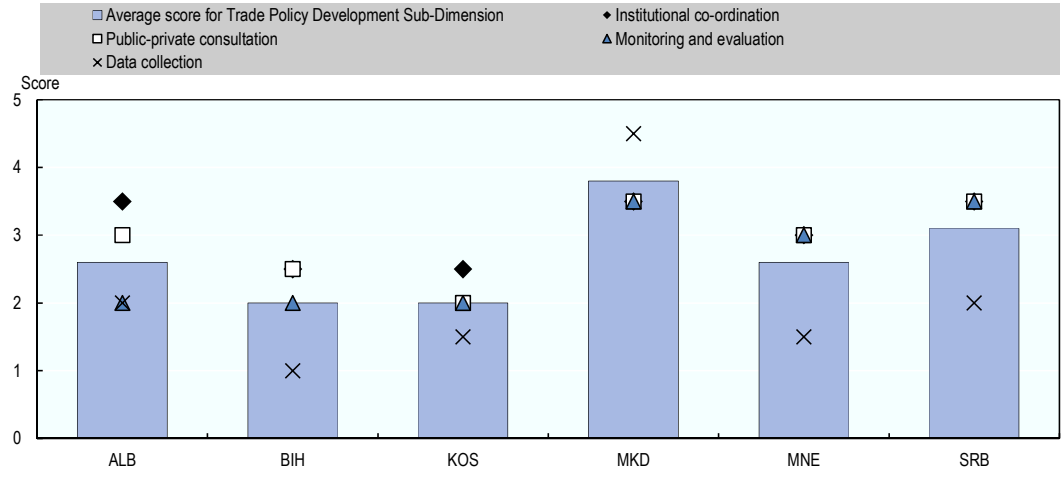
This section addresses the Trade Policy Development Sub-Dimension. To that end, it examines four qualitative indicators that assess the effectiveness of a national framework for formulating, implementing and evaluating trade strategy.

- **Institutional co-ordination** in trade policy usually involves a leading ministry co-ordinating the work of different stakeholders 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. Co-ordinating bodies should also take international commitments such as the WTO and CEFTA into account.

- **Public-private consultation** focuses on potential trade policy impacts on business and civil society. Effective private sector and civil society consultation mechanisms address the impacts before adopting new agreements and policies.
- **Monitoring and evaluation** systems regularly assess trade policy impacts on specific sectors and on the economy and society as a whole. Policy makers then adjust trade policies accordingly.
- **Data collection** enables 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. Ideally, data should relate to the most detailed level of economic activity, contain basic price valuations, and separate domestically produced and imported intermediate goods and services.

Figure 2.7. **Trade Policy Development: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321306

SEE economies have strengthened inter-institutional trade policy co-ordination and public-private consultation mechanisms. However, in most economies impact evaluations on how trade measures affect the national economy are sporadic and lack high-quality statistical trade data (Figure 2.7).

The Former Yugoslav Republic of Macedonia has the highest average sub-dimension score of almost 4, which signifies strong implementation and budding evaluation activities in all four indicators. Albania, Montenegro and Serbia score about 3 – policy framework adoption and implementation. With a score of 2, Bosnia and Herzegovina and Kosovo have policy frameworks largely in place, but have room for improvement in implementation. More efforts directed at data collection are needed in all the economies except for the Former Yugoslav Republic of Macedonia.

Institutional co-ordination mechanisms are largely in place

All SEE economies have a single body to co-ordinate trade policy formulation and implementation – the ministry of economy or trade. Trade policy co-ordination is usually performed by inter-ministerial committees or working groups. Their work is mainly focused on implementing CEFTA commitments, advancing WTO commitments or negotiations, preparing relevant EU *acquis* chapters and putting specific trade measures in place. However, comprehensive co-ordination mechanisms for particularly complex areas of trade policy, like trade facilitation and trade promotion, are missing. SEE economies would particularly benefit if operational national committees for trade facilitation were established.

Table 2.1. **Trade Policy Development Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Institutional co-ordination	3.5	2.5	2.5	3.5	3.0	3.5
Public-private consultation	3.0	2.5	2.0	3.5	3.0	3.5
Monitoring and evaluation	2.0	2.0	2.0	3.5	3.0	3.5
Data collection	2.0	1.0	1.5	4.5	1.5	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322851

Public private consultations have mixed levels of participation

All economies have formal private sector and civil society consultation mechanisms in place open to all relevant groups in society. However, economies differ as to the breadth and depth of stakeholder participation in practice.

In the Former Yugoslav Republic of Macedonia and Serbia a wide range of stakeholders are involved in public-private consultations, laws are published in a timely manner and consultation summaries are publicly available. In Serbia, a number of civil society associations actively participate in consultations (e.g. the National Association for Local Economic Development and the Standing Conference of Towns and Municipalities). In the Former Yugoslav Republic of Macedonia, in addition to regular consultations facilitated through the chamber of commerce, a National Entrepreneurship and Competitiveness Council (NECC) was re-established in 2012 and an advisory council has functioned within the customs administration since 2009.

Albania has a specific co-ordination council. In Bosnia and Herzegovina and Kosovo, more efforts are needed to ensure broad private sector and civil society participation. The legal obligation of advance notice also needs to be followed in practice.

Monitoring and evaluation activities are in early stages

The Former Yugoslav Republic of Macedonia, Serbia and Montenegro have well established monitoring and evaluation systems. Albania, Bosnia and Herzegovina, and Kosovo, however, do not monitor and evaluate regularly and usually only in specific sectors. Moreover, there is seldom a dedicated body or unit in place with a clear mandate, budget or staff to systematically conduct impact assessments. Although a number of SEE economies use regulatory impact assessments (RIAs) to ex ante evaluate the impact of draft laws and regulations, it is seldom used to measure trade-related impacts. Finally, economies rarely conduct complete impact assessments with inputs from a wider range of

trade analysis tools, which would need to include both quantitative techniques as well as a variety of qualitative assessment approaches.

Detailed trade data are lacking

The Former Yugoslav Republic of Macedonia is the only SEE economy to collect data to create symmetric detailed input-output tables covering all sectors. National statistics offices in all other SEE economies are still at an early stage of collecting the information needed to create national output tables (i.e. supply-use tables and symmetric input-output tables), which is an important element for in-depth analysis of trade flows.

The way forward in trade policy development

As SEE economies look to the future, they could consider creating specific advisory or economic councils or committees to strengthen civil society consultations for trade policy formulation. These bodies would have a broader advisory role, bringing together business groups, exporters' associations, trade experts, civil society representatives, trade unions, financial institutions and a greater number of SMEs.

Furthermore, analytical and econometric expertise can be further developed and existing inter-ministerial co-ordination strengthened to build trade policy monitoring and evaluation capacity. Monitoring and evaluation activities could incorporate systematic *ex post* and *ex ante* analysis of trade policy and agreements in all sectors of the economy.

There is also further room for improvement in collecting high-quality statistical trade data collection at the most detailed level of economic activity, with a basic price valuation and domestic or foreign origin noted. Finally, the results of monitoring could be disclosed in civil society discussions to deepen stakeholder dialogue.

Trade Liberalisation Sub-Dimension

An open market enables a country to trade freely with the rest of the world and capitalise on comparative advantages. Countries can benefit economically from liberalising trade (Hoekman, English and Aaditya, 2002). However, trade liberalisation measures – undertaken unilaterally or as part of binding multilateral and preferential trade and investment agreements – should be complemented by appropriate employment, labour and education policies so that the benefits of trade can be shared.

The Trade Liberalisation Sub-Dimension addresses to what extent a country has been integrated into global trade and which barriers are present. Factors that determine it include: 1) membership in the WTO; 2) the extent of EU and regional trade integration; 3) liberalisation of trade in services; 4) access to domestic and foreign market; 5) customs duties on capital goods.

WTO membership shows a country's commitment to abide by commonly agreed and shared fundamental principles: trade without discrimination, freer trade, predictability, promoting fair competition and encouraging development and economic reform. The commitment to free trade and certain international standards increases foreign and domestic firms' confidence in investing, thereby increasing trade flows, growth and further investment opportunities.

Regional trade agreements (RTAs) aim to further co-operation in trade policy and boost trade flows in groups of two or more partners. RTAs take diverse forms and may address trade in goods and services as well as investments. Even among WTO members, RTAs are still valuable as there are currently over 250 in force (World Trade

Organization, 2015). In South East Europe where half of the economies are not yet a part of the WTO, an RTA is an additionally valuable way of preparing to meet WTO membership criteria.

Liberalisation of trade in services can improve domestic firms' efficiency and productivity (Handjiski and Sestovic, 2011). Trade in services allows countries to specialise according to their comparative advantages in services and skills. The potential gains from liberalisation in services trade are significant because increased domestic and foreign competition complemented by effective regulation can enhance performance (Hoekman, English and Aaditya, 2002). The OECD Services Trade Restrictiveness Index (STRI) quantifies the magnitude of regulatory barriers to trade in services grouped into 18 sectors, each of which is composed of binary variables for the presence (1) or absence (0) of a restriction. Each sector has five policy areas:

1. restrictions on foreign ownership and other market entry conditions
2. restrictions on the movement of people
3. other discriminatory measures and international standards
4. barriers to competition and public ownership
5. regulatory transparency and administrative requirements.

The World Economic Forum (WEF) indicators assess the degree of domestic and foreign market accessibility. More specifically, the domestic market access indicator measures tariff rates, the complexity of tariffs (i.e. tariff dispersion, tariff peaks, specific tariffs and distinct tariffs) and the share of duty free imports, while the foreign market access indicator measures tariffs on imports and margins of preference in destination markets.

Finally, the openness of the capital goods trade regime is particularly significant for countries that do not produce capital goods locally and are dependent on imports of capital goods. High duties on imports of capital goods can have a particularly negative effect on FDI inflows and a country's international competitiveness. With access to cheaper capital goods, companies can gain export competitiveness. In addition, countries benefit from increased capital accumulation (OECD, 2005). Therefore, imports of capital goods should be exempted from customs duties in order to lower fixed investment costs.

Global, regional and bilateral agreements integrate the SEE economies into world trade systems

Three SEE economies are WTO members: Albania since 2000, the Former Yugoslav Republic of Macedonia since 2003 and Montenegro, which joined in 2012.

Although not yet members, the remaining economies have committed to following 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 begun to implement the required institutional and legislative provisions. Kosovo has yet to apply.

All SEE economies are EU candidate or potential EU candidate countries. Therefore, trade relations with the EU are part of the broader Stabilisation and Association Process which requires bringing national legislation into line with the EU *acquis* in several areas. The Stabilisation and Association Agreement (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 EU for both agricultural and industrial goods. Furthermore, it facilitates trade between the SEE region and the EU by encouraging the adoption of EU standards and conformity assessment procedures and the harmonisation of food safety, veterinary and phytosanitary legislation with the EU *acquis*. In addition, the autonomous trade preferences granted by the EU to SEE economies allow nearly all exports to enter the EU without customs duties or limits on quantities. In 2013, the EU was the region's largest trading partner for both imports (72.7%) and exports (81.8%).

An important landmark in the process of intra-regional trade liberalisation came in 2006, when CEFTA entered into force. The main objectives of CEFTA are to expand trade in goods and services, foster investment, eliminate barriers to trade, provide appropriate protection of intellectual property rights and harmonise provisions on modern trade policy issues. CEFTA has helped the SEE economies achieve full tariff liberalisation on trade in manufactured products and agricultural goods, establish a negotiating framework for the elimination of non-tariff barriers (NTBs), and begin negotiations on services trade liberalisation.

Countries in the European Free Trade Association (EFTA), Turkey and the Russian Federation follow EU countries as the SEE region's largest trading partners. The EU, EFTA and Turkey are part of the three diagonal cumulation zones applied by the region to varying degrees. All SEE economies have bilateral free trade agreements (FTAs) with EFTA and Turkey except Kosovo. Kosovo is in the process of ratifying an FTA with Turkey, but does not have one with EFTA. Only Montenegro and Serbia have bilateral FTAs with the Russian Federation.

Table 2.2. **The SEE economies' regional and bilateral trade agreements**

	Bilateral free trade agreements
ALB	EFTA, Turkey
BIH	EFTA, Turkey
KOS	Turkey (signed, to be ratified)
MKD	EFTA, Turkey, Ukraine
MNE	EFTA, Russian Federation, Turkey, Ukraine
SRB	Belarus, EFTA, Kazakhstan, Russian Federation, Turkey

Source: WTO (2015), *Preferential Trade Agreements* (database), http://ptadb.wto.org.

All SEE economies have committed themselves to joining the Pan-Euro Mediterranean (PEM) convention and amending all original FTA protocols, including the CEFTA protocol and the relevant bilateral origin protocols between the EU, EFTA and Turkey. They can then apply single diagonal cumulation under the terms of the PEM convention all SEE economies, apart from Kosovo, have signed and ratified. Furthermore, bilateral FTAs between SEE economies and the EU are modified to link them with the PEM convention, while the FTAs with EFTA and Turkey are currently being modified to link them with the PEM.

The SEE economies have also opened their services market to competition and foreign investment over the past ten years and SAAs include the liberalisation of service sectors. Furthermore, CEFTA negotiations on liberalizing trade in services were launched in 2014.

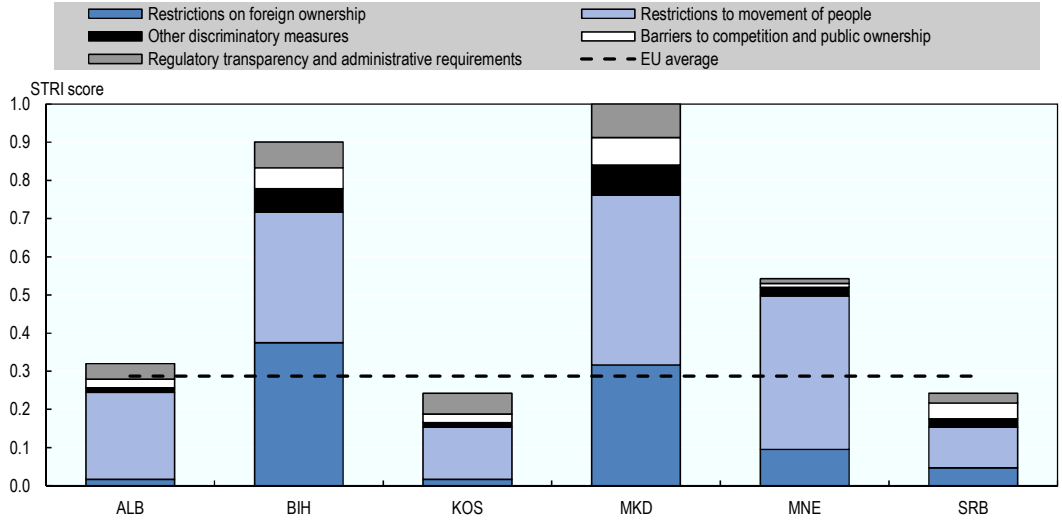
Trade in services is hampered by restrictions on the movement of people

The OECD Services Trade Restrictiveness Index (STRI) evaluated the restrictiveness of trade in services in five SEE priority sectors: construction services and four professional services – legal, accounting and auditing, architecture, and engineering (OECD, 2013). The assessment reveals that, across all services and countries, restrictions on the movement of people almost always make up at least half of all regulatory restrictions. Foreign ownership restrictions are the second most prevalent.

Legal services are by far the most restrictive sector among the professional services (Figure 2.8), with half of the SEE economies roughly twice as restrictive as the EU benchmark level. The most restrictive measure is the nationality requirement for offering legal services. It relates to most favoured nation regulations and does not take into account preferential measures. This is compounded by incomplete recognition of foreign qualifications and the absence of limited licence regimes which would enable foreign lawyers to practice foreign law in a host country. Furthermore, the SEE economies place restrictions on non-local lawyers and legal firms that do not apply to their domestic peers.

Figure 2.8. **Trade in legal services restrictiveness, 2013**

Services Trade Restrictiveness Index (STRI) score



Note: The STRI scores, based on regulation currently in force, take the value from 0 (open) to 1 (closed).

Source: OECD (2013), *STRI Assessment of Professional and Construction Services Trade in CEFTA*.

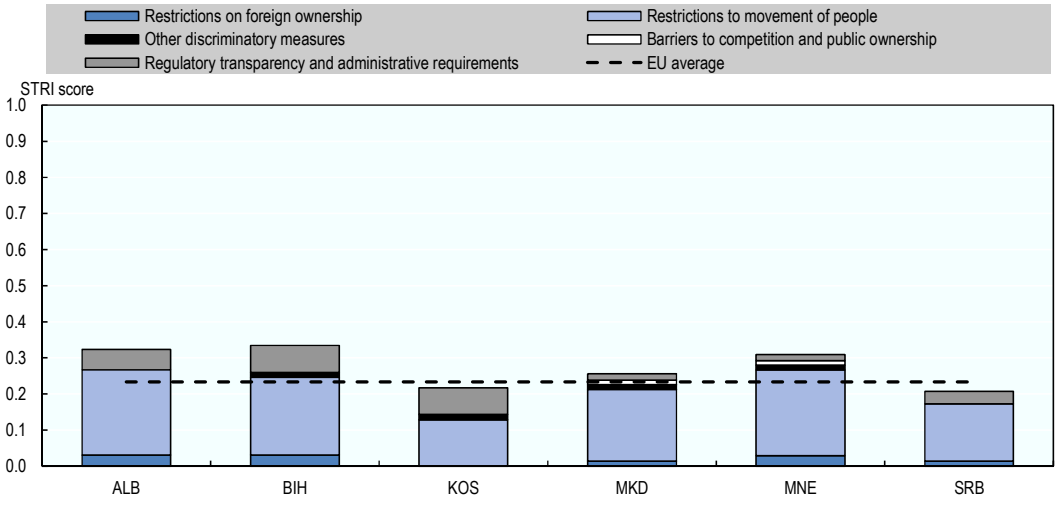
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Trade restrictiveness in architectural services in the SEE economies varies from 0.2 to 0.3 with four economies just over the EU benchmark and Kosovo and Serbia just under it (Figure 2.9).

Trade restrictiveness in engineering services in the SEE economies varies from 0.2 to 0.4, with all SEE economies over the EU benchmark (Figure 2.10).

Figure 2.9. **Trade in architectural services restrictiveness, 2013**

Services Trade Restrictiveness Index (STRI) score



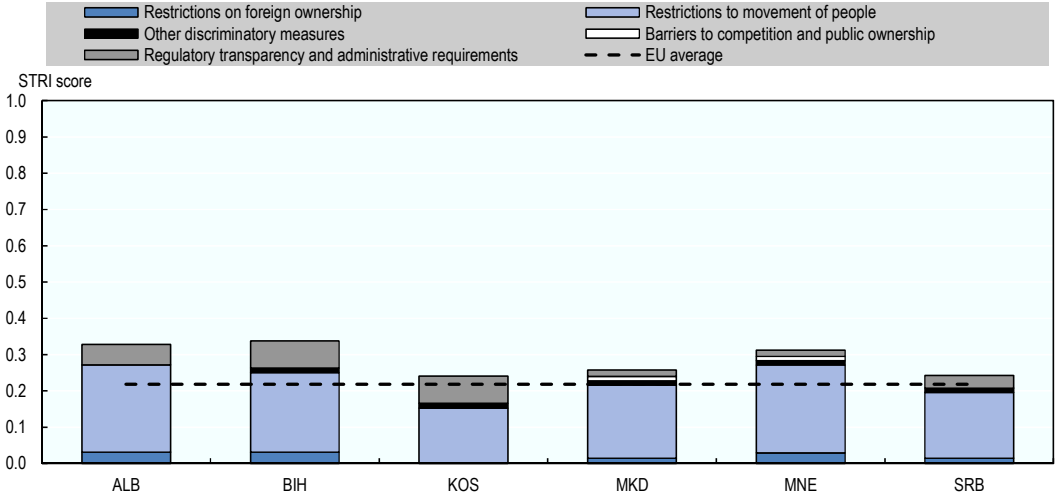
Note: The STRI scores, based on regulation currently in force, take the value from 0 (open) to 1 (closed).

Source: OECD (2013), *STRI Assessment of Professional and Construction Services Trade in CEFTA*.

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Figure 2.10. **Trade in engineering services restrictiveness, 2013**

Services Trade Restrictiveness Index (STRI) score



Note: The STRI scores, based on regulation currently in force, take the value from 0 (open) to 1 (closed).

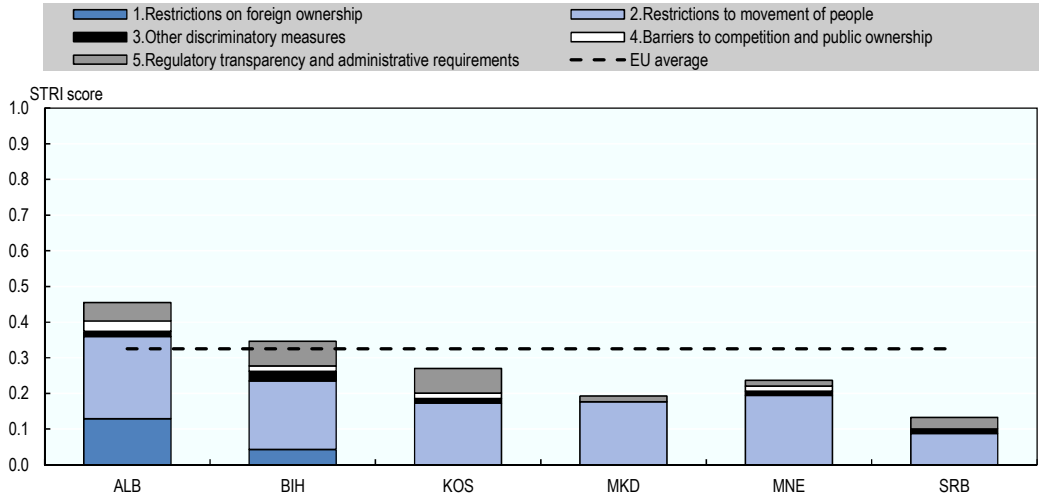
Source: OECD (2013), *STRI Assessment of Professional and Construction Services Trade in CEFTA*.

StatLink http://dx.doi.org/10.1787/888933321333

Accounting and auditing services are the least restrictive professional service sector, with all but two SEE economies being less restrictive than the EU average. The exception is Albania where it is about 0.15 higher than its next most restrictive sector (Figure 2.11).

Figure 2.11. **Trade in accounting and auditing services restrictiveness, 2013**

Services Trade Restrictiveness Index (STRI) score



Note: The STRI scores, based on regulation currently in force, take the value from 0 (open) to 1 (closed).

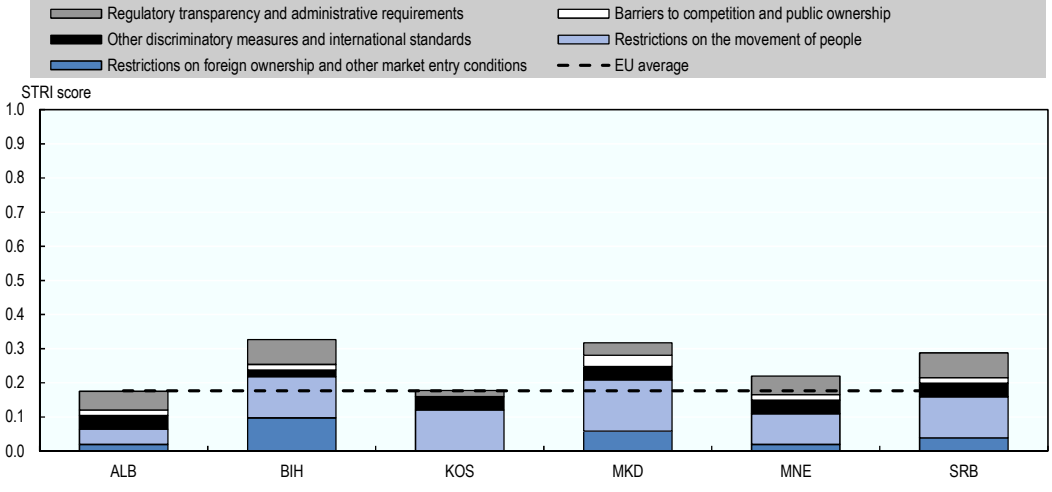
Source: OECD (2013), *STRI Assessment of Professional and Construction Services Trade in CEFTA*.

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The construction services sector does not have a high level of trade restrictiveness (Figure 2.12). However, four SEE economies are more restrictive than the EU benchmark and three are over 0.1 higher than the benchmark. Albania and Kosovo are right on the EU benchmark.

Figure 2.12. **Trade in construction services restrictiveness, 2013**

Services Trade Restrictiveness Index (STRI) score



Note: The STRI scores, based on regulation currently in force, take the value from 0 (open) to 1 (closed).

Source: OECD (2013), *STRI Assessment of Professional and Construction Services Trade in CEFTA*.

StatLink http://dx.doi.org/10.1787/888933321352

The tightest constraints are in the movement of people, regulatory transparency and administrative requirements. The most restrictive measures include restrictions on the duration of the stay of workers, limits on the acquisition of land and real estate, and burdensome administrative procedures for obtaining construction permits.

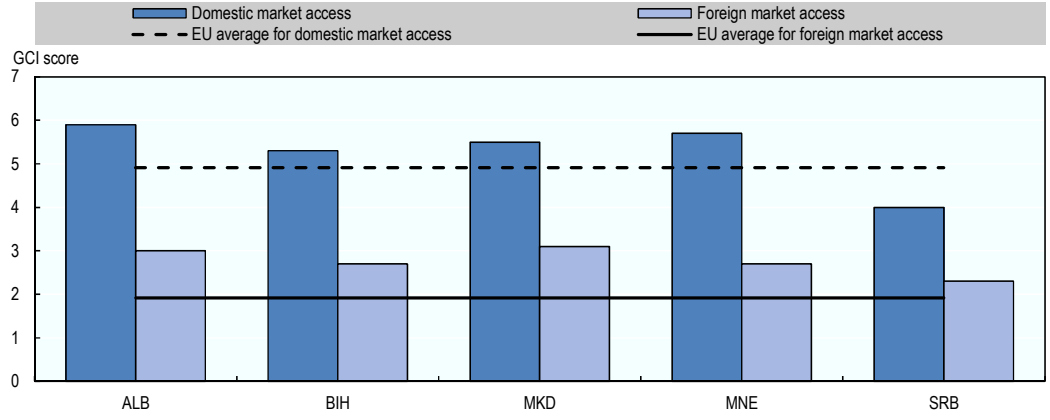
SEE economy trade policy frameworks are very open to foreign goods and foreign markets

The WEF domestic market access indicator evaluates the extent to which the policy framework of SEE economies welcomes foreign goods. With an average score of 5.3, SEE is more open to foreign goods than the EU, which averages 4.9. Four SEE economies range between 5 and 6 while Serbia lags behind at 4 (data for Kosovo are unavailable). Overall, the most problematic factors for importing foreign goods into SEE economies are tariffs and burdensome import procedures. In Albania, import efficiency is additionally restrained by relatively high levels of corruption at the border.

All SEE economies exceed the EU average of almost 2 in the foreign market access indicator which assesses exporters' access to foreign markets. Albania and the Former Yugoslav Republic of Macedonia have the highest levels of foreign market access with scores of 3 and 3.1 respectively, while Serbia scores the lowest at 2.3. The most important factors restricting SEE exports are identifying potential markets and buyers, access to trade finance, technical requirements and standards abroad, and the underdevelopment of appropriate technologies and skills (Figure 2.13).

Figure 2.13. **Domestic and foreign market access**

Global Competitiveness Index (GCI) score



Note: GCI scores take the value 1 (worst) to 7 (best). Data for Kosovo not available.

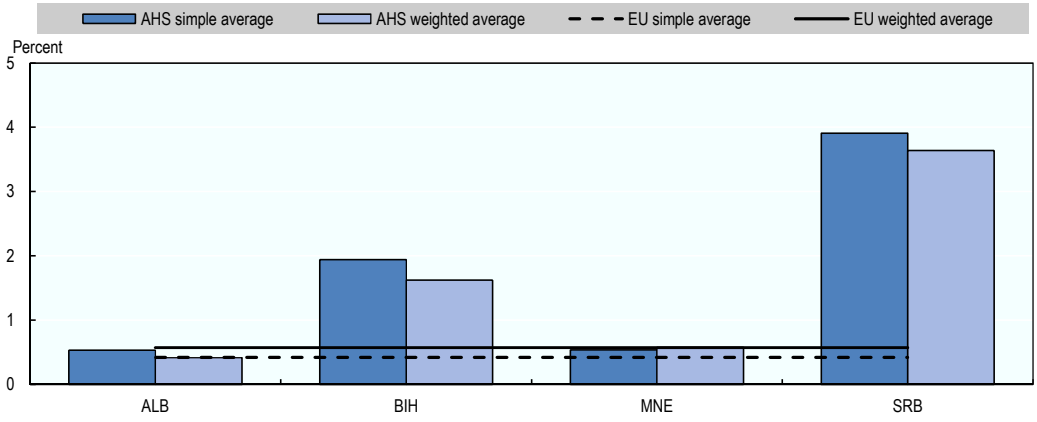
Source: WEF (2014), *The Global Competitiveness Report 2014-2015*, www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf.

StatLink http://dx.doi.org/10.1787/888933321360

Overall, the SEE economies' average applied tariffs for agricultural and industrial products are largely in line with EU levels. Quantitative restrictions on imports and exports for economic reasons have been abolished. Moreover, average customs duties on capital goods for two SEE economies were close to EU levels in 2013. Customs duties in Serbia and Bosnia and Herzegovina are higher than the EU average but are still lower

than 5%, so within the lower reaches of the International Trade Centre's protection scale and not a significant obstacle (Figure 2.14).

Figure 2.14. **Custom duties on capital imports, 2013**



Note: Data for Kosovo and the Former Yugoslav Republic of Macedonia not available.

Source: World Bank (2015b), *World Integrated Trade Solutions* (database), http://wits.worldbank.org/Default.aspx.

StatLink http://dx.doi.org/10.1787/888933321377

In terms of regional integration, the CEFTA framework has facilitated full tariff liberalisation between the SEE economies in trade in industrial and agricultural products and launched negotiations on the liberalisation of trade in services.

The way forward in liberalising trade

As SEE economies look to the future, they could continue addressing barriers to trade in services. Governments could further implement a regulatory guillotine process to remove regulations, permits and licences not designed to protect the public and which present an undue obstacle to trade.

Professional sectors would benefit from reducing restrictions on the free movement of people (i.e. foreign experts, professionals and skilled workers). A starting point would be to support the process of mutual recognition of professional qualifications such as skills and diplomas. All SEE economies could continue the on-going negotiation process of services trade liberalisation within the CEFTA framework.

Bosnia and Herzegovina, Serbia, and Kosovo could all continue their efforts towards WTO membership.

Trade Facilitation Sub-Dimension

SEE economies have achieved full tariff liberalisation in trade in manufactured and agricultural products since CEFTA entered into force in 2006, leading to increased trade flows. However, different adoption rates in international and EU standards have created 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.

Addressing NTBs requires co-ordination across government institutions and the private sector. Standards, technical regulations and conformity assessment procedures – the quality infrastructure system – can all give rise to technical barriers to trade. They aim 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 for foreign manufacturers or producers.

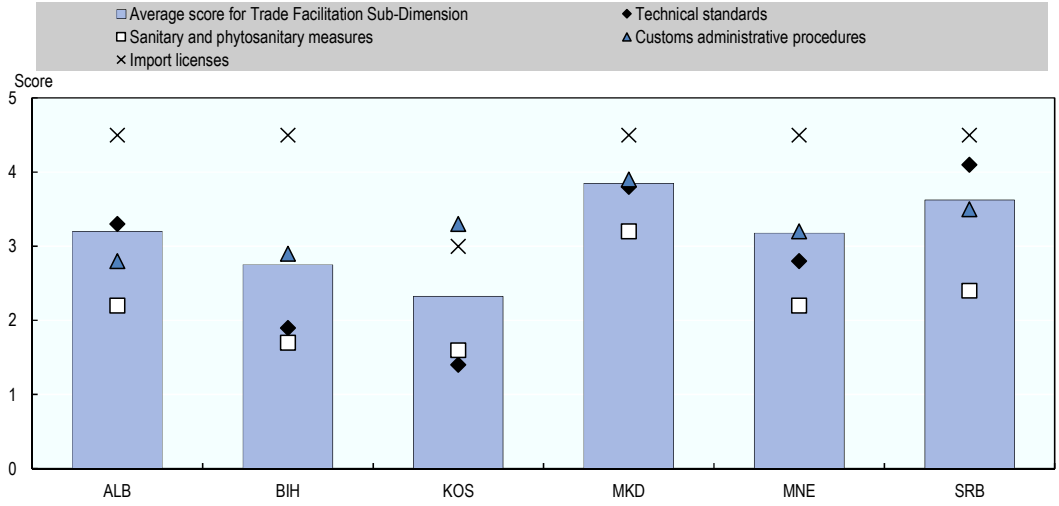
This section considers the Trade Facilitation Sub-Dimension through assessments of the four most important categories of NTBs.

- **Technical standards**, as defined by the WTO, "set out specific characteristics of a product – such as its size, shape, design, functions and performance, or the way it is labelled or packaged before it is put on sale" (World Trade Organization, 2015a). Products that do not meet technical requirements are not legal on the market. 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 (OECD, 2012). If technical standards are too stringent, not applied transparently or not publicly available they become technical barriers.
- **Sanitary and phytosanitary measures** aim to ensure food safety and protect the health of animals and plants. However, governments may use them to shield domestic producers from economic competition. Furthermore, a country needs modern core institutions, infrastructure and legislation to support effective legitimate SPS measures.
- **Administrative barriers** to trade include customs and administrative procedures at the border. While some administrative procedures may be necessary, burdensome export or import requirements may hinder trade (OECD, 2012). Consistent, predictable, simple and transparent customs and border procedures facilitate trade.
- **Import licenses** are "administrative procedures requiring the submission of an application or other documentation (other than those required for customs purposes) to the relevant administrative body as a prior condition for importation of goods" (World Trade Organization, 2015b). Non-automatic import licenses contradict WTO and EU guidelines in all but very specific cases.

Scoring for all indicators (except import licenses) differs from the standard methodology described in the methodology and assessment section. The indicators that measure technical standards, sanitary and phytosanitary measures, and administrative barriers are based on a multilateral monitoring framework (MMF) – developed by the OECD in consultation with the CEFTA Secretariat and trade experts – and report 2012 assessment results (OECD, 2012).

SEE economies have made steps towards removing non-tariff barriers. They all perform relatively well in the import licenses and administrative barriers qualitative indicators. The greatest room for improvement lies in sanitary and phytosanitary measures and to a lesser extent, technical barriers to trade in all SEE economies (Figure 2.15).

Figure 2.15. **Trade Facilitation: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321380

The Former Yugoslav Republic of Macedonia and Serbia lead with average scores of above 3.5, which indicates that policy frameworks are in place, implementation is advanced and some monitoring and evaluation activities are taking place. Albania and Montenegro score just above 3, which shows they that they implement policy frameworks to dismantle NTBs and could improve their monitoring and evaluation activities. Bosnia and Herzegovina and Kosovo, with scores over 2, have put in place and are implementing frameworks in half of the qualitative indicators. However, both economies would benefit from adopting frameworks that address sanitary and phytosanitary measures and technical barriers to trade.

SEE economies forego potential trade due to underdeveloped standards

Sanitary and phytosanitary (SPS) measures and technical regulations both specify product standards and are among the indicators with the lowest scores in the overall Trade Facilitation Sub-Dimension.

Table 2.3. **Trade Facilitation Sub-Dimension: Technical standards and SPS measures indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Technical standards	3.3	1.9	1.4	3.8	2.8	4.1
Sanitary and phytosanitary measures	2.2	1.7	1.6	3.2	2.2	2.4

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322874

In the technical barriers to trade indicator, the region is most advanced in accreditation and standardisation – albeit with wide variations between individual economies – while the most room for improvement comes in EU legislation implementation.

SEE economies have made efforts to become full members of the European Co-operation for Accreditation (EA) and, more importantly, to sign the EA Multilateral Agreement (EA MLA). For example, the Accreditation Body of Serbia (ATS) signed a new EA MLA in 2014, which included certification of management systems and persons, enabling the ATS to sign a new International Accreditation Forum (IAF) multilateral agreement later that year.

The priority for all SEE National Standards Bodies (NSBs) is to adopt European Standards (ENs) as national standards and withdraw conflicting national standards. Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia have adopted more than 50% of European Standards. For instance, the Institute for Standardization of Serbia (ISS) has adopted approximately 95% of all available European standards and thus met the most demanding requirement for full membership of the European standardisation committees CEN and CENELEC.

However, NSBs in a number of SEE economies do not have the capacity to participate actively in European standardisation activities. Only the Former Yugoslav Republic of Macedonia's NSB is a member of CEN and CENELEC, while the others – apart from Kosovo's – are affiliates and have observer status in CEN and CENELEC technical committees according to national priorities.

In Bosnia and Herzegovina, ministry-level competencies in EU technical legislation transposition are increasing while political constraints hinder progress. Remaining challenges include a shortage of human resources and insufficient co-operation with market surveillance authorities.

Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia have made significant progress in aligning their conformity assessment systems with the EU system through the EA's Multilateral and Bilateral Agreements (EA MLA/EA BLA) which recognise accreditation system equivalence and the reliability of conformity assessment results. However, only a few SEE economies have designated conformity assessment bodies (CABs) in all product areas.

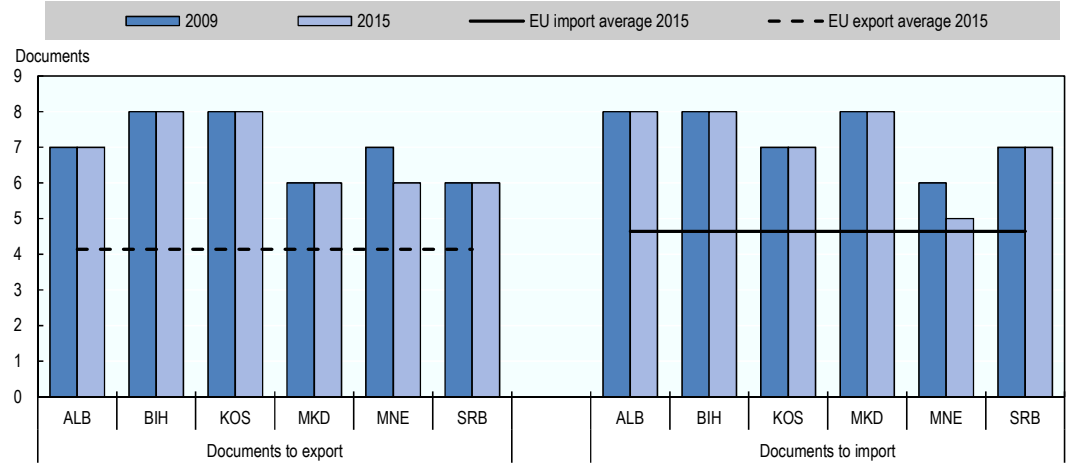
SEE economies have made progress in the development of legislative frameworks governing SPS. The strongest area was relevant SPS agency co-ordination, while the weakest was information and notification mechanisms. SPS agencies in SEE economies suffer from staff shortages, inadequate inspection equipment and restricted financial resources. Capacities for transposing EU SPS legislation are not sufficiently developed. Risk management and analysis, although regulated by framework laws and/or sub-laws in all SEE economies, are still not implemented in practice. Food safety and food quality non-conformities are not appropriately distinguished. Quality issues should be eliminated from import and export control. Although national legislation specifies co-operation between SPS agencies at the national level, it is sometimes weak in practice. All SEE economies lack the capacity to work actively on committees in international organisations. The absence of clear notification mechanisms and the incapacity of SPS enquiry points are also region-wide difficulties. The websites of relevant agencies, for example, are not regularly updated with new legislation.

Further customs administrative co-ordination could enable greater trade flows

The administrative barriers to trade indicator shows that SEE economies have made significant, constant progress in strengthening their systems for issuing advanced rulings and enhancing mechanisms for trade community co-operation. The weakest performances were in enquiry points, customs documentation, automation and the implementation of customs procedures and processes.

As reported by the World Bank's *Doing Business Report*, none of the SEE economies made any progress in reducing the number of required documents for importing and exporting from 2009 to 2015. The sole exception was Montenegro which reduced its document count for each category by 1 (World Bank, 2014). For export documents, SEE economies range from 8 to 6 compared to the EU average of 4 and, for import documents, from 8 to 5 compared to the EU's 4.5 (Figure 2.16).

Figure 2.16. **Documents required for export and import, 2009 and 2015**



Note: Data for Kosovo for the year 2009 as of 2012.

Source: World Bank (2015c), *Doing Business Data* (database), www.doingbusiness.org/data.

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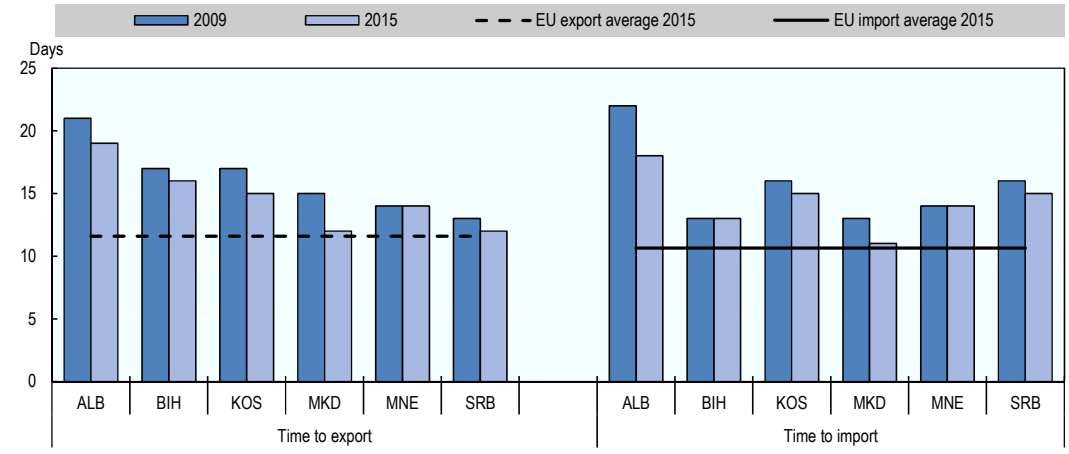
All the SEE economies reduced export and import times from 2009 to 2015, except Montenegro where they are constant. The Former Yugoslav Republic of Macedonia is the best performer – on a par with the EU average of just over 10 days for each category. Albania takes the most time to import or export at about 19 days for both (Figure 2.17).

All SEE economies reduced the cost of exporting and importing between 2009 and 2015. Albania and Montenegro outdo the EU average of around USD 1 000 per container for export and import. In Kosovo and in Serbia, the cost of exporting and importing a container is over USD 1 500 (Figure 2.18).

The World Bank Logistics Performance Index measures perceptions of customs clearance efficiency on an ascending scale of 1 to 5. The SEE economy average score is 2.5, almost a full point below the EU average of 3.4 (Arvis et al., 2014). The relatively low SEE scores in clearance efficiency reflect widespread inefficient customs practices such as burdensome import procedures and high levels of corruption at borders.

Figure 2.17. **Time required for exports and imports, 2009 and 2015**

Days



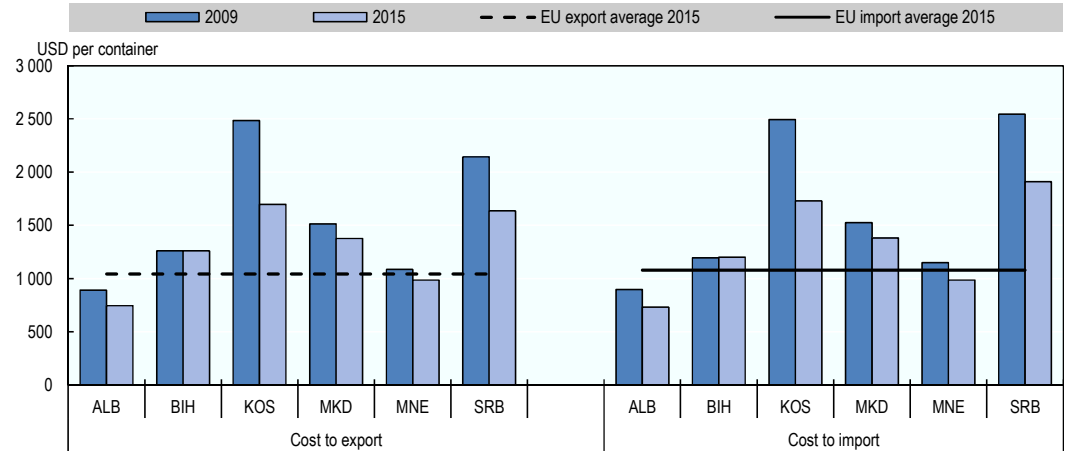
Note: Data for Kosovo for 2009 as of 2012.

Source: World Bank (2015c), *Doing Business Data* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933321409

Figure 2.18. **Cost to export and import, 2009 and 2015**

USD per container



Note: Data for Kosovo for the year 2009 as of 2012.

Source: World Bank (2015c), *Doing Business Data* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933321417

The SEE economies are all working to harmonise their national customs legislation in accordance with EU standards and the requirements of international trade (i.e. the WTO General Agreement on Tariffs and Trade [GATT], the WTO Trade Facilitation Agreement [TFA], the WCO Revised Kyoto Convention). Moreover, all SEE economies, with the exception of Bosnia and Herzegovina, have completed a WTO Trade Facilitation National Self-Assessment of Needs and Priorities.

The weakest points in customs procedures and administration are the lack of pre-arrival processing, insufficient use of simplified procedures (both required by WTO TFA Article 7 on the Release and Clearance of Goods), inadequately equipped customs laboratories and the lack of regular, specialised training for customs officers. Despite risk management systems designed to increase the efficiency of customs procedures, certain SEE economies still make extensive use of expensive physical inspections. A risk management system in line with the WTO TFA Article 7.4 on risk management measures should be fully functional at both the national and SEE regional level. Furthermore, potential efficiency gains from the electronic lodging and processing of customs declarations in SEE economies are countered by the mandatory submission of paper documents in the clearance process. Nor are electronic payment of customs duties, as required by WTO TFA Article 7.2, and the application of electronic signatures in place in most SEE economies. It is impossible to implement modern customs legislation or apply trade facilitation measures without a single functional IT system, the precondition for paperless customs clearance procedures.

When it comes to the import licensing system, all SEE economies, apart from Kosovo, have eliminated import licenses that do not comply with WTO, EU and CEFTA regulations. Overall, the import licensing systems are not designed to limit the quantity or value of imports, but to protect human health and life and ensure safety. They are administered in a fair, equitable manner.

Table 2.4. **Trade Facilitation Sub-Dimension: Customs procedures and import licensing indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Customs administrative procedures	2.8	2.9	3.3	3.9	3.2	3.5
Import licenses	4.5	4.5	3.0	4.5	4.5	4.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322886

In November 2014, CEFTA advanced regional trade facilitation co-ordination through two actions. The first was the decision to establish the Committee of Trade Facilitation to further co-operation between CEFTA members in reducing clearance procedure costs while maintaining safety and security (CEFTA, 2014a). The second was a ministerial conclusion "to launch negotiations with an aim to conclude a framework agreement between Customs Administrations of CEFTA Parties for simplification of inspections, exchange of data, and co-operation of trade partnership programmes by the end of 2015" (CEFTA, 2014b).

The way forward in facilitating trade across standards and administrative procedures

As SEE economies move forward, they could continue to maintain and adopt European Standards and withdraw conflicting national standards. Ministries responsible for transposing EU technical regulations could put plans in place for their full implementation with close co-operation with market surveillance authorities at all stages of the process. Moreover, the national co-operation mechanism between all quality infrastructure institutions, market surveillance authorities and customs authorities could be further developed. SEE economies could continue their efforts for full membership in

the European Co-operation for Accreditation (EA) and, more importantly, to sign the EA Multilateral Agreement (EA MLA). Connecting national CAB associations at the SEE regional level would facilitate networking between CABs, including those which do not yet have such national associations.

In the SPS area, SEE economies could further develop national capacities for risk assessment and management in inspection to avoid repeated sampling and testing of products imported from the SEE region. Traceability systems could be further developed to reduce the number and severity of food safety non-conformities and help distinguish between safety and quality issues. SPS national enquiry points could be established or strengthened. The capacity to participate in international agencies meetings and workshops could also be strengthened. Finally, the resources required for transposing EU SPS legislation could be enhanced by including the training of staff in transposition principles and practices. Each SEE economy could make a national list of the most traded agricultural products and prioritise related legislation transposition.

SEE economies could focus on implementing efficient risk management systems as one of the most important tools for trade facilitation. Doing so would require harmonising national systems with the relevant international standards and co-ordinating the development of joint risk profiles by the CEFTA working group on risk management. In order to reduce the number of physical and document inspections in customs clearance at the national level, a performance assessment could be carried out for existing high risk profiles. In line with the EU Customs Blueprint, a network of one-stop shops on the border and inland to clear goods only once encompassing all mandatory physical and document checks by different authorities and agencies could be considered. Furthermore, strengthened legal frameworks to implement the Authorised Economic Operator (AEO) model in line with WTO TFA, WCO and EU standards would facilitate the issuance of authorisations for simplified procedures (i.e. low risk profiles attributed to economic operators with AEO certificates). In addition, the mutual recognition of AEO certificates within the framework of CEFTA could be pursued as envisaged, especially in the area of safety and security, which facilitates the smooth flow of goods in international trade for reliable economic operators. Moreover, all SEE economies could establish a single enquiry (co-ordination point) for customs and agencies involved in the clearance process. They could also design user-friendly guidelines or handbooks to describe the most important areas of customs legislation and procedures. Finally, SEE economies could further implement their Category A commitments – those that can be undertaken immediately – in their WTO Trade Facilitation National Self-Assessments of Needs and Priorities.

Conclusions

SEE economies have made efforts to strengthen their institutional frameworks for trade policy formulation and have taken positive steps to integrate into the world trading system. However, non-tariff barriers (NTBs) and regulatory barriers to trade in services are still restricting import and export volumes in SEE economies.

As they move forward, the SEE economies need to focus on the reduction of NTBs, especially those arising from the application of sanitary and phytosanitary measures. Moreover, barriers to trade in services could be further addressed by reviewing in detail domestic regulations in priority sectors – i.e. those with the biggest comparative advantage – and removing those that are more trade-restrictive than necessary.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 3.

Education and competences in South East Europe

To improve education and competencies is to build the knowledge, skills and capacities of everyone in society. This chapter on the Education and Competences Dimension analyses performance and policy development through five sub-dimensions. The High-Quality Education Sub-Dimension examines quality and equity in early childhood, primary, secondary, initial vocational and higher education as well as teacher recruitment, retention and development. The Early-School Leaving Prevention Sub-Dimension evaluates strategies to prevent early leaving from primary to higher education. The Qualification Recognition Sub-Dimension assesses quality assurance agencies and the implementation of national qualifications frameworks. The Labour Market Alignment Sub-Dimension considers to what degree education is aligned with labour market needs, career guidance services and lifelong learning programmes. The Entrepreneurial Learning Sub-Dimension describes the extent to which SEE economies promote entrepreneurial learning and enterprise skills at all levels of education and training through policy development and evaluation and university-enterprise co-operation.

Main findings

A competent, well-educated workforce is central to a country's competitiveness. It creates better jobs, boosts productivity, generates prosperity and promotes social inclusion. In a global economy which is increasingly dependent on skills, economies where skill levels are lower need to develop their human capital to be competitive and ensure economic and social well-being.

The highly educated account for less than 20% of the workforce in the economies of South East Europe (SEE) against 36% in the EU. Similarly, 21% of the workforce are early school leavers, compared to only 12% in the EU. The OECD Programme for International Student Assessment (PISA) finds that participating SEE economies achieve below-average results in all disciplines (OECD, 2014a). The continuous expansion of education contributes positively to labour productivity (Mankiw et al., 1992) which, in South East Europe, was 40% of the EU average in 2012.

Education policy is a priority on national policy agendas in all SEE economies. The implementation of policies, however, remains a challenge. Education and skills levels are higher in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia than in Albania, Bosnia and Herzegovina and Kosovo.

Achievements

The SEE economies have made progress in delivering inclusive, quality education.

SEE economies have taken positive steps to improve the quality of education and increase the competencies of the labour force. All the economies in the region have introduced national strategies that 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.

SEE economies are implementing national qualifications frameworks. Governments have made it a priority to adapt their qualifications frameworks to the European Qualifications Framework (EQF) and thus ensure the quality and comparability of qualifications. Implementing and monitoring bodies have been established accordingly.

SEE economies have made efforts to draw up policy frameworks that support equity in education. All the economies have recognised the importance of ensuring equitable access to and participation in education. They address the issue in their education strategies with targeted measures.

Challenges

Despite their achievements, the SEE economies still face a number of challenges across different levels of education.

Student performances in mathematics, reading and science in SEE are well below the OECD average. This finding, from PISA data for Albania, Montenegro and Serbia, indicates that the education system at primary and lower-secondary level needs reform.

Teaching as a career choice suffers from a poor image in South East Europe. Teacher quality is arguably the in-school factor that most determines students' learning outcomes. Yet the best candidates are not choosing the teaching profession.

Work-based learning schemes like apprenticeships or internships are underdeveloped. Co-operation between VET providers and businesses in the SEE region needs to be reinforced, while the implementation of policy measures to improve matters needs further support. The business community should also take a more active role in VET policy making and particular attention should be given to quality assurance policy and practice in work-based learning.

Participation in lifelong learning is low in SEE economies. Continuing to learn after initial education is crucial to raising the productivity levels of the working-age population, tackling skills mismatches and addressing other challenges in the labour market. There is also a weak information base in this key policy area, as adult education surveys have not been conducted in most economies.

Recommendations

In order to foster and improve education and competencies in the region so that they contribute to greater competitiveness, SEE economies can take strategic action.

Prioritise the teaching profession over the coming years. Teachers should benefit from formal induction programmes, more and better continuing professional development opportunities, and enhanced appraisal mechanisms. A coherent policy framework for teaching should be established to address the attractiveness of the teaching profession and the recruitment and retention of qualified teachers. Training needs analysis for teachers should be initiated.

Make VET more attractive and relevant. VET is a key part of efforts to reduce youth unemployment and facilitate school-to-work transition, as it gives students valuable professional experience and the chance to acquire useful skills. Policy should include mechanisms to ensure that economic actors are properly engaged in the governance and provision of VET and that reliable labour market data inform VET programmes and the standard of qualifications.

Further address drop-out and early school leaving in policy measures. Such measures should always include intervention, the prevention of drop-out and early school leaving, and compensation (i.e. offering drop-outs and early leaver students opportunities to re-engage).

Further develop career guidance services. For career guidance services to be efficient and effective, labour market information needs to be better collected and disseminated and staff trained to provide useful guidance to students.

Overview

To improve education and competencies is to build the knowledge, skills and abilities of everyone in society. In a global economy that is becoming increasingly dependent on skills, economies with lower skill levels need to develop their human capital in order to be more competitive. If measured by the skills actually learned, the level of a population's education is very closely linked to the economy's long-run growth rate. An increase of 50 PISA points in educational achievement can translate into a rate of economic growth that is 1 percentage point higher in the long run (OECD, 2014a).

Education and competences are also closely bound up with other policy areas addressed in this publication:

- **Chapter 12. 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 individual earnings (ibid.). From a broader social perspective, education and skills contribute to social cohesion and act as a counterweight to rising global inequality and marginalisation (OECD, 2012).
- **Chapter 1. Investment policy and promotion** seeks to increase domestic and foreign direct investment (FDI), which depends on an educated 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. Adaptability is the capacity of an education system to adjust to new challenges, including those posed by global value chains, in order to keep the labour force globally competitive.
- **Chapter 13. Health policy** directly affects human resources and the attractiveness of the business environment, as good health improves worker productivity.

Box 3.1. Education and Competences Dimension in the SEE 2020 Strategy

The Education and Competences Dimension is a part of the Smart Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Smart Growth Pillar is to promote innovation and foster knowledge-driven growth in the region. SEE 2020 has made a 32% increase in average GDP per employed person relative to 2010 its headline target in the Smart Growth Pillar. That kind of rise in productivity should be accompanied by an 18% increase in the number of highly qualified persons in the labour force.

The SEE 2020 Education and Competences Dimension calls for the following actions to improve the regional knowledge and skills base:

- introduce policies to increase equitable access to, and participation in, high-quality education at all levels
- implement measures to prevent early school leaving and drop-out and improve completion rates at all levels of schooling
- standardise qualifications and remove obstacles to their recognition
- ensure education better matches economic and labour market needs
- develop entrepreneurship as a key competency at all levels of education and training.

The official SEE 2020 Strategy Co-ordinators for the Education and Competences Dimension is the Education Reform Initiative of South Eastern Europe (ERISEE) and South East Europe Centre for Entrepreneurial Learning (SEECEL). ERISEE is a regional platform for co-operation in education and training in South East Europe to support national reforms. SEECEL supports EU pre-accession economies in addressing issues of common interest to the entrepreneurial learning agenda included in the Small Business Act.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Education and Competences Dimension assessment framework

This chapter proposes an analysis of education and competences in the SEE region. It does not seek to be exhaustive, but considers five broad sub-dimensions based on the Smart Growth Pillar of the SEE 2020 Strategy.

- High-Quality Education

  How do early childhood education participation, teacher quality assessment and equity in education shape education outcomes? How, and to what extent, do the SEE economies' policies improve equity and participation?

- Early School Leaving Prevention

  What action plans are in place to prevent and reduce early school leaving and drop-out in SEE?

- Qualifications Recognition

  To what extent have the SEE economies adapted their national qualifications frameworks to the European Qualifications Framework? Are there provisions for student mobility? How effective are VET and higher education agencies in SEE?

- Labour Market Alignment

  How is co-operation between VET and business promoted or enabled? How effective are work-based learning and career guidance services? What policies are in place to promote and provide continuous education and training?

- Entrepreneurial Learning

  Do the SEE economies promote entrepreneurial learning and enterprise skills at all levels of education and training, and to what extent?

Figure 3.1 shows how the sub-dimensions and their constituent indicators make up the Education and Competences assessment framework.

Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, ERISEE collected qualitative and quantitative data on all sub-dimensions in the Education and Competences Dimension with the exception of the Entrepreneurial Learning Sub-Dimension where SEECEL collected the related data.

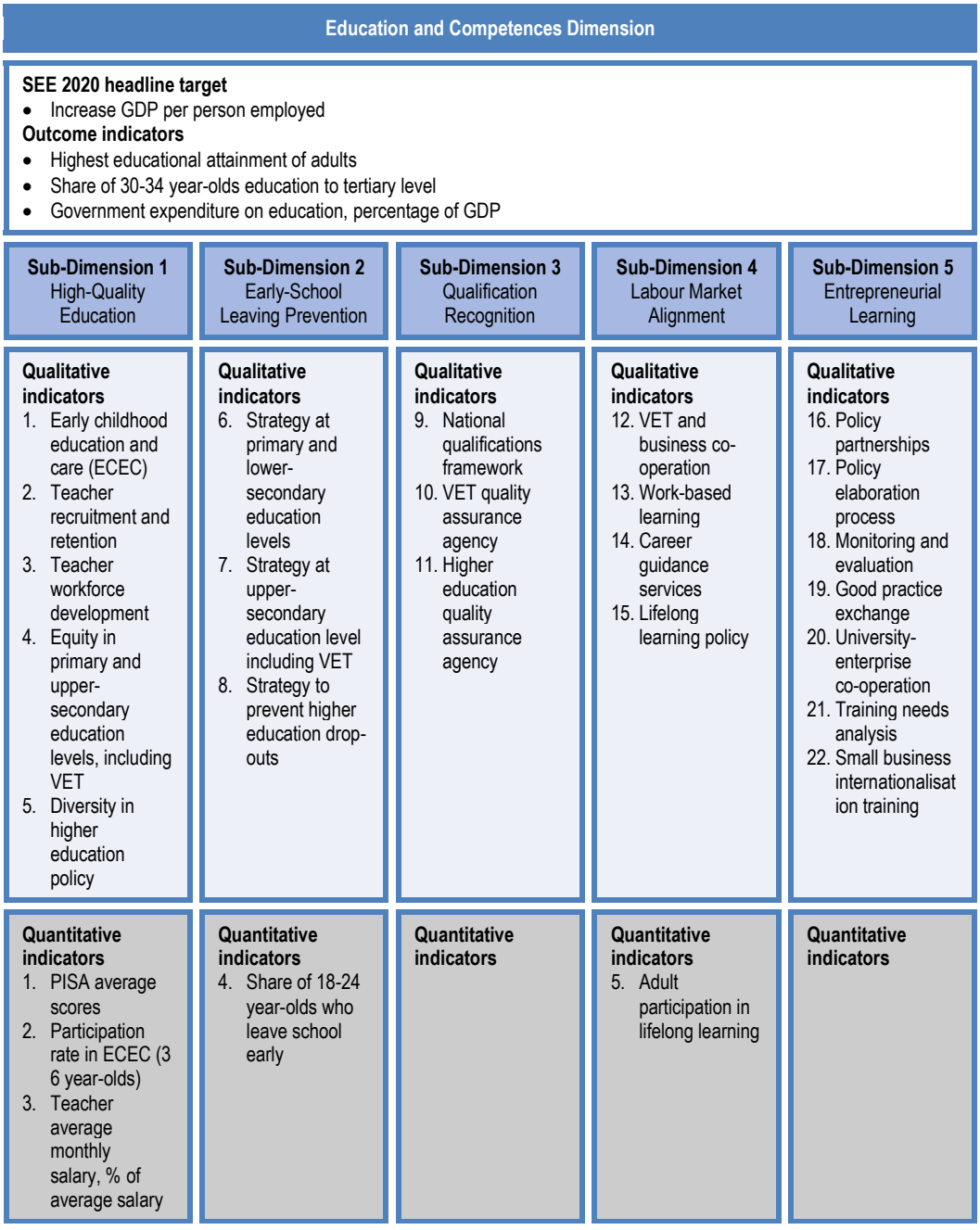
Quantitative indicators are based on national or international statistics. Qualitative indicators have been collected and scored in ascending order on a scale of 0 to 5.[1]

Education performance in SEE economies

The benefits of education take many forms. From a purely economic perspective, though, the main return expected is the increased productivity that comes with knowledge and skills. Indeed, education equips people with the skills that make them more productive in the workplace. It also transmits the knowledge and competencies that generate and help adopt the new ideas which drive innovation and technological progress.

Economic growth in a country or sector can be ascribed either to increased employment or to more efficient work, which can be described as labour productivity. Labour productivity, in other words, is a key measure of economic performance. Figure 3.2 presents GDP per person employed in the SEE economies and EU between 2008 and 2012.

Figure 3.1. **Education and Competences Dimension assessment framework**



Labour productivity is lower in the SEE economies than in the EU and further deteriorated between 2008 and 2009 due to the financial crisis. Between 2010 and 2012, however, it grew over 4% in Croatia and Montenegro, in Albania by 2%, and by 1.2% in the Former Yugoslav Republic of Macedonia. In Bosnia and Herzegovina and Serbia, there were very slight increases of 0.8% and 0.2%, respectively.

Figure 3.2. **GDP per person employed, PPP**

Constant 2005 international dollar



Note: Data for Kosovo not available.

Source: Adapted from ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm.

StatLink http://dx.doi.org/10.1787/888933321424

Educational attainment is closely correlated to better jobs and higher earnings

Perceived as a gateway to better labour opportunities and higher relative earnings, higher levels of educational attainment are associated with greater well-being, more social engagement and higher employment rates (OECD, 2014b). Educational attainment is frequently used as a measure of human capital and the level of an individual's skills – in other words, a measure of the skills available in the population and the labour force. Other measures of human capital are the results of the OECD's Programme for the International Assessment of Adult Competencies (PIAAC), though the SEE economies did not participate.

Box 3.2. **OECD's Programme for the International Assessment of Adult Competencies (PIAAC)**

The Survey of Adult Skills is an international survey conducted in 22 countries as part of the Programme for the International Assessment of Adult Competencies (PIAAC). It measures the key cognitive and workplace skills needed for individuals to participate in society and for economies to prosper. The first results from the Survey were released on 8 October 2013. The competencies assessed are: i) literacy; ii) reading components; iii) numeracy; and iv) problem solving in technology-rich environments.

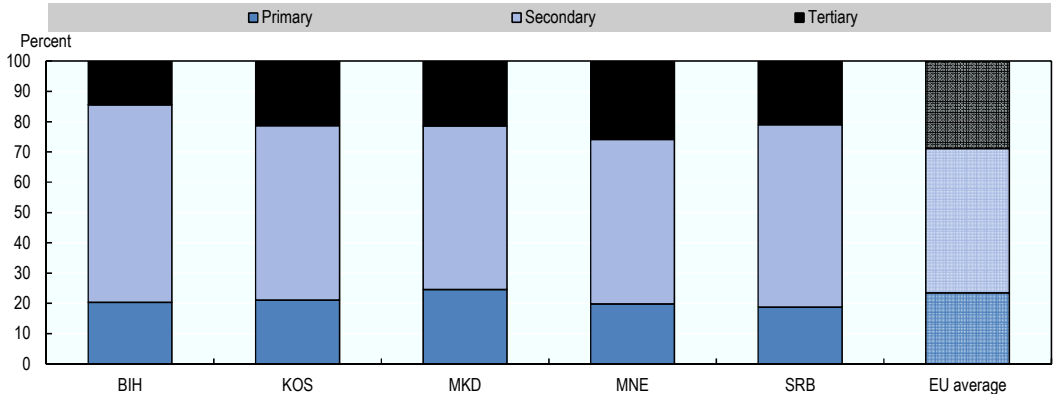
The evidence from PIAAC helps countries better understand how education and training systems can nurture these skills. Educators, policy makers and labour economists can use the information to develop economic, education and social policies that will continue to enhance the skills of adults.

Source: OECD (2015a), *OECD Skills Outlook 2015: Youth, Skills and Employability*, http://dx.doi.org/10.1787/9789264234178-en.

Figure 3.3 shows levels of educational attainment in the labour force in 2012. The share of highly educated individuals is lower in SEE economies with the exception of Montenegro, where the share is close to the EU average. Surprisingly, the proportion of workers educated only to primary level is lower in SEE economies than in the EU with the exception of the Former Yugoslav Republic of Macedonia. A high proportion of the labour force has a secondary school degree, as in the EU. The share, however, is relatively greater in SEE economies, particularly in Bosnia and Herzegovina, where two-thirds have completed secondary education as their highest level of educational attainment.

Figure 3.3. **Highest educational attainment, 2012**

Percent of people 15 years old and over



Note: Data for Albania not available.

Source: ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm.

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Evidence that economic strength may point to high graduate rates

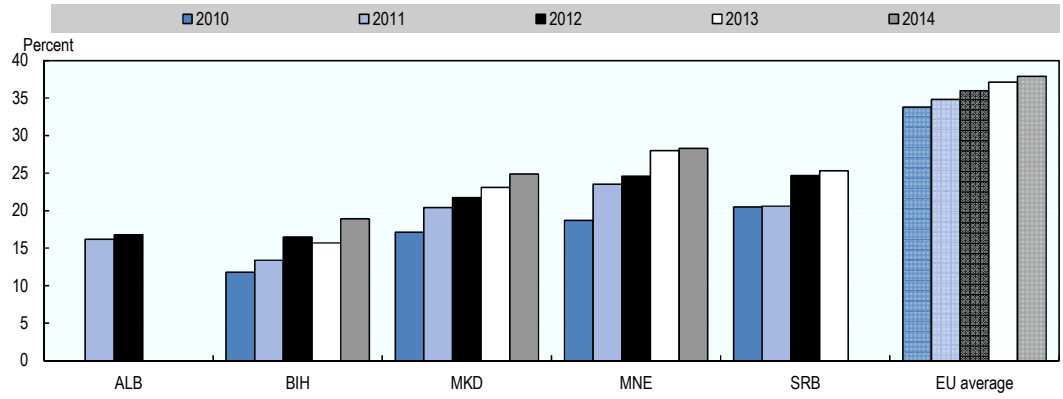
Higher education graduation rates illustrate a country's capacity as measured by its share of workers with specialised knowledge and skills. The EU forecasts that highly qualified employment will have grown another 13% by 2020 (CEDEFOP, 2012). It is projected that, by 2025, most job opportunities in the EU will require high- and mid-level qualifications, with a strong rise in demand for the highly qualified and for personnel with medium qualifications to meet replacement needs (CEDEFOP, 2015). A key objective of the Education and Competences Dimension is, therefore, to increase the share of the population educated to tertiary level.

Figure 3.4 shows the proportion of 30-34 year olds who have successfully completed tertiary education. SEE economies have lower shares of 30-34 year olds with a tertiary degree than the EU average, although some catching up is taking place.

In 2013, over 25% of 30-34 year olds in Montenegro and Serbia had completed higher education – respectively, a 9.3 and a 4.8 percentage point increase between 2010 and 2013. Of the SEE economies for which data were available, Bosnia and Herzegovina has, at 19%, the lowest proportion of 30-34 year olds with higher education degrees. However, that figure reflects an increase of 7 percentage points between 2010 and 2014.

Figure 3.4. **Share of 30-34 year-olds educated to tertiary level**

Percent



Note: Data for Kosovo not available. Data for Albania for the years 2010, 2013 and 2014 not available. Data for Serbia for the year 2014 not available.

Source: EC (2015a), *Candidate Countries and Potential Candidates* (Eurostat database), http://ec.europa.eu/eurostat/data/database?node_code=cpc; EC (2015b), *Education and Training* (Eurostat database), http://ec.europa.eu/eurostat/web/education-and-training/data/database; Montenegrin Ministry of Education.

StatLink http://dx.doi.org/10.1787/888933321447

Employment levels are a gauge of education levels

Higher levels of educational attainment are strongly associated with higher employment rates and perceived as a gateway to better job opportunities and earnings premiums. The average EU employment rate of recent graduates from tertiary education is 12.1 percentage points higher than those who left education on completing upper-secondary education.

In the OECD and EU, the highly qualified have the highest employment rates. In OECD member states, on average, over 80% of the tertiary-educated are employed, compared to 70% of people educated to upper-secondary education level and less than 60% of those who left education before that (OECD, 2014c). The highly educated also earn more – and the higher their level of education, the higher they earn (OECD, 2014b).

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. With the exception of Montenegro, the rate of young people not in employment, education or training (NEET) in the SEE economies is almost double the EU average. Young NEETs are considered "at risk", being jobless, inactive and with no access to learning. Most economies train much attention on youth unemployment (see Chapter 12 on employment policy) although "unemployment" underestimates how vulnerable young people can be. Broadening the perspective from unemployed youth to young NEETs affords a better insight into the challenges they face. Furthermore, it informs the development of policies that contribute to a better future for them and their countries.

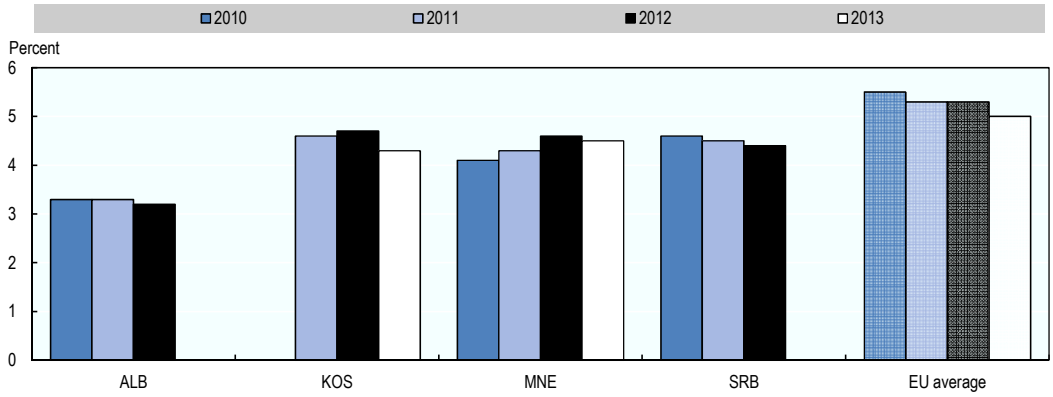
Higher expenditure on education can contribute to economic growth

Strong educational performance cannot be expected without sufficient resources and reforms. The main input indicator for measuring government funding of educational institutions is annual expenditure on education as a percentage of GDP. Countries invest

in education to foster economic growth, enhance productivity, contribute to people's personal and social development, and reduce social inequality. Figure 3.5 shows that the EU spends 5.3% of GDP on education and OECD countries 6.1%. The figure is lower in Serbia and fell further in 2011 to 4.8%. As for Albania, expenditure on education is even less at 3.3 % of GDP.

Figure 3.5. **Government expenditure on education**

Percent of GDP



Note: Data for Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia not available. Data for Albania for the year 2013 not available. Data for Kosovo for the year 2010 not available. Data for Serbia for the year 2013 not available.

Source: EC (2015c), *Government Statistics* (Eurostat database), http://ec.europa.eu/eurostat/web/government-finance-statistics/data/database; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators; Ministries of Education of Albania, Kosovo and Montenegro.

StatLink http://dx.doi.org/10.1787/888933321457

Although data on the SEE economies' annual expenditure on education by level are scarce, some are available for Serbia. Its spending on primary education in 2010-11 fell to 1.1% of GDP, while in secondary and tertiary education it remained constant. By comparison, EU expenditure on secondary schools dropped to 2.2% of GDP in 2011, while it rose to 1.3% for primary schools and to 1.4% for higher education.

High-Quality Education Sub-Dimension

The highest performing education systems are those that combine equity with quality (OECD, 2012). This section looks at the High Quality Education Sub-Dimension. To that end, it analyses to what extent South East Europe seeks to ensure equitable access to, and participation in, high-quality education. It assesses the quality of and access to early childhood education, standards of teaching, equity in compulsory and post-compulsory schooling, and considers student performance as measured by PISA results.

The High-Quality Education Sub-Dimension is composed of five qualitative indicators and three quantitative indicators.

Generally, policy frameworks to ensure access to and participation in high-quality education are in place in the SEE region. Although most of the SEE economies implement policy measures, Bosnia and Herzegovina and Kosovo do not yet have frameworks fully in place and implementation is lagging.

PISA results point to room for improvement in the quality of education

OECD's Programme for International Student Assessment (PISA) assesses the extent to which 15-year-old students have acquired key knowledge and skills in reading, mathematics and science. Results show what students in the highest-performing and most rapidly improving education systems can do (Table 3.1). In 2012, all 34 OECD member countries and 31 partner countries –representing more than 80% of the world economy – took part. Of the SEE economies Albania, Montenegro and Serbia were participants. PISA's findings allowed their policy makers to compare their students with those in other countries, set policy targets against measurable goals achieved by other education systems, and learn from policies and practices applied elsewhere.

Table 3.1. **PISA average scores in 2006, 2009 and 2012**

	Science			Mathematics			Reading		
	2006	2009	2012	2006	2009	2012	2006	2009	2012
ALB	..	391	397	..	377	394	..	385	394
MNE	412	401	410	399	403	410	392	408	422
SRB	436	443	445	435	442	449	401	442	446
HRV	493	486	491	467	460	471	477	476	485
OECD average	500	501	501	498	496	494	492	493	496

Note: Data for Bosnia and Herzegovina, Kosovo and the Former Yugoslav Republic of Macedonia not available.

Source: 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/10.1787/888933322893

The PISA results show that the SEE economies made progress between 2006 and 2012, especially in reading, though Montenegro's showing in 2012 was lower than in 2006. Generally, the region's average performances in science, mathematics and reading were below the OECD average. Girls performed better than boys by 62 points in Montenegro, 46 in Serbia and 15 in Albania compared to the OECD average of 38 points.

In reading, an average of 48% of students in the SEE economies fell short of the baseline proficiency level, compared to 19% among the EU8[2] countries. In mathematics, the proportion of students failing to reach baseline proficiency was 53%, compared to 21% in the EU8. As for science, the figure was 47% in SEE and 15% in the EU8.

Region-wide efforts are needed to improve early childhood education and care

Policy action needs to more fully acknowledge the essential role of early childhood education and care (ECEC) in reducing inequalities and raising proficiency in basic skills. The broadest definition of ECEC encompasses all forms of services and pedagogical settings covering children from birth up to compulsory schooling age. ECEC has been identified as one of the most effective ways of giving children a good start in education (EC, 2013). Pre-primary education helps set firm foundations for education and prepare pupils to take their place and succeed in formal schooling (Heckman, 2008). It also paves the way for successful lifelong learning, social integration and personal development.

PISA surveys find that 15-year-old pupils who attended at least one year of pre-primary education perform better than those who did not, even allowing for their socio-economic backgrounds. ECEC can also mitigate social inequalities, many of which

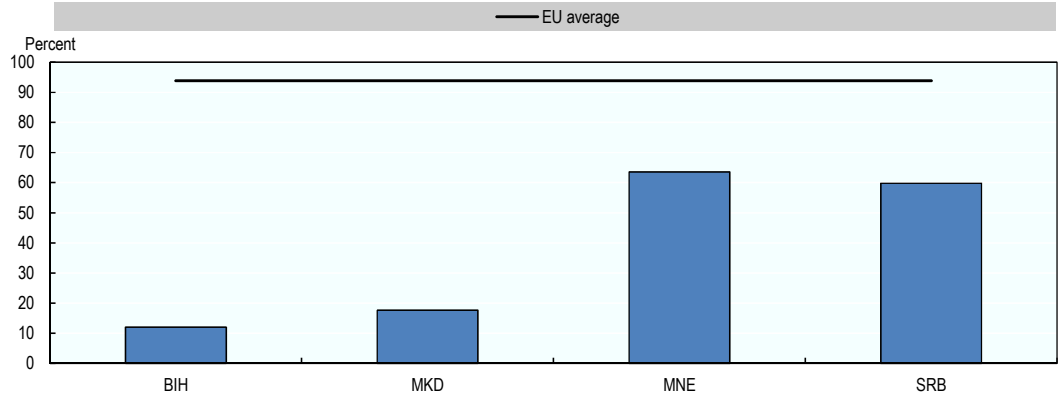
are already evident when pupils enter formal schooling and persist as they progress through the school system (Downey et al., 2004). Because inequalities tend to widen when school is not compulsory, starting earlier may narrow them.

ECEC participation rates among 3 year olds up to compulsory school age are low in the SEE economies. The latest available data (2012) show that the average rate was 93.9% in the EU and 86% in OECD countries. It is significantly lower in Montenegro and Serbia, even though it rose between 2010 and 2012 to 56% and 59%, respectively. Participation in Albania, too, was above 50%. In contrast, data from Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia point to very low ECEC rates of under 20% among 3-6 year olds.

Research suggests that low participation rates in ECEC are attributable to problems of poor provision and affordability (OECD, 2014b). As policy makers come to better acknowledge the essential role of ECEC in reducing inequality and improving basic proficiency in skills competences, they should take action to increase both the provision and affordability of pre-school education.

Figure 3.6. **Participation rate in early childhood education and care, 2013**

Percent of 3-6 year-olds



Note: Data for Albania and Kosovo not available.

Source: EC (2015b), *Education and Training* (Eurostat database), http://ec.europa.eu/eurostat/web/education-and-training/data/database; Ministries of Education of Bosnia and Herzegovina, Former Yugoslav Republic of Macedonia, Montenegro and Serbia.

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Improved access to ECEC is not enough in itself, however. Only high-quality ECEC secures good individual and social outcomes. Indeed, they are predicated on the quality of the provision (OECD, 2011). The indicator, **quality of early childhood education and care**, assesses the quality of ECEC in the SEE economies, measuring it against five policies the OECD has identified as key:

- setting and regulating quality goals
- setting standards and implementing a curriculum
- improving qualifications
- improving staff training and working conditions

- engaging families and communities and improving data collection, research and monitoring (OECD, 2012).

Table 3.2. **High-Quality Education Sub-Dimension: ECEC indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Early childhood education and care (ECEC)	3.0	2.0	2.5	3.0	3.5	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All the SEE economies have developed some form of quality assurance standards for early childhood education and care and all economies implement them, at least in part. Montenegro, for example, has developed a comprehensive strategy for early and pre-school education which it has implemented since 2010. The Former Yugoslav Republic of Macedonia, for its part, also has an ECEC programme that covers important learning areas such as cognitive development, socio-emotional development and languages. As for Bosnia and Herzegovina, it is currently drawing up a strategic document on ECEC.

All SEE economies have room for improvement when it comes to engaging families and communities and improving ECEC data collection, research and monitoring.

Improving teacher quality should be considered a priority in coming years

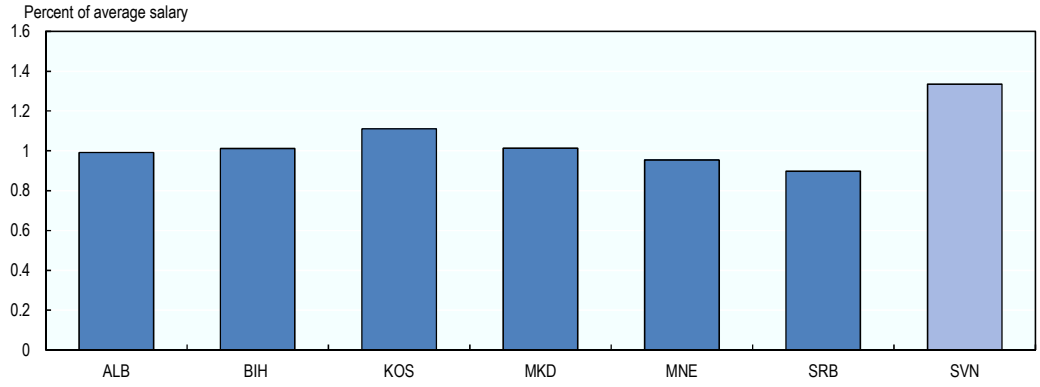
Teacher quality is arguably one of the most important in-school factors in student learning outcomes. Research finds that raising teaching quality is perhaps the policy direction most likely to lead to substantial gains in school performance (OECD, 2005). Policy needs to evaluate whether the teaching profession is sufficiently attractive to talented potential candidates and whether teachers are sufficiently rewarded and enjoy enough support in their work. Serbia is the only SEE economy to take part in the OECD's Teaching and Learning International Survey (TALIS) (Box 3.3), which makes international comparison of SEE economies' teachers' working conditions and school learning environment challenging.

Research indicates that wages and alternative employment opportunities are important determinants of the attractiveness of the teaching profession (Santiago, 2004). Figure 3.7 shows teachers' average monthly wages at all levels of education as a percentage of average national salaries in the SEE economies. It is important to compare teachers' pay levels with those in other occupations to gauge whether teaching is an attractive career prospect. However, little internationally comparable data are available.

Teachers' average salaries are low in SEE economies compared to Slovenia, where teachers earn more than the average national monthly wage. A teacher's average monthly salary in the SEE region is similar to the national average monthly wage in Albania, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia. Figure 3.7 shows that, in Montenegro and Serbia, teachers earn less than the national average but more in Kosovo.

Figure 3.7. **Average teacher monthly salary**

As a percent of average salary



Source: OECD calculations based on data from Education Reform Initiative of South East Europe (ERISEE).

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Box 3.3. **OECD's Teaching and Learning International Survey (TALIS)**

The OECD's Teaching and Learning International Survey (TALIS) is the first international survey to focus on the working conditions of teachers and the learning environment in schools. Its aim is to help countries to review and develop policies that foster the conditions for effective schooling.

TALIS focuses on lower-secondary school teachers and the principals of their schools and seeks to provide policy-relevant data and analysis on the following key aspects of schooling:

- the role and functioning of school leadership
- how teachers' work is appraised and the feedback they receive
- teachers' professional development
- teachers' beliefs and attitudes about teaching and their pedagogical practices.

TALIS is a collaborative effort by member countries of the OECD and partner countries which has been conceptualised as a programme of surveys. It began in 2008 in 24 countries, focusing on lower-secondary education. TALIS 2013 covers 34 countries and enables them to conduct the survey in their primary and upper-secondary schools.

Source: OECD (2014c), *TALIS 2013 Results: An International Perspective on Teaching and Learning*, TALIS, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264196261-en.

Teachers' salaries are the largest single item of expenditure in formal education and directly affect the attractiveness of the teaching profession. Since compensation and working conditions determine whether the profession can attract and retain skilled, high-quality teachers, SEE economies should take teachers' pay into careful consideration as they seek to ensure quality teaching and sustainable education budgets.

Further research into differences in teachers' working hours across the SEE economies is needed to further explain variations in teacher's wages. One policy which might draw more teachers without inflating education budgets may be to encourage teachers to take on more hours for higher pay.

Two qualitative indicators assess whether policies have provisions for not only attracting, selecting and recruiting the best teachers, but for training them, too, and supporting them in their professional development throughout their careers.

The **teacher recruitment and retention** indicator gauges the development and implementation of policies to recruit and train teachers at all levels of education, including initial VET. As for the second indicator, **teacher workforce development**, it assesses whether teachers receive regular, state-of-the-art training and other opportunities to improve the quality of their work. Training is important because it improves overall teaching standards by bringing practitioners' knowledge and methods up to date with the most recent and effective teaching and learning practices (OECD, 2005).

Table 3.3. **High-Quality Education Sub-Dimension: Teacher quality indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Teacher recruitment and retention	2.0	1.0	1.5	3.0	2.0	3.0
Teacher workforce development	2.5	2.0	2.5	2.5	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322912

All economies have legislation that governs teacher recruitment at all education levels. The Former Yugoslav Republic of Macedonia and Serbia have developed selective recruitment procedures. Their SEE peers, however, have generally not established admission criteria that would make the initial teacher training entrance exam competitive and selective. Discussions with stakeholders also revealed that students entering the teaching profession were not the top performers in their final high-school exams and the teaching profession suffers from a poor image. Job satisfaction surveys among teachers are not in place in the region.

Legislation that governs the formal provision of and teachers' participation in continuous professional training is in place in all economies and is often compulsory. Schools are encouraged to allot time to teachers' professional development. In Serbia, teachers with a certain number of hours of professional development are entitled to a wage rise. Montenegro, for its part, rolled out a programme for the development of a comprehensive continuous training programme between 2005 and 2008.

In most economies, however, even though professional training for teachers is mandatory, training is inefficient, its content is outdated and does not correspond to teachers' needs.

Equity in education needs to be further promoted

Greater equity in education pays off – for society and individuals alike – and can contribute to economic growth and social development (OECD, 2012). Indeed the highest-performing education systems are those that combine quality with equity. 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. In SEE economies, most students have the opportunity to work towards the highest levels of attainment, regardless of their personal and socio-economic circumstances. Nevertheless, the latest PISA results show that students from

socio-economically advantaged families tend to fare better in school than their peers from deprived backgrounds.

Governments that support students and their families are able to increase education participation rates – particularly among low-income students – by covering part of the cost of education and related expenses. In this way, they can address issues of access and equal opportunity. Analysis of the issue calls for data on the financial aid – student loans, scholarships or direct transfers – granted to students at different education levels. Such data, however, are not available in the SEE economies.

Two qualitative indicators – **equity in primary and upper-secondary education levels, including VET** and **diversity in higher education** – measure the extent to which education policies support disadvantaged students. Although ensuring equity in education needs to encompass all levels of education, national policy approaches tend to focus on tertiary education. Widening access to education may involve a general policy approach that targets all categories of students, under-represented groups or – most commonly – both. In addition to broadening access to higher education, which remains crucial from a long-term perspective, an education system needs to be effective enough to ensure that students who begin higher education go on to secure their final degree-level qualification.

Table 3.4. **High-Quality Education Sub-Dimension: Equity indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Equity in primary and upper-secondary education levels, including VET	3.0	2.0	1.5	3.5	2.0	3.5
Diversity in higher education policy	3.0	2.0	2.0	3.0	2.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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With the exception of Kosovo, where measures to build equity in education suffer from poor co-ordination among the responsible stakeholders, all SEE economies take some form of strategic approach that involves systematic support measures for students who fall behind at school. Most SEE governments provide direct support to students with the greatest needs in, for example, the form of free textbooks and school transport.

Bosnia and Herzegovina, Kosovo and Montenegro lag behind when it comes to the actual implementation of disadvantaged student support measures. The Former Yugoslav Republic of Macedonia runs several programmes, such as the provision of free textbooks and conditional cash transfers. Serbia has developed individually tailored programmes with regular classes to help students with special educational needs. It has also developed a monitoring framework to measure progress towards inclusive education.

All SEE economies seek to increase participation in tertiary education as part of their national education strategies. With the exception of Albania and the Former Yugoslav Republic Macedonia, however, there are no measures in place to open up higher education to disadvantaged students. Albania has introduced a quota for Roma and Egyptian minority students, while the Former Yugoslav Republic of Macedonia takes action to narrow geographic disparities.

The way forward for inclusive, high-quality education

As the SEE economies look to the future, they could consider a number of policy interventions for more inclusive education.

Bosnia and Herzegovina, Kosovo and Montenegro might consider further developing and implementing measures for greater equity in education at primary and secondary education level. Effective practices could be to build stronger ties between schools and the parents of disadvantaged students and to take further action to make education more widely accessible to disadvantaged groups such as minorities.

Albania, the Former Yugoslav Republic of Macedonia and Serbia would benefit from developing monitoring schemes that track their progress in implementing policies and serve as a basis for corrective action plans.

As for widening participation in higher education, all SEE economies could seek ways of gathering better baseline data on the family backgrounds of university students and where they originate from. Such data would inform and help design measures (e.g. targeted scholarship schemes) that reach out more effectively to students from under-represented groups.

Early-School Leaving Prevention Sub-Dimension

This section looks at the Early School Leaving Sub-Dimension through assessments of the SEE economies' efforts to reduce early school leaving at primary school, upper-secondary level and in higher education.

The European Union defines early school leavers as 18-24 year olds who have gone no further than secondary education and are no longer in education or training (EC, 2006). The notion of education drop-out, by contrast, extends to students who complete lower-secondary school, but then quit – in their upper-secondary year, for example, or when in higher education.

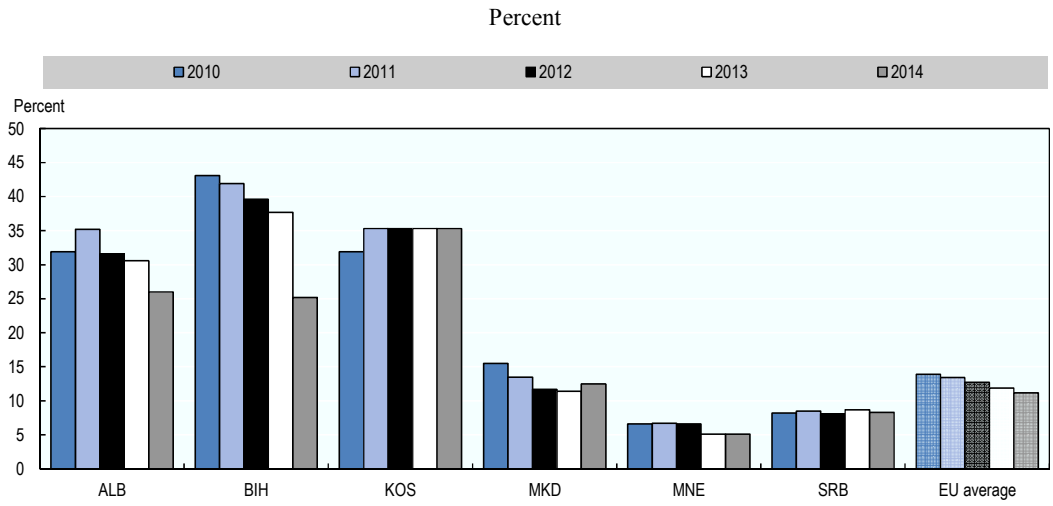
Early school leavers are at an immediate disadvantage when it comes to employment. In the long run, they earn less and experience increasingly longer, more frequent spells of unemployment (EC, 2014). Moreover, starting education then dropping out without a qualification is an inefficient use of public funds. Governments, therefore, have a strong incentive to reduce the number of early school leavers and drop-outs.

Action to prevent early school leaving should not be confined to compulsory education

Generally, SEE economies have taken positive steps to design and implement policies that seek to reduce early school leaving at primary and lower-secondary education level. When it comes to upper-secondary school and tertiary education and training – when education is no longer compulsory – SEE economies do not have consistent approaches in place. The main quantitative indicator in this policy area is early leavers as a percentage of 18-24 year olds (Figure 3.8).

It seems that early school leaving is less of an issue in Bosnia and Herzegovina, Montenegro and Serbia than in the EU countries. In Albania and Kosovo, though, the share of early school leavers is over 30% of 18-24 year olds, which would appear to call for urgent policy action.

Figure 3.8. **Early leavers from education and training among 18-24 year-olds**



Source: EC (2015a), *Candidate Countries and Potential Candidates* (Eurostat database), http://ec.europa.eu/eurostat/data/database?node_code=cpc; EC (2015b), *Education and Training* (Eurostat database), http://ec.europa.eu/eurostat/web/education-and-training/data/database; Kosovar Ministry of Education.

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It would be useful first, however, to understand the individual characteristics of early school leavers. Several studies address the issue, but no systematic data collection of the early school leavers' individual characteristics in the SEE region is in place.

Three qualitative indicators assess the SEE economies' **strategies to prevent early school leaving** at three levels of education: **primary and lower-secondary schools**, **upper-secondary education including initial VET**, and **higher education**.

Table 3.5. **Early-School Leaving Prevention Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Strategy at primary and lower-secondary education levels	3.5	2.0	2.0	3.0	2.0	3.0
Strategy at upper-secondary education level, including VET	1.0	0.0	1.0	2.0	1.5	2.5
Strategy to prevent higher education drop-outs	0.5	1.0	0.0	1.5	1.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The overriding reason for early school leaving is that students cannot afford to stay on in education (Quinn, 2013). As for higher-education drop-outs, additional factors are scant attention to the needs of a diverse student population and the absence of a student-centred approach in the curriculum.

When it comes to compulsory education (primary and lower-secondary school), all SEE economies have introduced schemes to reduce early school leaving. They combine prevention, intervention and compensation measures. Intervention addresses difficulties that emerge at an early stage, with a special focus on pupils at risk of leaving school early.

One positive aspect of the SEE education systems is that there is no provision for tracking students at an early stage, as pupils study in the same classroom for eight to nine years. Indeed, international evidence from cross-country comparisons suggests that, for the most part, early tracking reduces equal opportunity in education and reinforces the effects of the family's socio-economic background on educational outcomes (Hanushek and Wößmann, 2006; Brunello and Cecchi, 2007; Schütz et al., 2008). However, most SEE economies have developed mechanisms for identifying children at a high risk of dropping out and have intervention measures in place.

Albania, the Former Yugoslav Republic of Macedonia and Serbia are in the process of implementing measures. The other four economies do not have the capacity or the resources to fully implement measures. The most worrying situation is in Kosovo. It has developed a large number of measures to reduce the high proportion of early school leavers but has not been able to implement them.

When it comes to upper-secondary education, where students no longer have to attend school, most economies have no strategic approach. However, Serbia and the Former Yugoslav Republic of Macedonia do address the issue in their education-related strategies.

The National Education Council in Serbia also issues recommendations on how to reduce early school leaving and how to help students who have dropped out to continue their education. The Former Yugoslav Republic of Macedonia's VET strategy has provisions for cutting the rate of upper-secondary school drop-outs.

As for Montenegro, it has conducted an in-depth study into education drop-outs. It finds that boys are more at risk than girls in towns and girls more than boys in rural areas; that drop-out rates are higher among poor students; and, generally, that drop-out is more frequent during the three years of upper-secondary school. Schools in Montenegro provide individual and group counselling and try to work closely with parents.

Very few initiatives address dropping out of higher education in South East Europe. Serbia has monitored its domestic situation and estimates that about one-third of all students in higher education drop out (Tomev and Meinardus, 2012). That picture, however, may not be very reliable, as students who merely change subjects may find themselves in the drop-out statistics.

The way forward for curbing early-school leaving and drop-out

As the SEE economies look to the future, they might consider what further action they can take to address dropping out from upper-secondary school and higher education.

Identifying young people at risk of dropping out would be one important step in the right direction (Box 3.4). In fact, Albania, Kosovo and Montenegro could all develop a more comprehensive approach that includes prevention, intervention and compensation.

All the economies would benefit from analysing national, regional and local factors before designing any measures to address the issue. Ideally, they would include measures to reduce higher education drop-out rates in their overall strategies on higher education and focus on student-centred approaches.

Box 3.4. **Identifying low-skilled young people at risk of dropping out, an example from Estonia**

Young people with low skills are more likely to drop out of education and to struggle to enter the labour market. Increasingly, OECD countries are making efforts to identify the groups most at risk and reach out to them quickly. The Estonian Educational Information System (EEIS) is a national register that consolidates information on the education system which encompasses educational institutions, pupils, teachers, graduation documents and curricula.

Local governments can use EEIS to access information on the pupils living in their jurisdiction and on those who have moved to a school in another local government area. Educational institutions are obliged to enter information into the EEIS and to check and amend it for accuracy. Pupils and teachers can view the education-related information held on them. The register tracks each student's education career. It also shows whether a student has dropped out of school and if he/she has continued in evening classes, vocational school, or some other place of learning.

Source: OECD (2015a), *OECD Skills Outlook 2015: Youth, Skills and Employability*, http://dx.doi.org/10.1787/9789264234178-en.

Qualification Recognition Sub-Dimension

Guaranteeing the free movement of people in Europe is one of the EU's most important tenets. Understanding and accrediting qualifications issued by the different national education and training systems, however, remains a challenge. The EU has developed the European Qualifications Framework (Box 3.5) as a tool to translate, compare and recognise different national credentials and promote mobility across Europe. Students who are mobile in their higher education years are more likely to continue being mobile after graduation (OECD, 2013a).

Box 3.5. **European Qualifications Framework (EQF)**

The European Qualifications Framework (EQF) is a translation tool that helps communication and comparison between qualifications systems in Europe. Its eight common European reference levels are described in terms of learning outcomes: knowledge, skills and competences. It thus enables any national qualifications system, any national qualifications framework (NQF) and any qualification in Europe to refer to the EQF levels. Learners, graduates, providers and employers can use the levels to understand and compare qualifications issued in different countries and by different education and training systems.

Source: EC (2015d), *Find information on the EQF, NQF's* (webpage), www.ec.europa.eu/ploteus/search/site?f[0]=im_field_entity_type%3A97.

This section examines the Qualification Recognition Sub-Dimension. Accordingly, it evaluates the SEE economies in their efforts to standardise qualifications and remove obstacles to their recognition. It uses three qualitative indicators to assess whether qualifications frameworks are in place and to measure how effective and efficient national VET and higher education agencies are.

Further standardise qualifications to facilitate their recognition

Generally, SEE economies have taken positive steps towards designing qualifications frameworks and have begun implementing them. Indeed, their performance in that respect has been robust against the qualitative indicator, **national qualifications frameworks**.

Table 3.6. **Qualification Recognition Sub-Dimension: Framework indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
National qualifications framework	3.0	1.5	3.0	3.5	4.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322949

The purpose of the indicator is to assess how the SEE economies are proceeding with the implementation of their national qualification frameworks (NQFs) at all education levels. NQFs can make education systems more transparent, provide single benchmarks for a range of qualifications, and strengthen links between qualifications and learning outcomes.

Although all the economies have started to put their national qualifications frameworks into effect, they are at different stages.

Montenegro has made particularly good headway and, in 2014, became one of the 27 countries in Europe to have referenced their national qualifications framework to the EQF. The Former Yugoslav Republic of Macedonia began referencing in May 2014 and has now inventoried all qualifications at all education levels.

By contrast, Bosnia and Herzegovina's progress remains slow due to the complex, fragmented nature of its institutions. Serbia is working on merging its Higher Education Qualifications Framework with its draft VET Qualifications Framework to form a lifelong learning framework. It might now consider approving the necessary legislation and tackling governance and institutional ownership issues if it is to go ahead with NQF implementation. Albania is revising its NQF legislation, reviewing its VET qualifications and strengthening its institutions to implement the framework more soundly (ETF, 2015a).

Two qualitative indicators assess whether quality assurance government agencies are in place and how effective they are: **VET quality assurance agency** and **higher education quality assurance agency**.

Table 3.7. **Qualification Recognition Sub-Dimension: Quality assurance agencies indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
VET quality assurance agency	2.5	2.0	2.5	2.5	3.0	2.0
Higher education quality assurance agency	2.5	3.0	3.0	2.5	3.0	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322957

Quality assurance is an important bridge between learning outcomes, the accreditation system, the certificate supplement and the multidimensional role of the national qualifications framework. VET agencies should be properly staffed and funded, flexible and autonomous, and operate with political support while maintaining links with both the public and the private sectors. A single, strong agency is more effective than various government bodies with different duties (EC and EACEA, 2012). Ideally, the agency operates in accordance with EU quality assurance standards and guidelines, produces annual performance results that are publicly audited, has branches nationwide, and regularly trains its staff.

All SEE economies show very similar performances in the effectiveness and efficiency of their VET and higher education agencies. VET agencies have a much wider range of tasks (e.g. designing qualifications, developing curricula, preparing exams) than higher education agencies which focus on accreditation and quality assurance. VET-related tasks are often executed by more than one agency or department, in fact, and the challenge of collaboration can blunt their effectiveness.

All SEE economies have authorised both VET and higher education agencies. They operate in accordance with a clear set of regulations and standards and have a formal mandate to evaluate quality assurance and to approve new programmes in VET and higher education institutions.

In Albania, Montenegro and the Former Yugoslav Republic of Macedonia, the agencies seem well staffed. Their operational effectiveness would gain from offering their personnel regular training and engaging an independent assessment body to monitor their activities.

Labour Market Alignment Sub-Dimension

The Labour Market Alignment Sub-Dimension examines the importance of matching education outcomes with labour market needs in order to make young graduates more employable and ease their transition from school to work. The areas of adult education and policies towards a national policy framework for lifelong learning complete the sub-dimension.

Education outcomes need to better meet economic and labour market needs

The SEE economies generally lack a co-ordinated approach to ways of matching education outcomes with labour market needs. Two qualitative indicators analyse their policies in that regard and assess progress they have, or have, not made.

The **VET and business co-operation** indicator assesses to what extent VET institutions work with the business community and whether efficient policy measures are in place to facilitate such co-operation. That VET providers and business work together is essential to securing stakeholder commitment and enabling VET institutions to produce the knowledge, skills and competences needed on the labour market.

The second qualitative indicator is **work-based learning**. It assesses existing work-based learning schemes (like apprenticeships and internships) in the region. Apprenticeships usually refer to work-based training as part of initial vocational education and training, while internships generally denote practical training for students during or on completion of their studies. Gaining practical experience that is relevant to employers can ease graduates' transition from education to the labour market.

Table 3.8. **Labour Market Alignment Sub-Dimension: Business in education indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
VET and business co-operation	2.5	1.0	2.0	2.5	1.5	1.5
Work-based learning	2.0	1.0	2.0	3.0	2.0	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322966

Work-based learning schemes are thus a crucial component of labour market policy. Evidence shows that the design and implementation of work-based learning schemes – i.e. how they are set up and managed over time – are essential to their success and sustainability. The OECD report, *Off to a Good Start? Jobs for Youth* (2010), advocates the use of internships and other forms of on-the-job learning as ways to give students a grounding that smooths their entry into the workplace.

SEE economies show considerable room for improvement when it comes to collaboration between VET providers and businesses, even though most economies have developed some measures to improve it.

In Bosnia and Herzegovina, however, only a number of uncoordinated, donor-funded projects have brought together VET providers and businesses. Ad hoc consultations take place for policy formulation (curricula design, regulation, VET funding, etc.) and implementation (i.e. the type of training, the length of practical training schemes, etc.).

Albania's Employment and Skills Strategy 2014-2020 contains policy measures to facilitate collaboration between VET providers and companies, but implementation is slow. Overall, the inclusion of business representatives in VET policy making is very limited in SEE economies. A structured approach is needed for VET-business collaboration to take place and to improve.

The provision of work-based learning is an area where the SEE economies have much to improve. In Bosnia and Herzegovina companies have no legal obligation or incentive to offer apprenticeships. In fact, practical instruction mostly takes place in schools.

Albania and Kosovo have developed frameworks, but not yet implemented them. A decision at a 2013 Council of Ministers in Albania obliges schools to organise 30 days of compulsory training for VET students. The main challenge is that enterprises are unwilling or unable to co-operate.

The government of the Former Yugoslav Republic of Macedonia recently reformed its VET system where work-based learning is a key area. The Law on VET offers businesses incentives to provide training, together with guidelines, standards and tools to facilitate implementation. The VET Centre has also agreed to social partnership protocols and memoranda of understanding with chambers of commerce and industry associations.

Montenegro is developing policy measures to improve the provision of high-quality work-based learning. However, its focus is on higher education. In Serbia, between 20% and 30% of total learning time, depending on the education profile, must be in a workplace.

There is little tradition of internships in the SEE economies, by contrast, and legal frameworks regulating internships and apprenticeships are not in place. For work-based learning to be successful, there needs to be guarantees of quality and on-the-job instruction would have to comply with national labour codes.

No SEE economy currently has provisions for matching practices to help students find a suitable company. Monitoring and feedback mechanisms, such as skills validation, which are commonly used in OECD countries, are lacking in all SEE economies. Yet they should be part of any work-based learning agreement.

Career guidance capacity needs to be built

In EU countries, the employment rates of recent graduates vary significantly according to field of study. There have consequently been calls for education and training systems to be more relevant to the labour market and to provide improved career and counselling services – both before the end of compulsory schooling to offer guidance in choice of study and before students graduate or otherwise complete their studies – and to offer students guidance to the labour market.

When young people choose the wrong career, the costs of later changes in direction may be high. Similarly, insufficient information when they need it most may undermine motivation and cause them to drop out (OECD, 2010). Career guidance services are best provided in close collaboration with employers in all sectors and employment services providers.

The **career guidance services** indicator measures to what extent these services are provided. The scores in Table 3.9 point to a shortage of efficient career guidance services in the SEE region.

Table 3.9. **Labour Market Alignment Sub-Dimension: Career guidance services indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Career guidance services	2.0	1.0	1.0	2.0	1.5	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322970

Bosnia and Herzegovina and Kosovo have produced information booklets for pupils in the final year of primary (i.e. lower-secondary) school. Because they have very little experience of such practices, students tend to enrol in subjects where there is an over-supply.

Some universities in Albania, the Former Yugoslav Republic of Macedonia and Serbia house career guidance centres. Students seldom use them though, apparently preferring to seek out information by other means. The inference is that the centres are not particularly helpful.

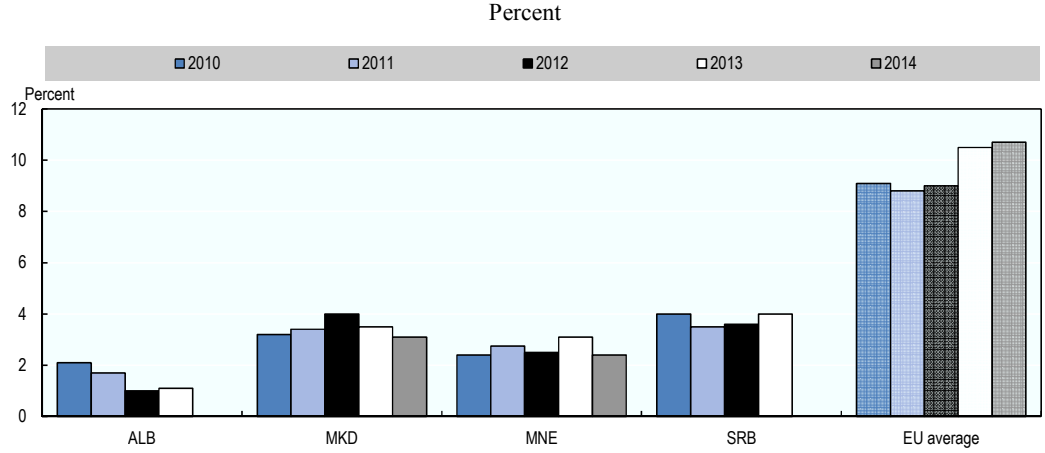
Career guidance is often a service provided by employment service agencies, but co-operation could be improved. In the Former Yugoslav Republic of Macedonia, around 100 teachers were trained in 2014 in career guidance and career centres have opened in 37 VET schools. If career guidance services are to be efficient, the information they need to improve their information provision and staff should be properly trained. Career guidance calls for regular assessment if the service is to be effective.

Lifelong learning provision can be increased

Even after graduating from formal education, workers should seek to maintain and upgrade their skills through continued learning to stay abreast of the constant changes on the labour market. Participation in lifelong learning (LLL) is key to high labour productivity (ILO, 2008).

The main quantitative indicator is adult participation in lifelong learning as a share of all 25-64 year olds who received formal or non-formal education or training in the previous three months.

Figure 3.9. **Participation in lifelong learning among 25-64 year olds**



Note: Data for Bosnia and Herzegovina and Kosovo not available. Data for Albania and Serbia for the year 2014 not available.

Source: EC (2015b), *Education and Training* (Eurostat database), http://ec.europa.eu/eurostat/web/education-and-training/data/database; Ministries of Education of Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia.

StatLink http://dx.doi.org/10.1787/888933321498

Participation in lifelong learning is low in SEE economies. While over 10% of individuals in the EU in 2013 had participated in some form of education and training, LLL rates in the SEE region do not exceed 4%. Participation is particularly low in Albania, falling even further between 2010 and 2013. Data for Bosnia and Herzegovina and for Kosovo are not yet available.

The **lifelong learning policy** indicator gauges to what extent the SEE economies have developed and implemented policies to provide opportunities to pursue education and training at any stage in their life.

Table 3.10. **Labour Market Alignment Sub-Dimension: Lifelong learning policy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Lifelong learning policy	2.0	1.0	1.0	2.5	2.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322988

With the exception of Bosnia and Herzegovina and Kosovo, all the SEE economies have developed some form of strategic approach to lifelong learning.

Montenegro, the Former Yugoslav Republic of Macedonia and Serbia have developed specific strategies, while Albania has incorporated LLL provisions into its education strategy. However, all three could place more emphasis on implementing measures. As for Bosnia and Herzegovina and Kosovo, they should look to comprehensively improve their lifelong learning policies.

There is also a weak information base for the key policy area of lifelong learning, as the SEE economies (with the exception of Serbia in 2011) have not conducted surveys in line with EU provisions in the field of continuing learning. In other words, they have not

harmonised their practices in accordance with the Adult Education Survey and Continuing Vocational Training Survey (CVTS).

Entrepreneurial Learning Sub-Dimension

The Entrepreneurial Learning Sub-Dimension considers to what extent SEE economies promote entrepreneurial learning and enterprise skills. Entrepreneurial learning includes "all forms of education and training … which contributes to entrepreneurship spirit and activity with or without a commercial objective" (Gribben, 2006). To that end, the sub-dimension uses seven qualitative indicators developed by the South East European Centre for Entrepreneurial Learning (SEECEL), the European Training Foundation (ETF) and experts from the SEE economies. The indicators are intended to gauge the progress of pre-accession countries in implementing the principles of the Small Business Act for Europe, the EU's policy framework for promoting entrepreneurship.

The assessment looks at overall policy frameworks for entrepreneurial learning and considers whether tertiary education teaches entrepreneurship and how it organises the sharing of good practices. Two of the seven indicators address skills required by SMEs, assessing training provisions to meet business needs and preparing SMEs for doing business internationally. The current performance is benchmarked against the evaluation in the SME Policy Index 2012 (OECD et al., 2012).

Entrepreneurship is an important driver of economic growth and a critical building block for a more flexible workforce. "A sense of initiative and entrepreneurship" is one of the eight key competences in the lifelong learning framework which the EU (2006) defines as the set of knowledge, skills and attitudes that are fundamental in a knowledge-based society and which should be acquired by the end of compulsory education and through lifelong learning. Entrepreneurial learning has since become a priority not only in the Small Business Act for Europe (EC, 2008), but also in the EU's overarching Europe 2020 strategy (EC, 2010) and the Entrepreneurship 2020 Action Plan (EC, 2012).

Education for entrepreneurship can make a difference – students who participate in entrepreneurial programmes start more companies and do so earlier. The percentage of all alumni who become entrepreneurs 3 to 5 years after leaving school is between 3% and 5%, whereas for those who participated in an entrepreneurship education the percentage rises to 15% and 20% (EC, 2012).

Policy makers increasingly consider enhanced knowledge and skills as critical to business performance and wider economic growth. Ready access to quality training services is thus vital to ensuring the quality and adaptability of the labour force.

Policy frameworks promote entrepreneurial learning

A policy framework is instrumental for promoting entrepreneurial learning as a key competence at all levels of education. To assess the framework, this section uses five indicators:

- The **policy partnerships** indicator considers how stakeholder co-operation and partnership arrangements are developing to support entrepreneurial learning.
- The **policy elaboration process** indicator measures to what extent entrepreneurial learning is included in national policy instruments and development plans.

- The **monitoring and evaluation** indicator gauges whether entrepreneurial learning activities are monitored and evaluated.
- The **good practice exchange** indicator assesses whether good practices are exchanged among entrepreneurial learning providers.
- The **university-enterprise co-operation** indicator measures collaboration between academia and the business community.

Table 3.11. **Entrepreneurial Learning Sub-Dimension: Policy indicator scores**

		ALB	BIH	KOS	MKD	MNE	SRB
Policy partnership	2015	2.0	3.5	2.0	3.5	3.5	2.5
	Change since 2012	-1.0	-0.5	1.0	0.5	-0.5	-0.5
Policy elaboration process	2015	3.0	4.0	3.0	3.5	4.0	3.5
	Change since 2012	1.0	2.0	0.0	0.5	0.0	1.5
Monitoring and evaluation	2015	2.0	2.0	2.0	2.0	3.0	2.0
	Change since 2012	0.0	0.0	0.0	-1.0	1.0	0.0
Good practice exchange	2015	3.0	3.0	3.0	3.0	3.0	3.0
	Change since 2012	0.0	0.0	-1.0	-1.0	2.0	-1.0
University-enterprise co-operation	2015	2.5	3.0	2.5	3.0	3.0	3.0
	Change since 2012	0.5	2.0	1.5	0.5	0.0	2.0

Source: These scores are based on a draft assessment, which the OECD South East Europe Regional Programme is currently conducting under a project to assess the implementation of the Small Business Act for Europe in the Western Balkans.

StatLink http://dx.doi.org/10.1787/888933322999

The SEE economies' overall strong and improving performances across the policy framework for entrepreneurial learning indicators still paint a mixed picture.

Policy elaboration has improved and all SEE economies have emphasised entrepreneurial learning as a priority area within national development plans and/or in education strategies. Some specific entrepreneurial learning strategies have even been designed. Strong policy partnerships to promote entrepreneurial learning have been put in place in, for example, Bosnia and Herzegovina and Montenegro. Other economies will need to co-ordinate better with the key players to ensure system-wide reform. Overall, the SEE economies share good practice at a regional level, primarily through a platform developed by SEECEL. The sharing of know-how at national level is mixed, however.

As for collaboration between academia and the business community, it is improving – thanks chiefly to Bologna Process reforms, which require work placements as part of study programmes. However, there are too few examples of systematic co-operation (or national policy debates and initiatives) in this area. As for monitoring and evaluation, there is room for substantial improvement in all SEE economies, with the exception of Montenegro.

Bosnia and Herzegovina has significantly improved its policy elaboration process for entrepreneurial learning since 2012, while the action plan for lifelong entrepreneurial learning strategy in the Former Yugoslav Republic of Macedonia allocates specific funds to improve partnerships in entrepreneurial learning. Montenegro, in addition to the quality assurance process it has introduced in schools, collects data on the implementation of entrepreneurial learning in formal education – a key factor in its performance in the

monitoring and evaluation indicator. Serbia in particularly has made strides in its performance in the university-business co-operation indicator.

Albania and Kosovo would benefit from intensifying their efforts, particularly in partnership arrangements in the formal education system and the wider area of non-formal learning.

As they look ahead, however, the SEE economies might consider a particular policy challenge –closer, more consistent co-ordination in the area of entrepreneurial learning between sector-based education strategies, SME development, employment and R&D. Efforts also need to be made to take a holistic approach to designing and implementing entrepreneurial learning policy, which encompasses curricula, teacher training and school governance.

Another challenge for SEE economies is to fully incorporate entrepreneurial learning into their education systems and to develop monitoring and evaluation systems at all levels. The conclusions of the EU Council of Ministers on 22 June 2015 – although relating to entrepreneurship in vocational education – were an important signal to EU aspirants to intensify the systemic monitoring and evaluation of measures to promote entrepreneurship.

As for collaborative efforts between universities and business, all SEE economies could consider launching national policy debates as to why and how regular interaction between higher education institutions and businesses is important to building strong local, regional and national economies.

Finally, further efforts should be taken to exchange and promote good practice not only at a regional level but also within each national context – e.g. by organising annual events or using information technology platforms to disseminate good practices.

Enterprise skills development should focus more on internationalisation

Advanced knowledge and skills are critical to business performance. This section considers training needs analyses for enterprises as a pre-requisite to sound policy decisions. It then looks at training small businesses in how to prepare for international operations.

Any strategic approach to improving skills needs to take as its starting point a systematic analysis of business interests, particularly skills gaps, skills weaknesses and future skills perspectives. The **training needs analysis** (TNA) indicator gauges to what extent TNA lays an empirical basis for improved policy making and better targeting of resources to support human capital development within and for small businesses. It is also critical for policy monitoring and evaluation.

The second qualitative indicator, **small business internationalisation training**, evaluates training opportunities for small businesses planning to branch out into international operations. Training schemes should give SMEs operating in key economic sectors advanced knowledge and understanding of international standards and markets.

The TNA indicator is benchmarked against performance in 2012, while the indicator, training for small business internationalization, was first assessed in 2015.

All SEE economies have improved their performance in training needs analysis since 2012 with the exception of Kosovo. Indeed, they generally fare well in this area. The average score in the training for small business internationalisation indicator,

however, is lower than the average score in training needs analysis. Although all the economies provide such training, Serbia leads the way.

Table 3.12. **Entrepreneurial Learning Sub-Dimension: Training indicator scores**

		ALB	BIH	KOS	MKD	MNE	SRB
Training needs analysis	2015	3.5	3.5	2.5	2.5	3.0	4.0
	Change since 2012	0.5	1.5	0.0	-0.5	0.5	1.0
Small business internationalisation training	2015	1.5	2.5	2.0	2.5	2.5	3.0

Source: These scores are based on a draft assessment, which the OECD South East Europe Regional Programme is currently conducting under a project to assess the implementation of the Small Business Act for Europe in the Western Balkans.

StatLink http://dx.doi.org/10.1787/888933323005

As the SEE economies look ahead, they might consider taking skills analysis beyond standard surveys to include a more evolved dialogue with small business support organisations and concentrate on management and high-level occupational skills in key sectors. For example, countries with sector-based skills councils could set up focus groups where business representatives would, in a timely manner, tell training providers about changing skills requirements. As SEE economies look to join the EU single market, they will have to build a more highly developed training environment for SMEs – particularly in key sectors with EU trade potential.

Conclusions

Overall, SEE economies have taken positive steps to improve the quality of education and the competences of the labour force. All the economies in the region have introduced national strategies to improve education broadly and/or to address specific aspects. Although education-related statistics such as the share of the tertiary-educated population are below the EU average, convergence is progressively taking place. The implementation of national qualifications frameworks is on-going in all SEE economies. They have also sought to establish policy frameworks supporting equity in education, while systemic developments in incorporating entrepreneurial learning into national education systems are evolving. Important first steps have been taken in building entrepreneurship into national education systems as a key competence.

Despite their achievements, SEE economies still face a number of challenges. The performance of 15 year olds in mathematics, reading and science is well below the OECD average, which points to the need for reform in primary and lower-secondary schools. There is a need for better-quality, systematic assurance policies and practices. The quality of teaching could also be improved. The best candidates are not choosing the teaching profession because it suffers from a poor image in the SEE region. Collaboration between VET providers and businesses needs to be reinforced to improve and increase practical learning of relevance to the workplace (also true of higher education). Finally, lifelong learning participation rates are very low in in the SEE region. Monitoring and evaluation support structures and capacities should be made part of national education systems, particularly in evolving policy areas like the key entrepreneurial skills.

The drive to improve skills within small businesses should continue, particularly through direct engagement with the SME community in order to ensure a better fit between supply and demand. This is particularly important in economic sectors with

growth potential and job creation could benefit. It is equally important for SMEs that have the potential to trade across the region, with the EU and beyond.

Responding to these challenges will contribute to the development of a competent, well educated workforce, which will in turn increase productivity, prosperity and social inclusion.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).
2. EU8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

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Chapter 4.

Research, development and innovation in South East Europe

Research and development is systematically undertaken in creative work to increase the sphere of knowledge or invent new ways of applying existing knowledge. Innovation is the introduction of a new or improved product, service or process. This chapter on the Research, Development and Innovation (RDI) Dimension considers four sub-dimensions in its assessment of RDI performance and policy development. The RDI Policy Governance Sub-Dimension assesses co-ordinated strategy development and implementation as well as public research organisations. The Research Base Sub-Dimension measures research organisation funding. The Private Sector RDI Activities Sub-Dimension examines government activities to facilitate private sector RDI through business grants, fiscal support, promotion and public procurement practices. The Business-Academia Collaboration Sub-Dimension evaluates government initiatives to bring the two communities together to foster innovation such as business-academia mobility, researcher evaluation and IPR legislation.

Main findings

Research, development and innovation (RDI) is an important part of efforts among emerging and middle-income economies to move up global value chains, escape the "middle-income trap" and move towards knowledge-based economies.

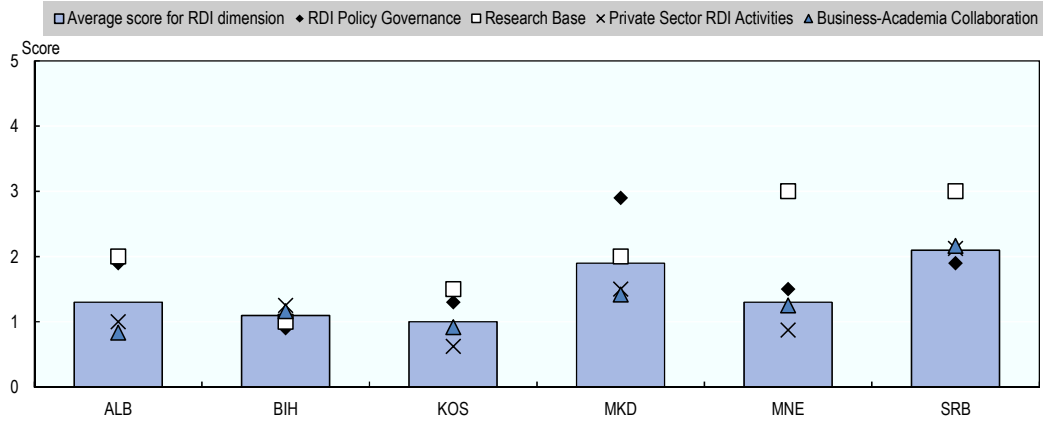
Investment in R&D in the South East Europe (SEE) region is less than one-quarter of its level in the EU countries. (The sole exception is Serbia, where it is still less than one-half.) RDI output such as scientific publications and patents is therefore scant.

The governments of the SEE economies are increasingly coming to recognise the importance of RDI policies for their longer-term development, competitiveness and sustainability.

The assessment conducted for this publication assigns the region an average score of 1.6 out of 5 (Figure 4.1), which signifies that the SEE economies have started to shape RDI policies. Most of the economies are in the process of adopting new strategies and legislation or piloting new policy instruments related to RDI. Two of them (Serbia and the Former Yugoslav Republic of Macedonia) perform more robustly, with average scores of around 2, which indicates that they have adopted, if not yet implemented, most frameworks. The other four economies score 1.4 or lower, which suggests that their RDI policies are still very much in the pilot phase.

As regards RDI policy areas, the strongest is the region's research base, which builds on a tradition of academic research in the region. Frameworks governing private sector innovation and linkages between business and the academic research community leave, on the other hand, much greater room for improvement.

Figure 4.1. **Research, Development and Innovation (RDI): Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have seen recent improvements in research, development and innovation.

SEE economies have made efforts to make more efficient use of their limited R&D expenditure. All SEE economies have introduced some form of competitive project funding for R&D activities and some have even introduced international peer reviews in the evaluation process.

SEE economies have improved their RDI policy frameworks. Even though the Former Yugoslav Republic of Macedonia is the only economy with a dedicated innovation strategy, several others are in the process of developing them. Several RDI implementing agencies have been established in recent years to ensure effective policy implementation.

The SEE region recognises RDI international co-operation as a priority. Acknowledging their internal challenges and lack of critical mass, most SEE economies have placed great emphasis on international – and regional – co-operation in R&D and innovation. All the SEE economies are part of in the European Framework Programme for Research and Innovation, "Horizon 2020". They have also collectively adopted a regional strategy for R&D and innovation.

Challenges

Despite these achievements, the SEE economies still have to address a number of challenges that prevent the region from transitioning into knowledge-based economies.

Overall R&D expenditure in the region is low and there are few researchers. The SEE economies (except for Serbia) invest less than 0.5% of their GDP on R&D (compared to the EU average of 2%). Furthermore, only a very small portion of that expenditure comes from the private sector – 12% on average compared to 54% in the EU.

Inter-ministerial RDI policy co-ordination and monitoring and evaluation practices are not fully developed. Typically, there is little or no communication between science- and economy-related ministries, while policy initiatives are usually ad hoc with limited budget support. All SEE economies have room to improve the monitoring and evaluation of RDI policies.

Business-academia co-operation is limited. There are few financial instruments for supporting collaboration between the business and academic research communities in the region. None of the SEE economies has adopted policies to foster mobility between the private sector and public institutions. Many new initiatives in the region offer institutional support for innovation or knowledge transfer, but they often struggle to achieve sustainability. In addition, very few patents are produced in the region and governments have not yet adopted legislation to incentivise researchers to protect and commercialise intellectual property created by publicly funded research.

Few policy instruments are being implemented by the SEE governments to stimulate private sector RDI activities. There are no tax incentives for private sector R&D expenditure or for public procurement of innovation. Some economies in the region do however provide grants for R&D activities in companies.

Recommendations

Measures addressing identified challenges can facilitate the development of knowledge-based economies.

Improve RDI policy governance. Governance can be improved by adopting dedicated innovation strategies and establishing national level co-ordination bodies to implement them. Independent implementing agencies would ensure effective implementation of policies. Finally, monitoring and evaluation of policies should become standard.

Place greater emphasis on research excellence through competitive R&D grant schemes. Merit-based, internationally peer-reviewed grant schemes should give adequate funding to selected grants and have selection criteria which incentivises both international scientific collaboration as well as joint business-academia activities.

Develop indirect instruments (such as tax credits) and direct measures (grants, matching grants, loans, etc.) to incentivise private sector R&D. It is important that measures are designed carefully, financed adequately and regularly monitored and evaluated. Emphasis needs to be placed on the quality and transparency of the selection process. Seed financing for proof-of-concept type of activities in companies could be followed up with adequate access to finance at later stages in the development of innovative companies.

Include incentives and support for collaboration between business and academia in RDI policies. Governments can consider a range of policy instruments to support collaboration between industry and academia such as innovation vouchers, technology transfer offices, business and technology incubators, and science and technology parks. Besides these support measures, incentives can be built into national or institutional legislation to stimulate mobility between private research and public research and promote the commercialisation of technologies (through IP policies in particular).

Overview

Research and development (R&D) is "creative and systematic work undertaken in order to increase the stock of knowledge […] and to devise new applications of available knowledge" (OECD, 2002). R&D covers three types of activities: basic research, applied research and experimental development.

As for innovation, the *Oslo Manual* describes it as the introduction of a new or significantly improved product, service or process. It may also apply to the implementation of a new or significantly improved marketing method, organisational method in business practices, workplace organisation or external relations (OECD/Eurostat, 2005).

R&D plays an important role in the innovation process although it is also important to note that not all innovation is R&D-based or technological in nature. Innovation can also rely on a firm's skilled workers and its interactions with other firms and research organisations. It is for that reason that this chapter considers research, development and innovation (RDI) policies as inseparable. The policies it assesses are:

- those that support basic research and build the knowledge base
- those that seek to transfer knowledge from research bodies to companies
- those that support research and innovation activities which take place in the private sector.

Research, development and innovation are important productivity and economic growth factors. As the rate of social return of business R&D is higher than that of its private return, there is justification for public intervention. In addition, the effect of public R&D on productivity depends on the intensity of the business R&D effort. Therefore, governments need to support both public and private RDI activities. Policy makers must draw up appropriate policy frameworks to facilitate flows of knowledge between the two sectors (Guellec and van Pottelsberghe de la Potterie, 2001).

RDI is closely linked to a number of the policy dimensions and instruments for boosting competitiveness covered in this publication.

- **Chapter 3. Education and competences** with higher education in particular, is vital to increasing the number and quality of researchers in the region who can carry out RDI activities. Economies in the region are making an effort to improve the quality of education and all have introduced national education strategies. However, data from Albania, Montenegro and Serbia suggest that student performance in mathematics and science in the SEE region is below the OECD average. Higher education enrolment rates in the natural sciences and engineering are low and there is insufficient support for PhD and post-doctoral studies. University professors concentrate on teaching activities and there are few incentives for university employees and students to work with the private sector.
- **Chapter 9. Access to finance** remains one of the biggest problems for innovative companies in the region. The regional Western Balkan Enterprise Development and Innovation Facility (EDIF) – established by the SEE economies, the European Commission (EC), the European Bank for Reconstruction and Development (EBRD), the European Investment Fund (EIF) and others – is intended to provide access to finance for innovative and high growth SMEs in the region. However, further efforts at the national level are also needed. Business angel investment in the region is particularly weak, for example, although individual economies have made some efforts to support the activities of angel networks. One of the main challenges is the lack of a legislative framework for venture capital activities in the whole region.
- **Chapter 14. Effective public services** that foster a strong business environment are needed for innovative companies to develop. And although the SEE economies have appreciably simplified business registration formalities – which is particularly valuable for start-up companies – the cost of starting a business is still significantly higher than in OECD countries.
- **Chapter 1. Investment policy and promotion** which is proactive and transparent attracts foreign direct investment (FDI) which, in turn, draws new technologies to a country. Organising FDI-SME linkage programmes produces technology spillovers into the local economy. The reverse is also true: proactive RDI policy that offers businesses incentive to innovate can be a powerful driver of FDI.

Box 4.1. **Research, Development and Innovation Dimension in the SEE 2020 Strategy**

The Research, Development and Innovation Dimension is a part of the Smart Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The Smart Growth Pillar's central objective is to promote innovation and foster knowledge-driven growth in the region, both regarded as the main future sources of competitive advantage and value added. SEE 2020 sets a headline target of a 32% rise in average labour productivity over 2010 in the Smart Growth Pillar.

The Research, Development and Innovation Dimension uses the four sub-dimensions of the Western Balkans R&D Strategy for Innovation, adopted by the SEE economies in 2013. An objective is set for each sub-dimension:

- establish a research excellence fund
- increase gross domestic expenditure on R&D
- introduce technology transfer programme, promote networks of excellence, and create early stage and start-up programmes
- set up a regional RDI organisation that fosters better governance of RDI policies.

The official SEE 2020 Strategy Co-ordinator for the Research, Development and Innovation Dimension is the Regional Cooperation Council (RCC) and the Western Balkans Research and Innovation Strategy Exercise (WISE) Steering Committee. The RCC seeks to promote and improve regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy. The Western Balkans R&D Strategy for Innovation includes plans to create WISE, a regional RDI organisation which is currently being established.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Research, Development and Innovation Dimension assessment framework

This chapter proposes an analysis of research, development and innovation in the SEE region. It does not seek to be exhaustive, but considers four broad sub-dimensions drawn from the Smart Growth Pillar of the SEE 2020 Strategy. The chapter also offers insights into the SEE economies' performances by analysing aspects of the underlying RDI policy framework in South East Europe. The four policy sub-dimensions are:

- RDI Policy Governance

  What are the SEE economies doing to improve the design and implementation of RDI policies? How can policy governance be strengthened? Are overall policy frameworks in place? If so, to what extent have they been implemented? Do the SEE economies have strategies? Does RDI policy making include inter-ministerial co-ordination, implementation agencies and international co-operation?

- Research Base

  How do research sectors perform? What are the levels of funding? How efficient is the granting of funds? How efficient is the governance of public research organisations?

- Private Sector RDI Activities

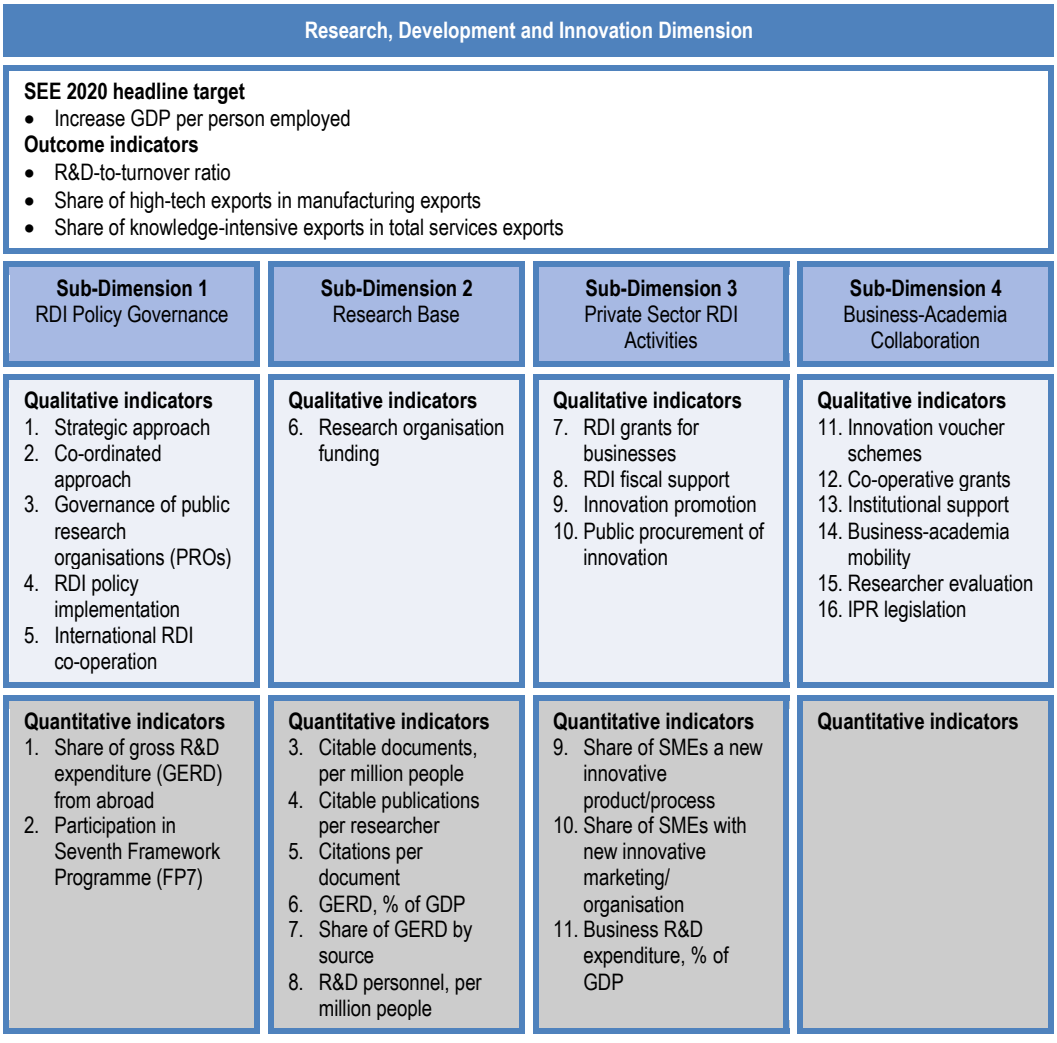
  How does the private sector perform in RDI? What is the level of spending on R&D? What policy instruments are used to support business investment in R&D – grants, tax credits, innovation promotion and demand-side measures like innovation procurement?

- Business-Academia Collaboration

  Do industry and research organisations collaborate and transfer technology? Can any collaborative ventures serve as examples of good practice? What other policy instruments – e.g. vouchers, co-operative development grants, institutional support, IPR legislation – are in place?

Figure 4.2 shows how the sub-dimensions and their constituent indicators make up the RDI Dimension assessment framework.

Figure 4.2. **Research, Development and Innovation Dimension assessment framework**



Each sub-dimension is assessed by quantitative and qualitative data, which were collected by the RCC and WISE Steering Committee with the assistance of the OECD. Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

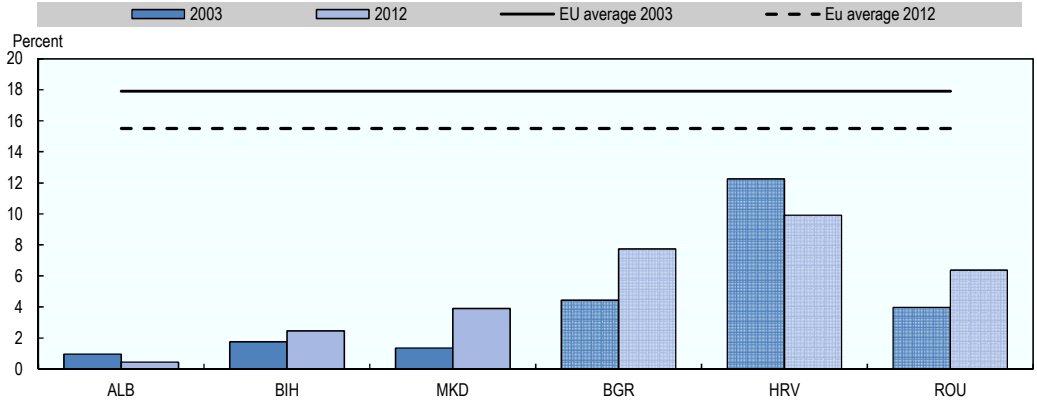
RDI performance in SEE economies

EBRD's *Transition Report 2014* analyses the results of the fifth round of the Business Environment and Enterprise Performance Survey (BEEPS) study (2012-14) in R&D and innovation. It concludes that R&D spending by the private sector is very low, even in the high-tech and medium high-tech industry sectors. In those sectors the SEE average R&D-to-turnover ratio of 0.7% is a fraction of Israel's (5.4%) and lower than in the Russian Federation (1.5%), Central Europe and Baltics (1%) and Central Asia (0.8%). Furthermore, an analysis of "make or buy" behaviour shows that the SEE economies are mostly in the "buy" category (Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia,) or in the "low innovation" category (Albania). Nevertheless, 22% of businesses in the SEE economies are engaging in some kind of innovation, which places South East Europe ahead of other transition regions, including Israel.

High-technology exports account for less than 4% of all exports in Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia, 10% of all exports from Croatia, and 15.5% of EU country exports on average. The available data suggest that SEE economies chiefly export low value-added products, even though the relative share of high-tech products in exports rose between 2003 and 2012 (Figure 4.3). One explanation is that off-shoring by foreign companies moving their manufacturing facilities to the region has also led to a drop in EU high-tech exports.

Figure 4.3. **High-technology exports, 2003 and 2012**

Percent of total manufactures exports



Note: Data for Kosovo, Montenegro and Serbia not available.

Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

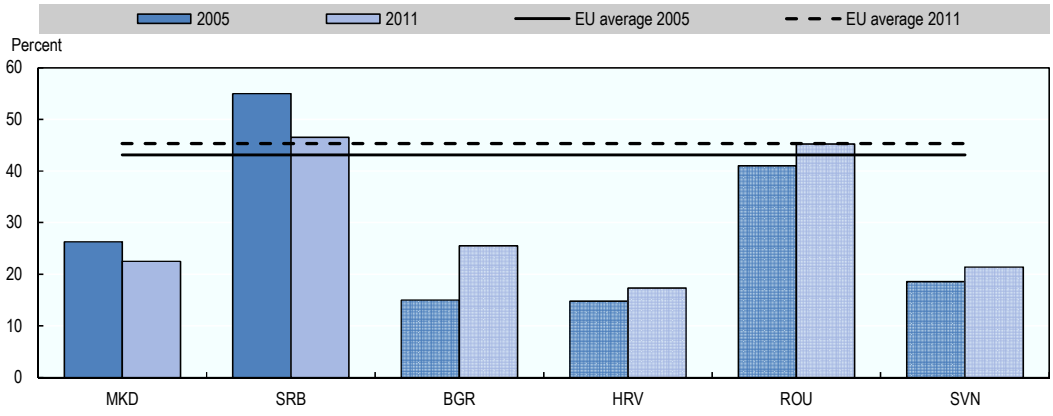
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Employment in knowledge-intensive activities accounted for to 7% of total employment in the Former Yugoslav Republic of Macedonia in 2013 and 14.4% in Serbia (the only two SEE economies for which data are available), compared to 13.9% in the EU

countries (EC, 2014a). A similar level between Serbia and the EU is found in their share of knowledge-intensive service exports in their total exports – 46.5% and 45.3% respectively. Serbia's high share of knowledge-intensive exports is attributable to its generally low level of service exports and the high percentage of ICT services it provides. The Former Yugoslav Republic of Macedonia does not perform at EU levels – only 22.5% of all its service exports originate from knowledge-intensive activities (Figure 4.4).

Figure 4.4. **Knowledge-intensive services exports in selected SEE economies, 2005 and 2011**

Percent of total service exports



Source: EC (2014a), *Innovation Union Scoreboard 2014*, http://dx.doi.org/10.2769/88936.

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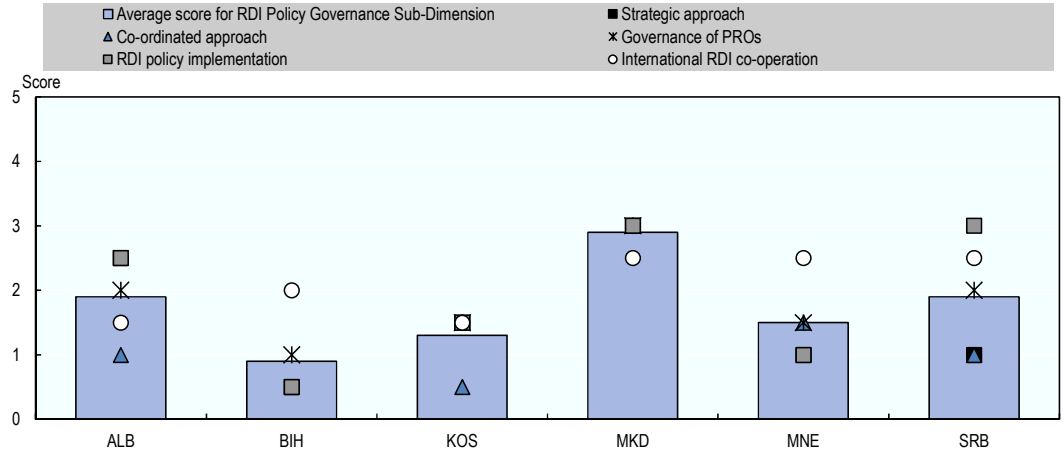
RDI Policy Governance Sub-Dimension

This section considers the RDI Policy Governance Sub-Dimension and examines what SEE economies are doing to improve the design and implementation of RDI policies (Figure 4.5). It gauges whether they have put strategies in place, whether they have implementing agencies and to what extent the agencies have implemented the strategies. The sub-dimension assesses, too, whether governments have studied policy co-ordination and, finally, appraises governance of R&D organisations and collaborative international RDI.

R&D and innovation policies are becoming increasingly complex. There are more policy instruments that can be administered by the different ministries and a multitude of new actors involved in the innovation system. Countries face the challenge of optimising the policy mix and establishing multi-level governance (OECD, 2014a).

The SEE economies are in the process of putting in place policies to improve RDI governance. Most of them struggle with policy co-ordination and implementation. However, they generally have strategic documents to regulate RDI policy and place strong emphasis on international co-operation in RDI.

Figure 4.5. **RDI Policy Governance: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Policy co-ordination is one of the biggest challenges

A well-rounded framework is built on a sound strategy co-ordinated through a whole-of-government approach and implemented by strong, independent agencies. This section uses three of the five indicators in the RDI Policy Governance Sub-Dimension to assess the SEE economies' RDI policy frameworks.

- The **strategic approach** indicator assesses the very important role RDI strategies play in innovation policy governance. They help to emphasise the role that RDI plays in a country's overall economic development, to prompt the main players to rise to societal challenges and to steer and attract private investment (OECD, 2014a). The monitoring and evaluation of RDI policies has become a key aspect of RDI policy governance that OECD countries have built into their most recent RDI strategies.
- The **co-ordinated approach** indicator measures how an economy approaches the challenging task of co-ordinating RDI policies between the large number and range of stakeholding ministries and agencies. Typically, science- and economy-related ministries take some ownership of the implementation of innovation policies. Both horizontal and vertical co-ordination is called for across the policy cycle – within and between ministries and their agencies.

  High-level policy councils are one key mechanism for co-ordinating RDI policies (see Box 4.2). They may be government advisory bodies to the government that co-ordinate and align policies between ministries. Or they may operate like a "horizontal ministry of innovation" with the task of joint planning (OECD, 2012).
- The **RDI policy implementation** indicator separates policy making from policy implementation which yields greater flexibility, independence and better responsiveness to changes in economic needs (OECD, 2010a). It also improves the evaluation of programmes and puts the emphasis firmly on performance-based funding (Innovation Policy Platform, 2013). To implement RDI policies,

countries can use a single agency that handles both research grants and innovation support programmes, or they may operate a research agency and a separate innovation promotion agency.

Policy frameworks are not generally very advanced in South East Europe, although some individual economies fare better than others, as Table 4.1 shows.

Table 4.1. **RDI Policy Governance Sub-Dimension: Strategic approach to innovation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Strategic approach	2.5	0.5	1.5	3.0	1.0	1.0
Co-ordinated approach	1.0	0.5	0.5	3.0	1.5	1.0
RDI policy implementation	2.5	0.5	1.5	3.0	1.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Box 4.2. **Research and Innovation Council, Finland, an example of good practice**

Governments may set up innovation council to improve the co-ordination of innovation policy at the highest levels of government. Finland has a Research and Innovation Council, chaired by the Prime Minister, to co-ordinate its national science policy. Its members are the Minister of Education and Science (co-chair), the Minister of Economy (co-chair), the Minister of Finance, up to six other ministers appointed by the government and ten other members appointed by the government for the parliamentary term. The Council's membership reflects the full spectrum of expertise in research and innovation.

The Innovation Council in Finland assists the government and its ministries by following national and international developments in research, technology and innovation, addressing important matters in the development of science, technology and innovation policy and the human resources they entail, and preparing proposals and plans for the Government. The Council also prepares advice to the government on the development and allocation of public research and innovation funding. Finally, it co-ordinates all government activities in the field of science, technology and innovation policy.

Since it came into being, the Council has developed two national strategies for RDI in Finland, the latest one being "Reformative Finland: Research and Innovation Policy Review 2015-2012". Its wide-ranging expertise has allowed it to take into account national, EU and global economic and RDI trends and to base its recommendations on OECD analysis and EU documents.

The Council's objective is to tackle some of the main issues facing Finland today. For example, even though Finland has the third highest R&D intensity in the world (at 3.4% of GDP in 2012), private sector expenditure has dropped by 5% since 2000 and the country has not used R&D inputs significantly enough in terms of increasing exports of knowledge-intensive products and services, innovation rate of SMEs or other outputs. Still, some of the proposed measures are starting to take effect as Finland performs better on average than other OECD countries when it comes to collaborative work between business and academia, international co-operation for innovation, the quality of scientific publications and funding received from the EU framework programme.

Source: Finnish Ministry of Education and Culture (n.d.), *Research and innovation council,* www.minedu.fi/OPM/Tiede/tutkimus-_ja_innovaationeuvosto/?lang=en.

The most advanced economy is the Former Yugoslav Republic of Macedonia, which scores 3 on all three indicators, meaning that not only has it drafted and formally adopted its policy framework, it also has full provisions for implementation. The national innovation strategy of the Former Yugoslav Republic of Macedonia was prepared with the assistance of the OECD and adopted in 2013. Its implementation is fully under way thanks to a World Bank loan which provides the necessary finance for the policy instruments.

The National Committee for Innovation and Entrepreneurship at the Prime Minister's Office was established when the strategy was being drafted, as was the Advisory Group for Innovation. Both bodies are made up of representatives from all the relevant ministries and from the private sector. The Committee has a clear mandate to examine a wide range of policies that goes beyond R&D, education and innovation. Finally, the Former Yugoslav Republic of Macedonia has also set up very efficient funding agencies to implement the policies.

The other economies do not typically have formally adopted innovation strategies, though they may have developed a draft (as Kosovo has done with OECD assistance) or, like Serbia, be in the process of drafting. R&D strategies also incorporate innovation, usually in the form of technology transfer – the so-called "science push" approach.

Nor do the other economies have formal mechanisms for policy co-ordination. Some form of co-ordination is done by research councils, but they confine themselves to setting the priorities for pure research, as they have no private sector representation and do not deal with business innovation.

On the implementation front, three of the economies (Albania, the Former Yugoslav Republic of Macedonia and Serbia) have set up independent implementing agencies, while the other three economies have kept implementation within the ministries.

As the SEE economies look to the future, they could consider the benefit they would derive from a dedicated innovation strategy. It should include clear action plans and address policy instruments that act as an incentive for collaboration between industry and academia and private sector RDI activities. To ensure effective implementation of the strategy, a national level co-ordinating body for innovation policies could be created with members from all the relevant ministries, academia and the private sector. SEE policy makers could build monitoring and evaluation of policies into the strategy. Finally, professional implementing agencies could take charge of implementing policy measures.

More instruments are needed to govern the strategic development of public research organisations

There are many ways in which governments can steer the work of public research organisations (PROs). They can give direction in the form of long-term objectives, goals and plans. Indeed, PROs' long-term research programmes often have to be approved by the government. It is important to include a variety of skills and backgrounds in PROs' governing bodies and to include private sector representatives. Finally, many OECD countries require regular self- and external evaluations of PROs (OECD, 2011a). The **governance of PROs** indicator reflects the development of these factors.

Table 4.2. **RDI Policy Governance Sub-Dimension: Governance of PROs indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Governance of PROs	2.0	1.0	1.5	3.0	1.5	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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In SEE economies, national strategic visions are not reflected in PROs' long-term research plans which they do not set or co-ordinate in any way with national priorities and policies. Governments chiefly confine themselves to generally supervising PROs, with only a few providing high-level direction or being involved in setting PROs' objectives. Typically, PROs' governing boards comprise a mix of government-appointed representatives and PRO employees – it is their job is to ensure that the PRO is operating in compliance with the law.

In the PRO accreditation processes, which most of the SEE economies have, PROs submits their long-term research plans and governments typically approve them automatically if all other accreditation criteria are met. Indeed, most of the SEE economies do not include independent members in PROs' governing boards or perform independent evaluations of PROs.

However, recent amendments to the Law on Higher Education in the Former Yugoslav Republic of Macedonia, adopted in 2013, contain provisions for advisory councils in all universities in which representatives from the business sector and local government would sit. As for independent assessments, ten higher-education institutes (HEIs) were recently evaluated in Montenegro as part of the project, higher education and research for innovation and competitiveness (HERIC). The World Bank has also examined the technology transfer capacities of six public R&D institutes in Serbia. No economy performs such assessments on a regular basis, though.

As the SEE governments look to the future, they might consider improving the governance of PROs to ensure that their research plans meet national strategic goals. As a first step, the private sector should be included in the governing bodies of research organisations and the government consulted over the long-term research plans of individual institutions. Regular external evaluation would ensure that PROs comply with the agreed objectives.

International RDI co-operation is sought to offset low critical mass

International co-operation in R&D is increasingly important in OECD and partner countries. In many countries, particularly those that participate in the EU Framework Programme, funding from abroad accounts for a significant share of overall R&D expenditure. In all countries, though, the competition to attract and retain top talent is becoming a priority and the internationalisation of research is one way to do so.

International RDI co-operation also exposes the local research community to new ideas, fosters healthy competition which leads to excellence, taps into foreign funding opportunities and gives access to international research organisations (such as the European Centre for Nuclear Research (CERN).

The **international RDI co-operation** indicator assesses how developed government tools in this area are. Typically, countries use bilateral or multilateral agreements to promote international RDI co-operation. The intensity of government-backed

co-operation can range from researcher exchanges to the financing of joint projects. International research centres and extensive research infrastructures can also provide a strong basis for cross-border collaboration. The latest policy trend in OECD countries has been to offer financial incentive for joint international projects – either through performance-based institutional funding or project funding (OECD, 2014a).

Table 4.3. **RDI Policy Governance Sub-Dimension: International RDI co-operation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
International RDI co-operation	1.5	2.0	1.5	2.5	2.5	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323036

Other tools include joint projects, promotion and information campaigns, and mobility schemes. To stimulate the inward international mobility of students and researchers, OECD countries have used key policy instruments like financial incentives, favourable working conditions, recognition of qualifications, social and cultural support, special immigration policies and the lure of an overall international environment (OECD, 2014a).

International co-operation remains a significant source of R&D funding for the region. On average, 10% of gross domestic expenditure on research and development (GERD) in the SEE region stems from international sources – the same percentage as in the EU countries – chiefly from EU framework programmes for research and innovation.

All SEE economies implement active measures to support international co-operation in R&D and innovation. Measures include bilateral and multilateral co-operation agreements, incentives built into domestic project funding, support for researchers preparing project applications in response to EU calls for proposals, training programmes and workshops.

All SEE economies are automatically eligible for the European Framework Programme for Research and Innovation, "Horizon 2020" funding. All SEE economies, save Kosovo,[2] have been "associated countries" of Horizon 2020 since 1 July 2014. They also participated as associated countries in the Seventh Framework Programme (FP7) with varying degrees of success. Finding consortium partners, preparing successful applications and motivating SMEs to take part were all challenges in FP7 for the SEE economies (Table 4.4). They will be even more daunting when the region joins in the highly competitive, excellence-based Horizon 2020. The only economy in the region to be an Associate Member of CERN is Serbia.

Table 4.4. **SEE economy participation in Seventh Framework Programme**

	ALB	BIH	KOS	MKD	MNE	SRB
Number of participants	32	42	5	98	51	292
Total EU financial contribution (EUR millions)	2.0	2.5	0.3	10.7	4.1	52.2
Number of applicants	280	363	28	594	194	2 059

Source: Marinkovic, I. and E. Dall (eds.) (2014), *R&D and innovation in Western Balkans: Moving towards 2020*, www.wbc-inco.net/object/document/13962/attach/PUBLIKATION_WBCINCO_web.pdf.

StatLink http://dx.doi.org/10.1787/888933323045

The average regional score of 2.1 in the qualitative indicator, international RDI co-operation (Figure 4.5) – which measures the region's policies in support of collaborative RDI between countries – is one of the highest in the whole RDI Dimension. One contributory factor is the recent adoption of the regional Western Balkan R&D Strategy for Innovation, as the indicator factors in regional co-operation (Box 4.1).

The SEE economies' next step in improving international RDI co-operation is to adopt policies which actively support their researchers when they apply to join international RDI projects. Action to internationalise research could also include stimulating co-operation with research diasporas, exchange programmes, attracting foreign researchers and other policy instruments.

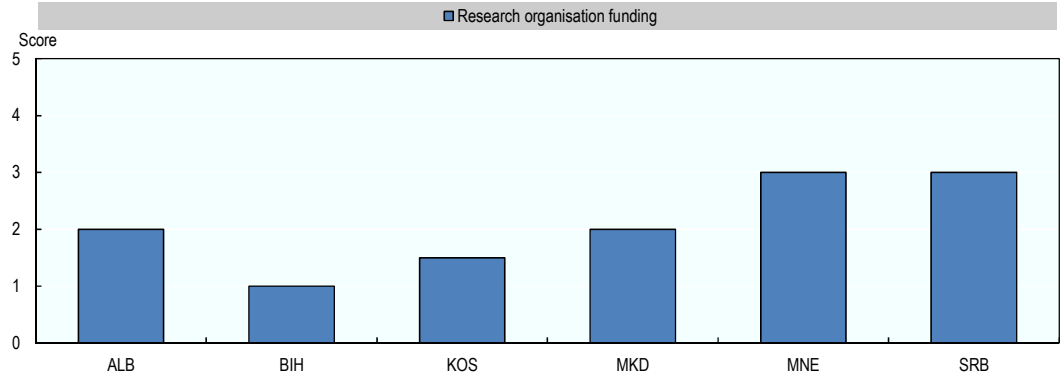
Research Base Sub-Dimension

The Research Base Sub-Dimension examines what economies in the region are doing to build a strong research base and create the conditions for research excellence. Although research organisation funding is the only qualitative indicator in this sub-dimension, it also covers important quantitative indicators such as expenditure on R&D and numbers of researchers. The number and quality of scientific publications are also cited as a measurement of the SEE economies' research output.

Public sector research institution activity and R&D in higher education have a direct, substantial impact on productivity and growth in the long term (Guellec and van Pottelsberghe de la Potterie, 2001). Research excellence is a pre-condition of innovation and competitiveness. That is why support for it is at the heart of "Horizon 2020" with a dedicated budget of EUR 79.3 billion for the period 2014-20 (EC, 2011a).

All SEE economies fund research organisations through a mix of institutional and project-based funding as indicated by no economy scoring less than 1 (Figure 4.6). In Montenegro, the Former Yugoslav Republic of Macedonia and Serbia, project-based funding is conducted through a peer-review process with clearly defined quantitative and qualitative criteria. It is often not competitive, however, and projects are not awarded the levels funding they request.

Figure 4.6. **Research Base: Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

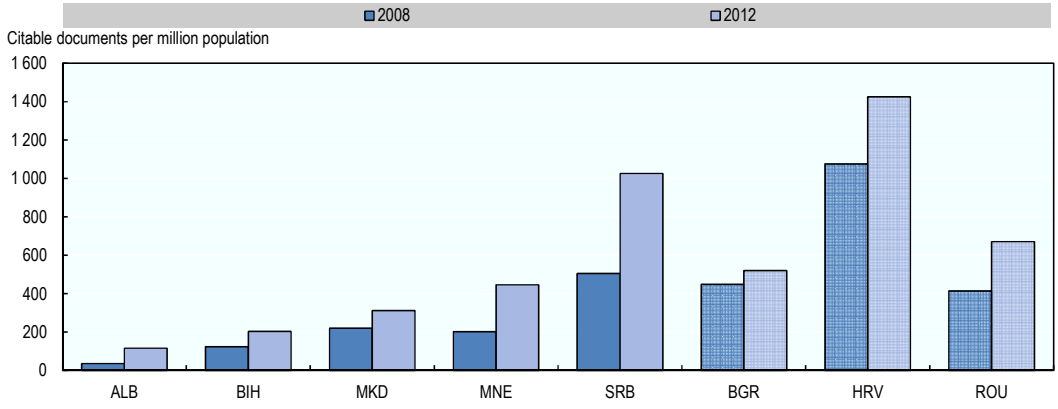
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Scientific publications show that some recent RDI policy measures are bearing fruit

The number of citable documents published by local researchers has been steadily growing in all the SEE economies (Figure 4.7), although the number of publications in Albania, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia is still lower than in the rest of the region.[3] Serbia is now publishing more documents per million inhabitants than Bulgaria and Romania. The high rate of increase in numbers of scientific publications in Serbia has come in the wake of a new legal framework for R&D introduced in 2003. It transformed all research funding into project funding, putting strong emphasis on internationally recognised publications and even tying researchers' salaries to their output.

Figure 4.7. **Citable documents, 2008 and 2012**

Per million population



Note: Data for Kosovo not available.

Source: Adapted from SCImago Journal and Country Rank (n.d.), *Country Rankings* (webpage), www.scimagojr.com/countryrank.php; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321553

Researchers in the region are, on average, more productive than their colleagues in some EU member countries. When looking at the annual number of citable publications per R&D personnel, the Former Yugoslav Republic of Macedonia registers the highest in the region with 0.55 publications per researcher – more than in Slovenia (0.33), Bulgaria (0.2) and Romania (0.42) and close to Croatia's average 0.6. Similarly, all other SEE economies produce more than 0.35 (SCImago Journal and Country Rank, n.d.; UNESCO, 2014; World Bank, 2015).

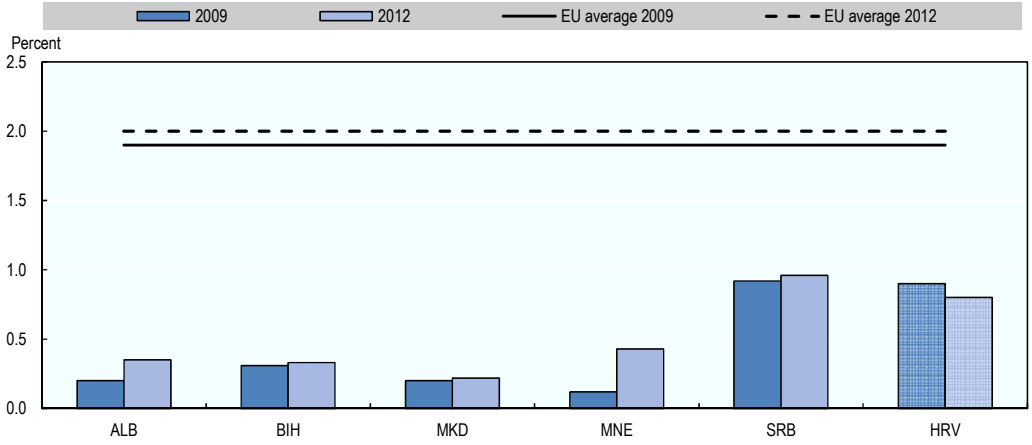
Despite recent improvements, however, the quality of the publications in the region remains low. The number of and journal quality of citations are a measure of a work's recognition. SCImago Journal and Country Rank data find Serbia's average citations per document is 0.38, the same as Croatia's and slightly lower than Bulgaria's 0.41. By contrast, Albania (0.1), Montenegro (0.18), the Former Yugoslav Republic of Macedonia (0.22), and Bosnia and Herzegovina (0.22) register almost twice as few citations per document. The lower quality of publications is also reflected in the fact that all the SEE economies have an h-index that is half Croatia's and those of other EU member countries (SCImago Journal and Country Rank, n.d.).

Overall R&D expenditure is low and researchers are few

Low expenditure on RDI is one factor limiting the further development of RDI in the region. No economy in the region invests more than 1% of GDP in R&D (Figure 4.8). Indeed, gross domestic expenditure on research and development (GERD) is less than 0.5% of GDP in all the economies except for Serbia, compared to the EU average of 2%.

Figure 4.8. **Gross domestic expenditure on R&D (GERD), 2009 and 2012**

As a percent of GDP



Note: Data for Kosovo not available. Data for Albania for the year 2012 as of 2013. Data for the Former Yugoslav Republic of Macedonia for the year 2012 as of 2011.

Source: Adapted from European Commission (n.d.), *Erawatch annual country reports* (webpage), http://erawatch.jrc.ec.europa.eu/erawatch/opencms/information/reports/country_rep/index.jsp?country=-1&count_rep=337f19ee-7d20-11e3-8b01-3b1a37daf5b5; EC (2015), *Sciences and Technology* (Eurostat database), http://ec.europa.eu/eurostat/web/science-technology-innovation/data/database.

StatLink http://dx.doi.org/10.1787/888933321560

However, R&D expenditure in the SEE region did not fall during the economic crisis and has not fallen since. Even though GERD is at extremely low levels, the positive sign is that the SEE economies have been able to maintain them.

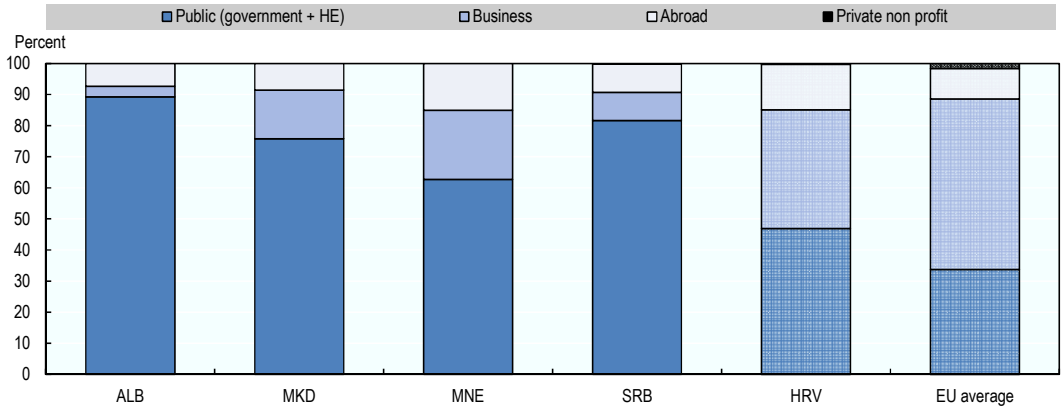
Most R&D expenditure in the region originates from governments (Figure 4.9). The private sector accounts for no more than 25% of R&D in any economy. The EU, by contrast, is coming close to its goal of two-thirds of R&D investment from the private sector – currently businesses account for nearly 55% of all R&D expenditure in the EU. Companies in SEE economies seldom invest in R&D and most research is still carried out in PROs such as universities and research institutes.

Nevertheless, it is worth stressing that business R&D expenditure in the region may be underreported, as there are no R&D tax incentives that would prompt companies to report their expenditure. Indeed, despite the significant fiscal constraints, SEE economies are stepping up their efforts to increase and diversify sources of R&D funding.

Both Montenegro and the Former Yugoslav Republic of Macedonia, for example, have recently launched major new RDI initiatives funded through World Bank loans. Serbia, for its part, is in the process of rolling out a research infrastructure investment programme supported by loans from the European Investment Bank and the Council of Europe Development Bank. However, greater funding needs better policies to ensure that such investment helps foster private sector R&D and improves business competitiveness.

Figure 4.9. **GERD by source of financing, 2012**

As a percent of total GERD



Note: Data for Bosnia and Herzegovina and Kosovo not available.

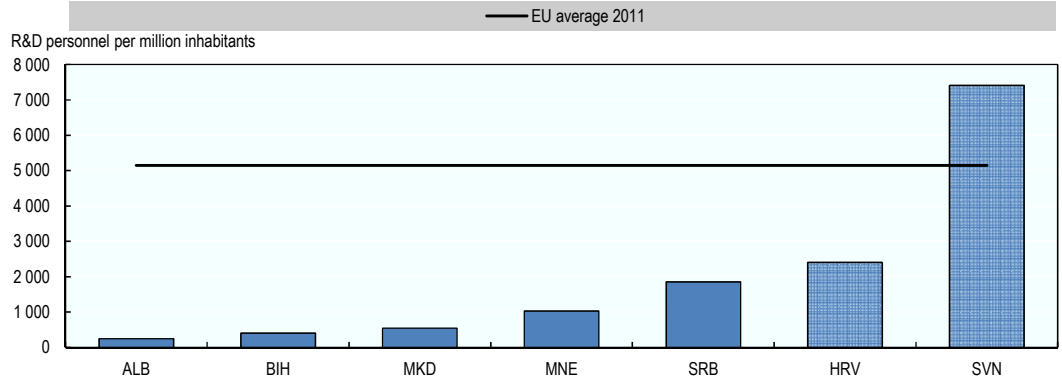
Source: Adapted from EC (2015), *Sciences and Technology* (Eurostat database), http://ec.europa.eu/eurostat/web/science-technology-innovation/data/database; EC (n.d.), *Erawatch annual country reports* (webpage), http://erawatch.jrc.ec.europa.eu/erawatch/opencms/information/reports/country_rep/index.jsp?country=-1&count_rep=337f19ee-7d20-11e3-8b01-3b1a37daf5b5; UNESCO (2014), *UNESCO Institute for Statistics* (database), http://data.uis.unesco.org.

StatLink http://dx.doi.org/10.1787/888933321578

The SEE economies have, on average, far fewer researchers than EU countries (Figure 4.10). Even increased investment cannot boost numbers of new researchers in short periods of time. Furthermore, the SEE economies lack long-term strategies for building human resources for R&D and attracting and retaining top talent.

Figure 4.10. **Total R&D personnel**

Per million inhabitants (FTE)



Note: Data for Kosovo not available. Data for Albania as of 2008; for Bosnia and Herzegovina as of 2007; for the Former Yugoslav Republic of Macedonia as of 2009; for Serbia as of 2012; for Croatia, Montenegro, Slovenia and the EU as of 2011.

Source: EC (2015), *Sciences and Technology* (Eurostat database), http://ec.europa.eu/eurostat/web/science-technology-innovation/data/database; UNESCO (2014), *UNESCO Institute for Statistics* (database), http://data.uis.unesco.org.

StatLink http://dx.doi.org/10.1787/888933321583

The quantity of public R&D funding cannot alone shape future outcomes. It needs to be effectively used, too. To maximise the effect of public R&D funding, most countries combine – in varying proportions – institutional (or "block") funding with competitive project-based funding. While institutional funding allows a certain stability and degree of research autonomy, project funding puts the emphasis on the research outcomes of individual researchers or research teams (OECD, 2014a). Funding mixes vary widely in the OECD, ranging between 26% of the budget being allotted to project funding in Switzerland to 76% in Chile. The recent trend has been to shift towards competitive forms of funding.

In response to the increasingly competitive global environment, some OECD countries have introduced research excellence initiatives, a mix between block and project funding. They provide large-scale, long-term funding to selected research units to help them improve their research infrastructure, recruit top researchers and train new researchers. More than two-thirds of OECD countries are now using such schemes (OECD, 2014b). Norway, for example, runs three kinds (see Box 4.3), all of which offer generous, long-term funding to research teams chosen for their scientific quality and high international standards.

Box 4.3. **Norway's research excellence initiatives, an example of good practice**

Norway's research excellence initiative comprises three types of support: Centres of Excellence (CoEs), Centres for Research-based Innovation (CRI) and the Centres for Environment-Friendly Energy (CEER). The CoE programme is an open competition for excellent basic research which has a strategic impact on the host institution. The CRI scheme is for academic and industrial partnerships and was developed from the CoE programme in 2006. All programmes are implemented by the Research Council of Norway

All three programmes provide generous, highly selective long-term funding. The CoEs receive between EUR 1 and 2 million of annual funding for periods of 5 plus years at a time and are expected to generate in-kind funding from their host institution. The criteria for selecting CoEs are scientific quality and high international standards. CRIs, for their part, are funded up to eight years. In 2011, Norway funded 21 CoEs, 21 CRIs and 11 CEERs. The rigorous evaluation of applicants translates into the low rates of successful applications –18% for the CoE programme and only 8% for the CRI and CEER schemes.

CoE funding has been particularly successful in promoting researcher recruitment and strengthening the internationalisation of Norwegian research, while CoE and CRI programmes have helped create networks of national and interdisciplinary collaboration.

The competitive nature of all three research excellence initiatives has helped to raise the standards of research in general. They have led to a stronger focus on scientific leadership and strategies. Both CRIs and CEERs have increased the number of partnerships between industry and academia. CRI has encouraged application-oriented research that has benefited supporting industries and organisations in the public sector through innovative ideas for enhancing processes and product development.

Source: OECD (2014b), *Promoting Research Excellence: New Approaches to Funding*, http://dx.doi.org/10.1787/9789264207462-en.

The **research organisation funding** indicator assesses the extent to which economies have developed funding policies.

Table 4.5. **Research Base Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Research organisation funding	2.0	1.0	1.5	2.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323052

Montenegro and Serbia have taken active measures over the past 15 years to emphasise research excellence through fair, competitive funding mechanisms. All the SEE economies, in fact, have instituted some form of project funding for R&D. The Former Yugoslav Republic of Macedonia increased its percentage of grant funding from 33% in 2009 to 66% of total R&D funding in 2012 (EC, 2014b). As for Serbia, it has awarded all its research grants through project based funding since 2003. However, calls for proposals in Serbia tend to have an extremely high success rate (over 80%), which suggests its project funding is not serving its main purpose of identifying and supporting excellence in research.

Most SEE economies award project-based funding through a competitive bidding process. The criteria, however, are restricted to domestic peer reviews and quantitative scientific output. Very few economies have included co-operation with industry and patents as grounds for awarding projects. Serbia is the only economy which has consistently assessed project proposals through international peer reviews.

To truly support research excellence, SEE economies could consider fine-tuning their R&D funding instruments and applying clear, transparent selection criteria that include not just research excellence but output such as patents, for example. Whenever possible, international peer reviews should be used.

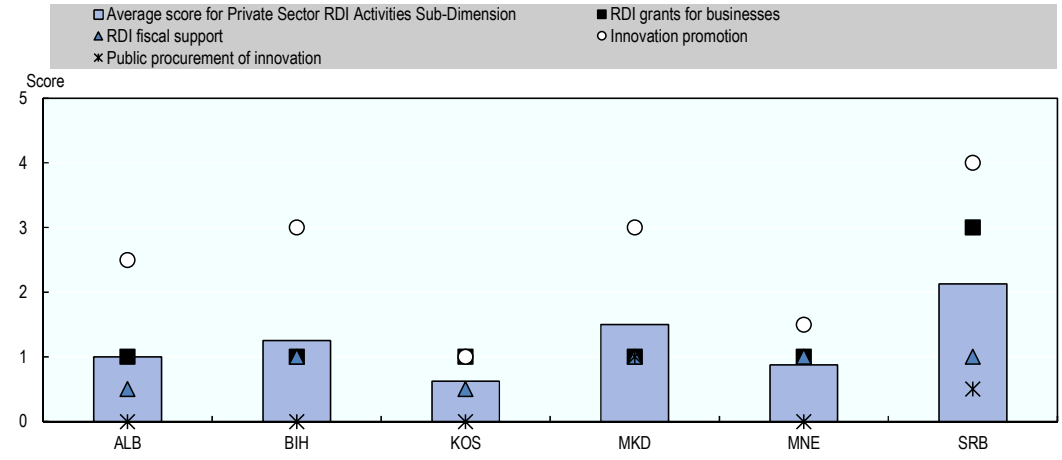
Private Sector RDI Activities Sub-Dimension

The Private Sector RDI Activities Sub-Dimension examines policy measures to support private sector R&D and innovation and stimulate firms' expenditure on R&D. Such measures include grants for businesses' R&D activities, fiscal support for RDI, demand-side policies to support innovation and innovation promotion activities geared primarily to the private sector. With an average regional score of 1.2, this is the lowest-scoring sub-dimension in the R&D and Innovation Dimension.

Financing is the most meaningful support that can be offered to innovative SMEs. Indeed, SMEs in the EU consider access to finance to be one of their most pressing concerns (EC, 2011b). Innovative SMEs, and start-ups in particular, have to contend with financial constraints due to the risk inherent in private sector RDI – it is too long-term and high-risk for investors. SMEs and early-stage businesses face the same problem in the SEE economies (Figure 4.11) which score an average of 1.2 when it comes to enabling business RDI activities.

Generally speaking, the SEE economies are making efforts to promote innovation in companies, but very few are offering them grants to engage in RDI activities. Serbia and the Former Yugoslav Republic of Macedonia are the only SEE economies with grants specific to private-sector RDI activities. None, however, appear to use policy instruments like fiscal support for RDI or public procurement of innovation, reflected by their scores of between 0 and 1 in both indicators.

Figure 4.11. **Private Sector RDI Activities: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321594

The private sector innovates but does not invest sufficiently in RDI activities

According to the Innovation Union Scoreboard (a Europe 2020 initiative), the Former Yugoslav Republic of Macedonia and Serbia perform well in business product and process innovation. In the Former Yugoslav Republic of Macedonia, 39% of companies reported producing innovation, as did 36% in Serbia, compared to an average of 38% in the EU. Figures are broadly similar when it comes to marketing and organisational innovations – 30% of firms have introduced them in the Former Yugoslav Republic of Macedonia and 39% in Serbia, compared with 40% on average in the EU (EC, 2014a).

However, businesses in the region invest very little in R&D activities. Business R&D expenditure in the Former Yugoslav Republic of Macedonia accounted for only 0.02% of GDP in 2010 (latest data available) and only 0.09% in Serbia, while the figure was 1.24% in the EU (ibid.).

A recent survey of companies in the agro-food sector in Bosnia and Herzegovina revealed that 86% had introduced some form of innovation in the previous three years (OECD, 2013a). A similar survey (with no sector focus) in Kosovo showed that product and service innovations were the most widespread, with 52% of companies having introduced them in the previous three years (OECD, 2013b). A more recent survey of innovative companies in Albania, conducted by the OECD in 2014, confirmed that there is a strong focus in the region on product and process innovation. It also found that only 3% of innovative companies in the Albanian economy had received any foreign or public support for their RDI activities.

Private sector RDI support is lacking

Governments use direct or indirect financial instruments to support RDI activities in the private sector. They might offer direct support like grants for businesses (which can also be designed to include a matching component), or indirect support such as tax incentives and demand-side policies to encourage innovation in the private sector.

- The **RDI grants to businesses** indicator assesses how governments use grants to enable businesses to investigate the technical and commercial feasibility of their innovation or to develop a prototype for a new or innovative product, process or service. Such instruments help offset shortfalls in early-stage financing, the scarcity of business development services and poor co-ordination between innovation actors (OECD, 2011b). Because direct support involves evaluating applicants against predetermined criteria of merit (e.g. the quality of the innovation itself or its market potential), policy makers should carefully design evaluations and focus them on specific policy objectives. And they should ensure that project selection is a competitive process.
- The **RDI fiscal support** indicator measures the development of such tools to reduce firms' costs and indirectly encourage them to engage in R&D activities. They allow companies to decide on their own what the nature and scope of their activities will be. Policy makers can develop different types of tax incentives to target different types of companies and expenditure. They need also to safeguard against the possible risk of using such measures by, for example, ensuring that preferential treatment is not given to large or international firms (as small firms may have less resources for processing complex tax claims).
- The **public procurement of innovation** indicator is one form of demand-side policies which governments can use to foster innovation (others include regulation and standardisation). Innovation criteria can be included in public procurement by replacing technical specifications with functional requirements. The practice can favour innovative solutions and, although it might generate a certain cost in the short-term (the lowest price not being the only criterion), it might also produce long-term economic benefits (OECD, 2011c).

Serbia has progressed the most in the region when it comes to supporting private sector RDI activities. The Innovation Fund of Serbia has been supporting business RDI activities since 2012. It runs two grant programmes: one for mini grants of up to EUR 80 000 that are 15% co-financed and another for conditional matching grants of up to EUR 300 000 which are 30% co-financed (Innovation Fund of the Republic of Serbia, n.d.). So far, the Innovation Fund has awarded EUR 6 million to companies across Serbia in various sectors.

Table 4.6. **Private Sector RDI Activities Sub-Dimension: Support for RDI activities in businesses indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
RDI grants for businesses	1.0	1.0	1.0	1.0	1.0	3.0
RDI fiscal support	0.5	1.0	0.5	1.0	1.0	1.0
Public procurement of innovation	0.0	0.0	0.0	1.0	0.0	0.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323064

The Former Yugoslav Republic of Macedonia, for its part, has recently set up its Fund for Innovation and Technology Development. It issued its first call for proposals from companies in February 2015.

The SEE governments do not use indirect financing instruments. None has made any attempt to publicly procure innovation and only the Former Yugoslav Republic of Macedonia and Serbia make reference to plans for demand-side policies in their RDI strategies. Similarly, no SEE economy offers companies tax breaks to encourage their RDI activities, even though they all mention tax incentives as an important measure in their strategic documents.

As the SEE economies look to the future, they might think of developing a spectrum of financial instruments to support companies across the innovation chain – from prototyping activities to entering the market and scaling up. Instruments should be carefully designed in accordance with international good practice and governments should build their administrative capacities to implement them.

RDI promotion reaches the general public in a variety of ways

Some public programmes in OECD countries encourage RDI in firms by providing information and advice. The programmes seek to address the fact that it is costly for small firms to access information and that they may not know what their needs are with respect to research, development and innovation. In addition, many countries and institutions organise business plan competitions with specific focuses – technological innovation, non-technological innovation, design, marketing, social innovation, etc.

Such initiatives aim not only to promote innovation but to offer investment-readiness support to applicants by helping them prepare business plans and pitch their ideas to investors. Some competitions also help winners raise additional financing, as access to finance is cited as one of the biggest follow-up challenges they subsequently face.

The **innovation promotion** indicator evaluates the development of programmes to promote RDI to key stakeholders.

Table 4.7. **Private Sector RDI Activities Sub-Dimension: Innovation promotion indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Innovation promotion	2.5	3.0	1.0	3.0	1.5	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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With an average score of 2.5 (Table 4.7), innovation promotion is the highest-scoring qualitative indicator in the RDI Dimension. There are many measures and schemes in the region to promote R&D and innovation to entrepreneurs, businesses and the general population. They include the "Best Technological Innovation" business plan competition in Serbia and Republika Srpska, the Balkan Venture Forum, the KosICT conference in Kosovo and many others.

The next step for the SEE economies would be to provide clear information on all existing events and support instruments for businesses and entrepreneurs and (in the local language) to help them apply for international schemes.

Business-Academia Collaboration Sub-Dimension

This section considers the Business-Academia Collaboration Sub-Dimension. It examines policy instruments that support collaborative RDI work between research organisations and industry and promote the transfer of technology, especially from the

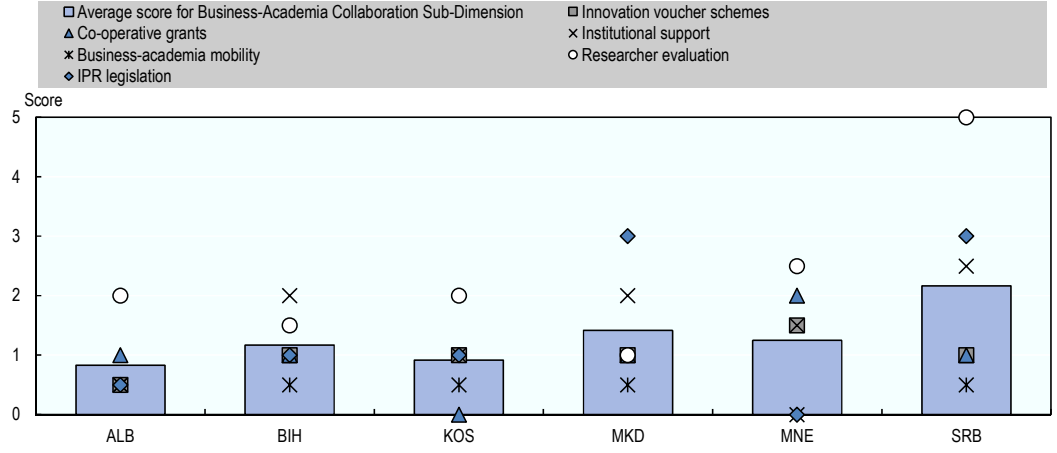
public research sector to the private sector. The section also looks at intellectual property rights legislation in publicly funded research and at patenting activity in the region.

Governments, research institutions and businesses all play a key role in developing innovation, coming together in the dynamic co-operation described by the Triple Helix Model of Innovation. The Triple Helix Model was developed by Henry Etzkowitz and Loet Leydesdorff in the 1990s (Etzkowitz and Leydesdorff, 1998) and has gained prominence in recent years. Its more recent understanding of the knowledge-based economy stipulates that the creation of the knowledge base depends on the synergies between the three main actors of the economy – university, industry and government. The triple helix concept is also often referred to as the "knowledge triangle".

Public policies in support of business-academia collaboration and technology transfer have seen changes in recent years. Whereas patents, licences and spin-offs remain important channels for commercialising technologies, new channels – collaborative research, the mobility of researchers, contract research, etc. – have gained importance (OECD, 2013c).

In general, SEE economies have not yet put in place policy mixes for supporting collaboration between the business and academic communities or for creating the conditions for technology transfer. Most governments are in the phase of developing or piloting different instruments (Figure 4.12), which gives the region an overall average score of 1.3 in the Business-Academia Collaboration Sub-Dimension.

Figure 4.12. **Business-Academia Collaboration: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Business-academia co-operation is underfunded

Financing business-academia co-operation can take several forms and serve either to promote linkages between individual researchers and businesses or to support joint project activities. Two qualitative indicators measure the use of funding instruments to incentivise collaborative ventures between public research and private business – innovation voucher schemes and co-operative grants.

The **innovation voucher scheme** indicator assesses the availability of small lines of credit that enable SMEs to purchase services from public knowledge providers. They are designed as incentives for small firms to introduce innovations (new products, processes or services) in their business operations (OECD, 2010b). Innovation vouchers are also important as they afford SMEs opportunities for greater exposure to public knowledge providers such as universities and research organisations. They thus help SMEs overcome obstacles like their perceptions of public institutions as irrelevant to business or their reluctance to take on the costs of identifying relevant providers.

The **co-operative grants** indicator evaluates the use of competitive grants to give businesses opportunities to launch joint research initiatives with researchers, turn research into socio-economic results and boost private sector productivity via innovation (OECD, 2013c). Many countries propose different forms of co-operative grants. Typically, they require the joint participation of research organisations and businesses and often require some level of co-financing. Such partnerships can be short- or long-term and are often centred on a firm-specific problem.

Table 4.8. **Business-Academia Collaboration Sub-Dimension: Financing indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Innovation voucher schemes	0.5	1.0	1.0	1.0	1.5	1.0
Co-operative grants	1.0	1.0	0.0	1.0	2.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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No SEE economies systematically use innovation vouchers to build linkages between companies and researchers. There was one attempt to pilot a scheme in Kosovo, but there was low interest and most applicants failed to meet the conditions of the call. As a result, only 3 out of 40 expected vouchers were granted.

However, countries do recognise the importance of innovation vouchers and many have included them in future plans and even in budget/IPA planning documents. Some countries do use SME vouchers but not specifically to engage public knowledge providers or develop innovation in businesses.

Montenegro is the only economy in the region to have introduced co-operative grants. The Higher Education and Research for Innovation and Competitiveness Project (HERIC) in Montenegro offers them. R&D funding is given to consortia where there is at least one domestic R&D institution, one foreign R&D institution and one business partner. Other economies in the region, such as Albania or Serbia, try to incentivise joint business-academia projects in regular R&D grant schemes by presenting co-operative grants as evaluation criteria or opening them up to businesses. However, without a dedicated grant scheme, there are unlikely to be long-term partnerships formed out of mutual interest.

As the SEE economies look ahead, they might consider making innovation voucher schemes and co-operative grants policy instruments. Vouchers enable businesses and institutions to make the first step of establishing contact and interest in joint work. After that, more sizable funding for joint projects is required. The size and specific design of each instrument needs to be based on good practices and tailored to the needs of local researchers and businesses.

New initiatives offer institutional support for innovation but struggle to be sustainable

Technology transfer and commercialisation require institutional support other than finance from a variety of actors. These actors, often referred to as innovation support organisations, play a critical role in providing infrastructure or services below market rates, together with training, mentoring and other types of support (Table 4.9).

Table 4.9. **Business-Academia Collaboration Sub-Dimension: Institutional support indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Institutional support	0.5	2.0	1.0	2.0	1.5	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Examples of the support offered by innovation support organisations are: technology transfer offices (TTOs), technology incubators and science and technology parks (STPs).

- Technology Transfer Offices (TTOs) assist public research organisations in managing their intellectual assets and changing them into benefits for the wider economy and society at large. TTOs are thus important instruments for bridging the gap between research and innovation – and between researchers and businesses or researchers and government actors (OECD, 2011d). TTOs also help facilitate the transfer of knowledge into the private sector either through spin-offs or licensing agreements. They also facilitate contractual research and assist in the protection and management of intellectual property (Box 4.4), all of which generate revenues for higher education (Thomas, 2007). TTOs have recently taken on another function – the funding of proof-of-concept type activities through their own seed funds (OECD, 2013c).
- Technology incubators support entrepreneurs and start-ups in the early stages of developing their business or innovation. They provide workspace, shared facilities and support services. Their main value added lies in the support services they provide to entrepreneurs and start-ups.
- Science and technology parks (STPs) offer companies physical space and often provide specialised laboratories, business development services and help companies establish collaboration with R&D institutions. STPs are not simply attractive, well-specified office style buildings. Rather, they are complex organisations, managed by specialised professionals, which seek to promote a culture of innovation and competitiveness by managing and stimulating the flow of knowledge and technology between universities, R&D institutions, companies and markets (International Association of Science Parks and Areas of Innovation, n.d.).

The **institutional support** indicator assesses the development of various types of support for technology transfer and commercialisation.

Technology incubators are the most developed form of institutional support for innovation in SEE. All the economies in the region have established such incubators or firmly intend to do so. However, they are almost always donor-funded initiatives and

struggle to achieve sustainability once project funding has ended. Examples of such initiatives are the Innovation Center Kosovo, Innovation Centre Banja Luka and the Business Technology Incubator of Technical Faculties in Belgrade.

Box 4.4. **KU Leuven Research and Development (LRD), Belgium, an example of best practice**

Leuven Research & Development (LRD) is the technology transfer office of the University of Leuven in Belgium and the KU Leuven Association. LRD is a separate entity within the university dedicated to transferring knowledge and technologies from the university to industry and society. LRD has a multidisciplinary team of 85 employees who are technology experts, legal counsellors, IT specialists and business and finance experts.

LRD has three main knowledge and technology transfer activities – supporting research collaboration with companies by advising researchers; setting up and managing joint research projects; and providing legal support for drafting and negotiating agreements. It also handles all aspects of intellectual property rights protection and promotion – it manages the patent portfolio of the KU Leuven Association, for example, and pursues an active patent and licensing policy to generate funds for further scientific research. LRD also supports the creation of new innovative spin-off companies with professional advice and access to venture capital, as well as accommodation in the incubators and science parks of the region. Finally, LRD is a stimulating force behind networking initiatives such as Leuven.Inc (Leuven Innovation Networking Circle) and technology clustering such as DSP Valley and LSEC (Leuven Security Excellence Consortium).

LRD registers up to 160 patents per year, facilitates contract research with a volume of EUR 200 million per year and has created a total of 102 spin-off companies. Overall LRD estimates that it has created around 10 000 jobs in the Leuven region. The technology transfer office contributed to KU Leuven's development from a traditional to an "entrepreneurial university".

LRD's success can be explained by several factors in what is known as "the value chain of innovation". The first is the presence of excellent researchers and cutting-edge research that is carried out at the University of Leuven. However, that research excellence needs to be combined with a spirit of entrepreneurship – researchers need to be encouraged and motivated to commercialise their findings. To that end, LRD found that quick success stories can serve as role models and are greeted with great interest by researchers.

Even though it has been a long process, LRD recognises the importance of raising awareness of both commercialisation opportunities and the support that LRD can provide in patent application, licensing, the creation of spin-off companies and contract research. Today, university-industry collaboration and technology transfer goals are embedded in all structures of the university, as well as the general academic culture.

LRD was also an active partner in planning and setting up the broader infrastructure for innovation in the region, such as clusters, science parks and incubators. Another key ingredient of their success was the availability of seed financing in the first years. Finally, it also comes down to personal leadership, clear concepts and adaptability – as well as good working relations with the government – to jointly preserve and promote the attractiveness of the region.

Source: KU Leuven (2015), *KU Leuven Research & Development - Technology transfer office*, www.lrd.kuleuven.be/en.

Science and technology parks, by contrast, exist only in Bosnia and Herzegovina and Serbia. One of the priorities of the Montenegrin government is the construction of a science and technology park in Niksic which is scheduled for completion in 2015-16.

The most underdeveloped form of institutional support for innovation in the region is the technology transfer office. Although universities in the region have started setting up TTO units, they typically comprise only one or two employees who often lack the experience and expertise to support researchers or companies in what should be regular TTO activities. The craze for TTOs, with every university wanting to set up its own, has led to a fragmentation of capacities. Mid-sized and smaller universities, even in highly developed countries, struggle to support effective TTOs. Hence, the emergence of new models such as regional TTOs that service a number of research organisations (OECD, 2013b).

Incentives for business-academia collaboration have not been built into policy

The right incentives structure can powerfully motivate businesses and research institutions to work together. They do not have to be financial or institutional to generate the desired behaviour. More specifically, they can encourage researchers to move between business and academia, which may change the direction of a researcher's career development or stimulate patenting behaviour at research institutions. Three indicators assess incentives for collaboration between private companies and public research institutions:

Business- academia mobility policies such as entrepreneurial leaves of absence or industrial PhDs facilitate close collaboration between academic staff at universities and private companies. Entrepreneurial leaves of absence, for example, typically allow professors to spend one or two years working in a private company, knowing they will resume their position upon return. Industrial PhDs are programmes designed jointly by research teams and businesses during which PhD candidates carry out research work requested by the private sector and do part of their PhD in a company.

Researcher evaluation has a trend of relying on the "publish or perish" imperative referring to using the number of publications as the main criterion. Many countries have now introduced additional quantitative and qualitative criteria, looking at the quality and not just the quantity, for example, of the publications that researchers have to their name. Examples are the impact factor, citations and the h-index. Other qualitative criteria are scientists' involvement in conferences, scientific journals, training younger researchers and publishing books.

Finally, to encourage the transfer of knowledge to the private sector and intensify links between the business and research communities, many countries include the number of patents and level of collaboration with industry as criteria for assessing the work of individual researchers. When researchers see that they are valued for the quality and range of their work, they are much more likely to collaborate with industry over the long term.

Intellectual property rights (IPR) legislation enables and incentivises the transfer of knowledge between academic institutions and private companies. In the 1980s, the United States passed the Bayh-Dole Act, or Patent and Trademark Law Amendments Act. It legalised the licensing of universities' patents to firms. In the wake of the act, according to the OECD (2003), US universities were granted some 20 000 patents between 1993 and 2000. Over that time, some of those academic patents generated millions of dollars in licensing revenue and led to the creation of over 3 000 new companies. As a result, countries all over the world view the Bayh-Dole Act as a catalyst having increased the social and economic benefits to be gained from publicly funded research.

Table 4.10. **Business-Academia Collaboration Sub-Dimension: Incentives indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Business-academia mobility	0.5	0.5	0.5	0.5	0.0	0.5
Researcher evaluation	2.0	1.5	2.0	1.0	2.5	5.0
IPR legislation	0.5	1.0	1.0	3.0	0.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Serbia has made significant efforts to include incentives for co-operation between business and academia in its legislation. Researchers in Serbia are evaluated nationally on a regular basis. Evaluations include both quantitative and qualitative criteria with different types of output and their results can affects a researcher's salary. The Innovation Law has intellectual property provisions which state that, although the intellectual property stays with the public research organisation, the researchers themselves are guaranteed half of the proceeds therefrom. However, Serbia has no comprehensive policy in place to improve mobility between academia and the private sector.

The Former Yugoslav Republic of Macedonia recently approved legislation that regulates how the intellectual property produced by publicly funded research is considered. The legislation will also facilitate technology transfer services.

There are many barriers in place preventing researchers from committing any of their time to the private sector. Without active measures to support mobility between public research and private business, people with experience of both will be few and far between and a deep cultural void between industry and academia will preclude any future development of innovation.

Researchers are evaluated at universities mainly for the purpose of career development. Only their scientific output (e.g. the number of papers published) is considered. Rarely are qualitative criteria or output related to the transfer of knowledge and collaboration with the private sector (such as patents) taken into account. Finally, in the absence of appropriate legislation safeguarding their intellectual property rights, researchers have no incentive to earn any sort of revenue from their research.

As they look to the future, SEE economies could consider improving financial and institutional support for collaborative partnerships between the academic research community and business. All the SEE economies have identified the lack of co-operation between the academia and industry as one of the key problems in RDI policy making. Further efforts are called for to create a policy mix that includes incentives, financing and support for collaborative ventures.

Conclusions

Governments in the SEE region are putting effort into improving their RDI policy frameworks, generally recognised as a priority in the region. However, overall R&D expenditure is low and still significantly below the EU average, even though it is growing and being used more efficiently.

There is little co-ordination of RDI-related policies and the governance of national RDI policies is often a challenge. The adoption of dedicated strategies and the introduction of national co-ordination bodies would improve matters. The SEE economies

would benefit from building a stronger research base and putting greater focus on research excellence.

Finally, policy makers could go further in giving the private sector incentive to increase its R&D expenditure and businesses and universities incentive to collaborate. To that end, the SEE economies could use a mix of indirect and direct measures and develop the infrastructure required to enable private sector involvement in the RDI process.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).
2. Kosovo has a "developing country" classification under Horizon 2020.
3. Data for Kosovo are not available.

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Chapter 5.

Digital society in South East Europe

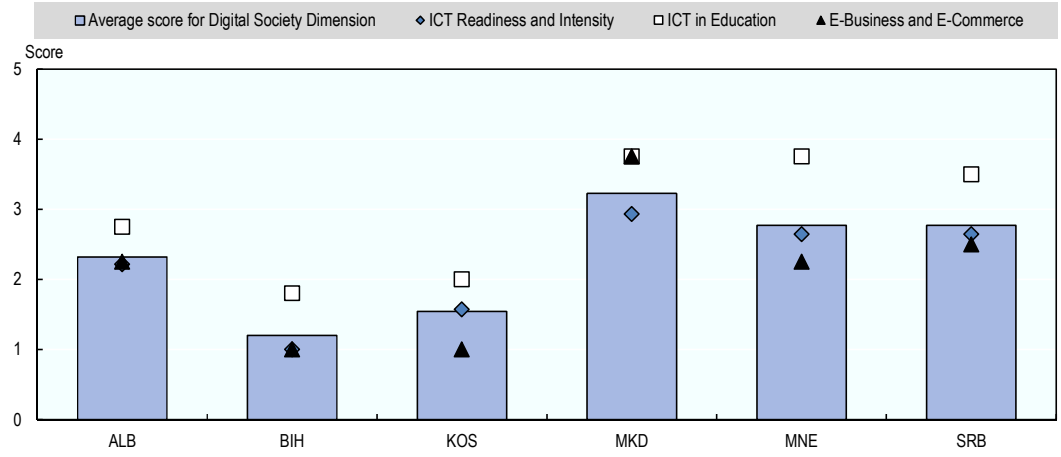
A digital society is one that seeks to exploit the full potential of information and communication technology (ICT) to spur innovation, economic growth and regional competitiveness, and to improve the quality of life. This chapter on the Digital Society Dimension focuses on three sub-dimensions in its assessment of digital society performance and policy development. The ICT Readiness and Intensity Sub-Dimension examines legal and institutional frameworks for developing a secure and accessible information society. The ICT in Education Sub-Dimension assesses the provision of ICT skills in curricula and how well graduates' ICT skills are matched to the labour market and information society as a whole. The E-Business and E-Commerce Sub-Dimension evaluates regulation and legislation in place to facilitate safe e-commerce.

Main findings

An inclusive digital society fosters innovation, economic growth and improvements in daily life for people and businesses. Information and communication technology (ICT) can ease market frictions, reduce transaction costs and improve competitiveness. The result is improved productivity and economic growth (OECD, 2014). ICT can also help improve the quality of life through the new forms of inter-personal communication and potential for distance learning that it offers.

Overall, there are signs that the economies of South East Europe (SEE) are making progress in their efforts to build an information society. Although the strength of the region's ICT sector is not yet comparable with the European Union's, convergence is progressively taking place. The Digital Agenda for Europe, adopted in 2010, provides all the economies in the region with a core framework for strategies to help them promote a digital society.

Figure 5.1. **Digital Society: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The SEE economies have also taken positive steps towards establishing an institutional and legal framework for promoting a digital society. Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia perform well and on a comparable level, while Bosnia and Herzegovina and Kosovo lag slightly behind on several indicators in this assessment.

The average score for the region is just over 2, which shows that a digital society policy and regulatory framework is mostly in place, though not yet very well implemented. Most of SEE economies' top scores come in the ICT in Education Sub-Dimension. The sole exception is the Former Yugoslav Republic of Macedonia which scores equally well in the E-Business and E-Commerce Sub-Dimension where all the other SEE economies fare the least well. Scores in the ICT Readiness and Intensity Sub-Dimension are mostly in line with the average sub-dimension score, partly because it is the largest dimension.

Achievements

The SEE economies have made progress in developing digital societies.

SEE economies have taken positive steps towards establishing an institutional and regulatory framework for information society, including broadband development. Most SEE economies have adopted a dedicated strategy for digital society and the laws required for putting a regulatory framework in place.

SEE economies have taken action to anchor cybercrime legislation in national penal codes. Most SEE economies have introduced cybercrime legislation in their penal codes and steps have been taken to establish operational cyber incident response teams (CIRTs).

All SEE economies have taken action to adopt mandatory standards for ICT in education. All SEE economies have developed ICT standards for secondary education and in some for primary education. Optional ICT subjects are offered throughout the region in primary education.

All SEE economies have adopted an e-commerce law. An electronic commerce law regulating the proper functioning of the market for information society services has been adopted in all SEE economies. Implementation is advanced in four of the six economies.

Challenges

Despite their achievements, the SEE economies still face a number of challenges that prevent them from developing into fully-fledged digital societies.

Implementation of the national digital society strategies is still in progress and there is room for improvement in the monitoring system. Levels of implementation vary widely between the SEE economies due to differences in capacity and budget allocations. Systematic monitoring and evaluation is seldom done.

Alignment with the EU 2009 regulatory framework for electronic communications is still to be finalised. While most economies recently adopted the EU 2009 regulatory framework for electronic communications, more work remains to be done on implementing the necessary secondary legislation.

E-accessibility remains at an early stage of development. The Former Yugoslav Republic of Macedonia is the only economy in the region which has developed a dedicated e-inclusion action plan. Measures to tackle the digital divide among the rest of the region remain scarce.

Recommendations

Steps and measures which address identified challenges can help support the growth of a digital society that is ready to make wider use of information and communication technologies in social and economic activities.

Advance broadband development through closer co-operation with the private sector. Broadband uptake is generally greater in mobile than in fixed broadband and annual government investment is low. Policy makers could consider action to build more effective public-private partnerships in broadband development.

Develop a strategic approach towards e-accessibility. Leveraging ICT so that the most marginalised groups in society also reap the benefits is a key component of an inclusive information society. Occasional, ad hoc measures are carried out by some SEE economies to improve the accessibility and usability of ICT. A more strategic approach could, however, be envisaged in the future in order to improve digital literacy and competences.

Further develop educational information management systems and allocate budgets that are large enough to implement ICT curricula in primary and secondary schools. ICT standards in school curricula are now well established. Actually introducing ICT curricula in schools is, however, in early-stage development. Coverage thus needs to be widened and a monitoring system for ICT equipment and teaching capacity in schools introduced.

Foster the development of e-commerce by analysing non-legal barriers. Analyses of non-legal barriers to e-commerce – such as the lack of information on laws and the high costs of adopting ICT solutions – would help to increase its use. A useful move in that regard would also be to improve data collection for e-commerce indicators.

Overview

A digital society is one that seeks to exploit the full potential of information and communication technology (ICT) to spur innovation, economic growth and regional competitiveness, and to improve the quality of life (OECD, 2014). Indeed, ICT contributes vitally to GDP and productivity growth in the EU, according to the European Commission in its *i2020, European Information Society for Growth and Employment* (EC, 2005).

Box 5.1. Digital Society Dimension in the SEE 2020 Strategy

The Digital Society Dimension is a part of the Smart Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Smart Growth Pillar is to promote innovation and foster knowledge-driven growth in the region. The SEE 2020 Strategy specifies three key policy fields in the Digital Society Dimension: the development of regional broadband infrastructure to provide high-speed Internet access, cross-border e-services and people's acquisition of digital skills to expand their employment opportunities. The Smart Growth Pillar has a headline target of a 32% increase in average labour productivity over 2010.

The Electronic South East Europe (eSEE) Initiative Secretariat is the official SEE 2020 Strategy Co-ordinator of the SEE 2020 Digital Society Dimension. The eSEE Initiative seeks to support a region-wide information society through projects, technical assistance, the codified sharing of good practices and overall co-ordination facilities.

The structure of the SEE 2020's Digital Society Dimension is modelled on the eSEE Initiative's Agenda+ 2007-2012.[1] Agenda+ sets out the priorities for developing an inclusive information society in South East Europe as agreed by the governments of the eSEE Initiative.[2]

Notes: 1. For further information on the eSEE Agenda Plus, go to www.eseeinitiative.org. 2. The eSEE Initiative signatory economies are: Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia, together with Croatia, the Republic of Moldova, and Romania.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

A well-designed information society strategy with clear action plans will help the SEE governments move towards a knowledge-based economy beneficial to all. In that regard, the OECD's Principles for Internet Policy Making (Box 5.2), spell out the tenets of effective policy for promoting the digital economy.

Box 5.2. OECD Recommendation of the Council on Principles for Internet Policy Making

In June 2011, at an OECD High-Level Meeting on the topic "The Internet Economy: Generating Innovation and Growth", the representatives of OECD Members, Egypt and further stakeholders agreed on a number of basic principles for Internet policy making as an important step in ensuring that the Internet remains open and dynamic. The Council adopted the principles on 13 December 2011.

The OECD Principles for Internet Policy Making call on the international community to promote the digital economy and to develop stakeholder capacity to bring publicly available, reliable data into the policy making process.

The principles include:

- promote and protect the global free flow of information
- promote the open, distributed and interconnected nature of the Internet
- promote investment and competition in high-speed networks and services
- promote and enable the cross-border delivery of services
- encourage multi-stakeholder co-operation in policy development processes
- foster voluntarily developed codes of conduct
- develop capacities to bring publicly available, reliable data into the policy-making process
- ensure transparency, fair process and accountability
- strengthen consistency and effectiveness in privacy protection at a global level
- maximise individual empowerment
- promote creativity and innovation
- limit Internet intermediary liability
- encourage co-operation to promote Internet security
- give appropriate priority to enforcement efforts.

Source: OECD (2011a), *OECD Council Recommendation on Principles for Internet Policy Making*, www.oecd.org/internet/ieconomy/49258588.pdf.

The Digital Society Dimension has close links with other dimensions analysed in this publication:

- **Chapter 4. Research, development and innovation** in all sectors of the economy are driven by ICT. In most OECD countries, it accounts for the largest share of business expenditure on R&D (BERD), between 20% and 25%, and between 0.2% and 0.3% of GDP (OECD, 2014)
- **Chapter 14. Effective public services** includes an important indicator on public e-services. Providing and expanding them so as to improve communication between government and citizens is an important component of policy to foster the digital society.
- **Chapter 3. Education and competences** is increasingly used in OECD and developing countries. Disparities in access to ICT persist, however, even among young people. Schools play a crucial role in reducing this digital gap.

Digital Society Dimension assessment framework

This chapter analyses efforts to build a digital society in the SEE region. It does not seek to be exhaustive, however. It confines itself to assessing three broad sub-dimensions that constitute the Digital Society Dimension based on the Smart Growth Pillar of the SEE 2020 Strategy:

- ICT Readiness and Intensity

  How ready is society for the digital economy? How wide is access to ICTs? How are they used? Is ICT infrastructure in place and to what extent? Is a legal and institutional framework for the development of an information society in place, and how far advanced is it?

- ICT in Education

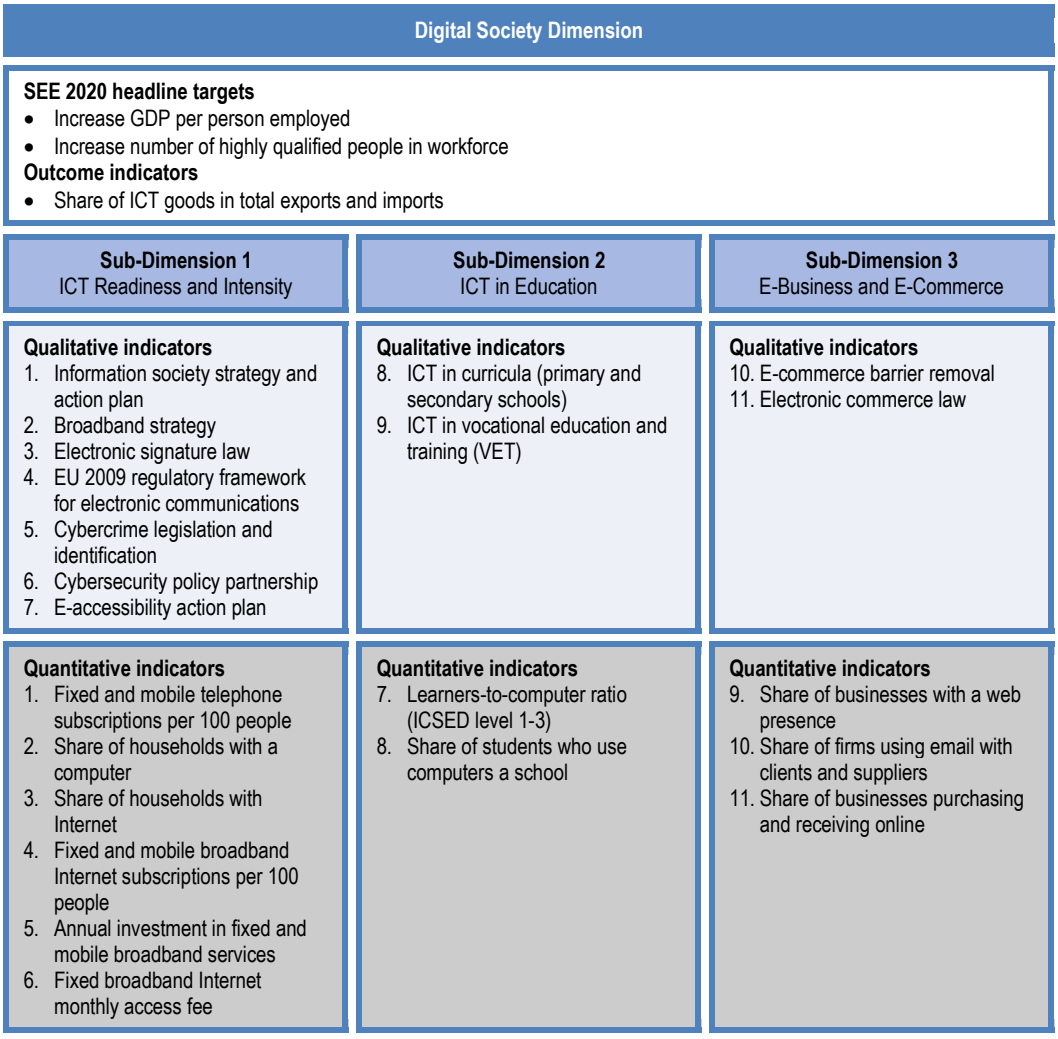
  How ICT-proficient are graduates? Do their ICT skills sets meet the demands of the labour market? How effective are policies for building ICT skills? Is ICT proficiency advanced enough to contribute to society's ICT readiness?

- E-Business and E-Commerce

  How well is e-commerce regulated? What action do governments take to strengthen the potential of e-commerce for supporting economic growth and thus enhancing competitiveness?

Figure 5.2 shows how the sub-dimensions and their constituent indicators make up the Digital Society assessment framework. Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Electronic South East Europe (eSEE) Initiative Secretariat collected qualitative and quantitative data on the Digital Society Dimension. Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Figure 5.2. **Digital Society Dimension assessment framework**



Digital society performance in SEE economies

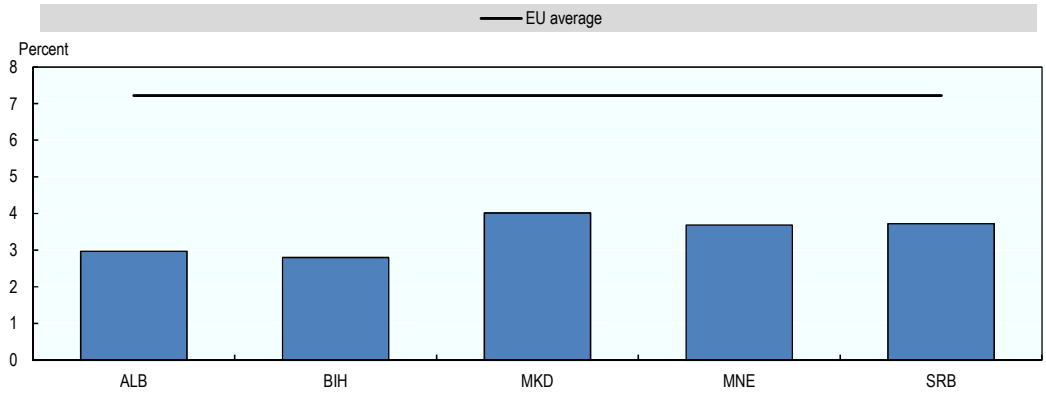
Measuring ICT goods imports as a percentage of all imports is a gauge of how well ICT has been absorbed into society and, therefore, of the sophistication of its use.

In all the SEE economies, ICT import shares are below the EU average. With 4.01%, the Former Yugoslav Republic of Macedonia has the highest share, followed by Serbia and Montenegro. Analysis nevertheless shows that, although the region has not yet converged with the EU, its economies are equipping themselves in readiness for the information society and further strengthening their ICT sectors.

As for ICT goods imports and exports (Figures 5.3 and 5.4), a closer look at them as a percentage of all service exports reveals that the competitive strength of the ICT sector is different between SEE economies. ICT goods exports as a share of overall exports are highest in Serbia, but still below the EU average. It is followed by the Former Yugoslav Republic of Macedonia, Montenegro and Albania.

Figure 5.3. **ICT goods imports, 2013**

Percent of total imports



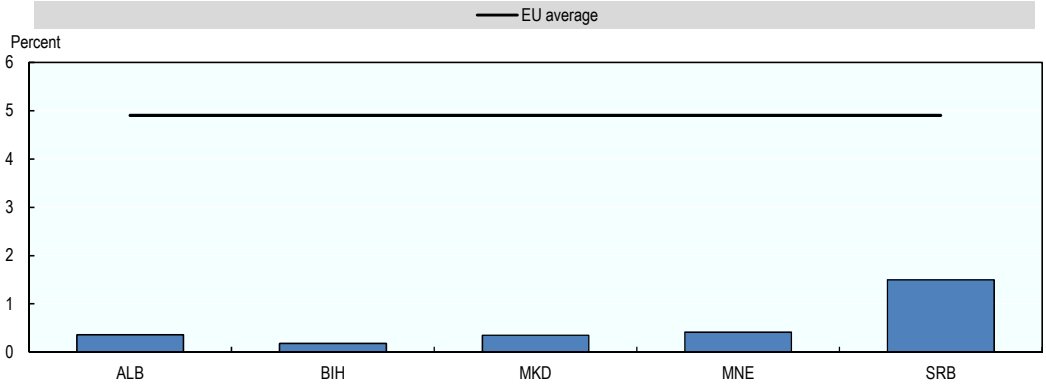
Note: Data for Kosovo not available.

Source: World Bank (2015a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321626

Figure 5.4. **ICT goods exports, 2013**

Percent of total exports



Note: Data for Kosovo not available.

Source: World Bank (2015a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321635

ICT Readiness and Intensity Sub-Dimension

The European Union has recognised the importance of ICT. Accordingly, it has launched its Digital Agenda for Europe, which forms one of the seven flagships of the Europe 2020 strategy (Box 5.3). Its prime objective is to develop a digital single market. It places special emphasis on improving interoperability, fostering the development of high-speed broadband Internet, strengthening online trust and security, and promoting digital literacy, skills and inclusion. The SEE 2020 Strategy's Digital Society Dimension also sees the construction of an information society as central to building competitive, equitable and sustainable knowledge economies and improving the quality of life.

Box 5.3. The Digital Agenda for Europe

The Digital Agenda for Europe set 13 specific goals designed to pave the way for the single digital market:

1. The entire EU to be covered by broadband by 2013
2. The entire EU to be covered by broadband above 30 Mbps by 2020
3. 50% of the EU to subscribe to broadband above100 Mbps by 2020
4. 50% of the population to buy online by 2015
5. 20% of the population to buy online cross-border by 2015
6. 33% of SMEs to make online sales/purchases by 2015
7. The difference between roaming and national tariffs to approach zero by 2015
8. To increase regular Internet usage from 60% to 75% by 2015 and from 41% to 60% among disadvantaged people
9. To halve the proportion of the population that has never used the Internet from 30% to 15% by 2015
10. 50% of citizens to use e-government services by 2015, with more than half returning completed forms
11. All key cross-border public services, to be agreed by member states in 2011, to be available online by 2015
12. To double public investment in ICT R&D to EUR 11 billion by 2020
13. To reduce energy use of lighting by 20% by 2020

Progress against these targets is measured in the annual Digital Agenda Scoreboard, which benchmarks countries against each other and provides a performance overview for each country.

Source: European Commission (n.d.), *About our Goals: Digital Agenda for Europe* (webpage), www.ec.europa.eu/digital-agenda/our-targets-0.

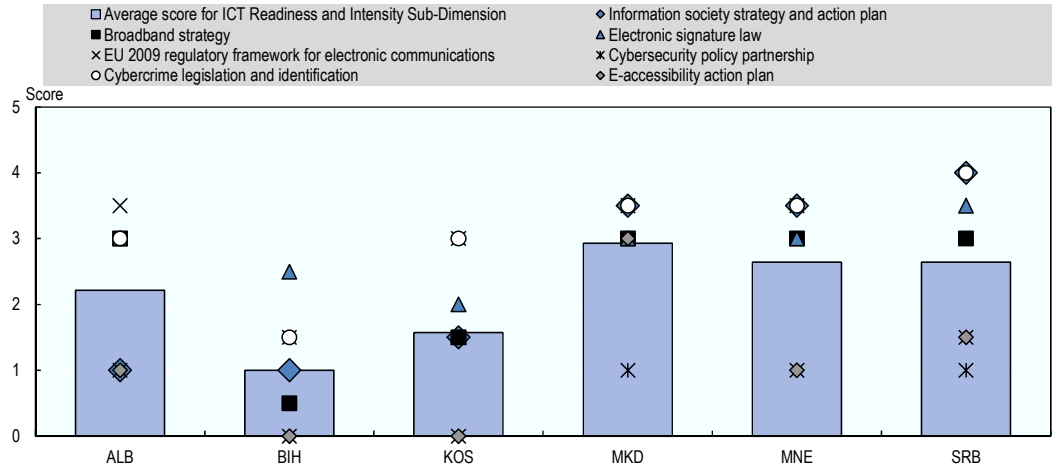
The ICT Readiness and Intensity Sub-Dimension reflects the goals of the Digital Agenda for Europe and assesses ICT access (or supply), use (or demand), quality and affordability. Access to and usage of ICT infrastructure determine a society's readiness for digital communication and offer an indication as to the intensity of its use (OECD, 2014).

Its seven constituent qualitative indicators may, accordingly, be divided into three thematic groups:

- institutional and regulatory strategic frameworks
- cybercrime and network security
- e-accessibility.

Measured against those seven indicators, there is mixed performance in the SEE region in ICT readiness and intensity as Figure 5.5 illustrates. However, a look at the average scores reveals that Montenegro, Serbia and the Former Yugoslav Republic of Macedonia perform on a similar level, with Albania just behind.

Figure 5.5. **ICT Readiness and Intensity: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Institutional and regulatory frameworks governing policy to further the digital society are indeed largely in place. The degree to which the SEE economies have implemented them varies, however. There is a mixed picture when it comes to broadband penetration, though some economies have concrete broadband strategies in place. Most of them have also aligned with the 2009 EU regulatory framework for electronic communications. Secondary legislation still appears to be partially implemented in most of the region, however.

As for cybercrime, most of the region's penal codes have statutes containing such offences, although government co-operation with the private sector on cybersecurity matters is still in its infancy. Policy that addresses e-accessibility to narrow the digital divide is also in very early-stage development.

Six quantitative indicators based on the Partnership on Measuring ICT for Development (OECD, 2011b) and the International Telecommunication Union (ITU) Guide to measuring the Information Society (ITU, 2012) complement the seven qualitative indicators. Both the Partnership and the ITU consider ICT development in fixed and mobile telephony, in Internet uptake and – particularly – in broadband services (fixed and mobile). To measure development, this section borrows indicators from the ITU's three-stage model (ibid.):

- Stage 1: ICT readiness – infrastructure and access
- Stage 2: ICT intensity – level of use
- Stage 3: ICT impact – ICT policy outcomes.

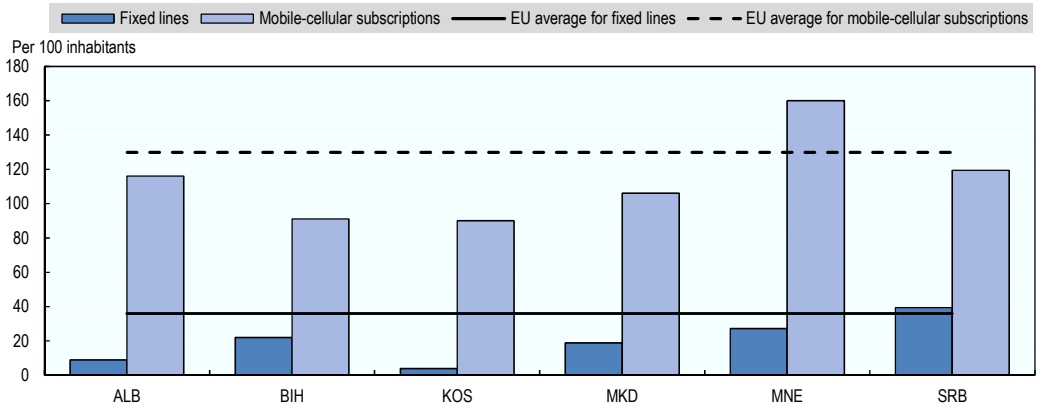
Mobile telephone subscriptions are in line with the EU, but landline subscriptions remain low

Fixed and mobile telephone penetration is measured by landlines and mobile-cellular telephone subscriptions per 100 inhabitants (Figure 5.6). The quality of an economy's power and telecommunications infrastructure is a decisive element in both domestic and foreign investment decisions. It is important therefore that the SEE economies assess their

landline and mobile subscription rates and develop their telephony infrastructure accordingly.

Figure 5.6. **Fixed lines and mobile-cellular telephone subscriptions, 2013**

Per 100 inhabitants



Source: ITU (2014), *ITU World Telecommunication/ICT Indicators Database 2014* (database), www.itu.int/pub/D-IND-WTID.OL-2014; Kosovo Agency of Statistics.

StatLink http://dx.doi.org/10.1787/888933321654

Penetration rates differ considerably between fixed and mobile telephone subscriptions. Throughout the region, landline subscription rates are lower than those for mobile-cellular telephones. While fixed phone penetration is higher than the EU average of 36 in Serbia, with 39 subscriptions per 100 inhabitants, it is lower in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Montenegro. As for Albania and Kosovo, the fixed phone to inhabitant ratio is less than 10 to 100.

The growth of mobile broadband, though welcome, should not replace further investment in fixed lines. The mobile-cellular subscription rate indicator shows that most SEE economies are only slightly below the EU average, with Montenegro, where penetration is greatest at 160 subscriptions, exceeds it.

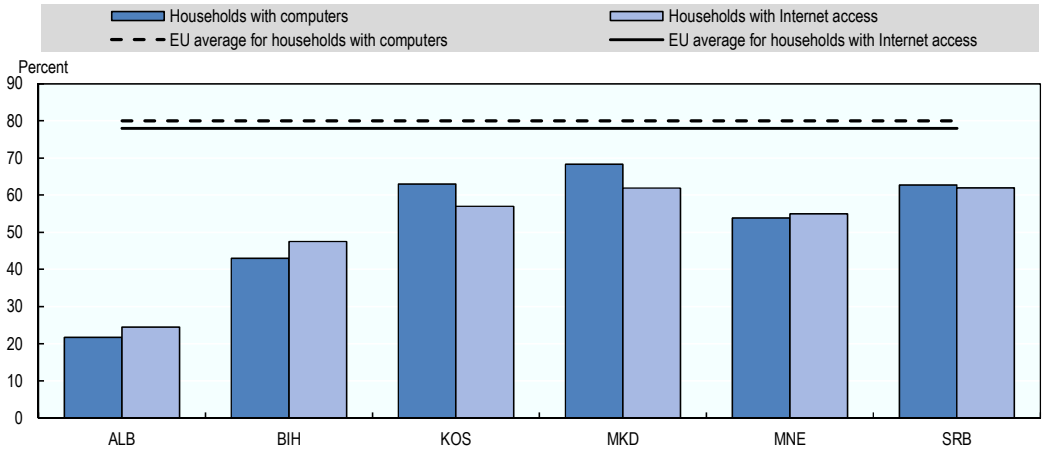
Mobile broadband uptake varies across the region, while fixed broadband remains low

ICT readiness and Internet access are measured by two ITU-defined connectivity indicators: the percentage of households with a computer and the percentage with access to the Internet (Figure 5.7). On both counts, the picture across the SEE region is uneven.

In half of the economies, the number of households with a computer, including tablets, is slightly lower than the number with Internet access, which suggests that other means of connecting to the web are gaining ground. Serbia and, to a lesser extent, the Former Yugoslav Republic of Macedonia and Kosovo show lower rates of Internet access than computer ownership. All three economies are above the regional average. As for Montenegro, more than one household in two is equipped with a computer and Internet access. In Bosnia and Herzegovina, however, and even more so in Albania, the percentages of homes with computers and Internet access are low. When it comes to mobile broadband penetration rates, they are considerably higher than for fixed broadband, although not yet up to the EU level.

Figure 5.7. **Households with a computer and access to Internet, 2013**

Percent



Note: Data for Kosovo as of 2011 due to a lack of more recent data.

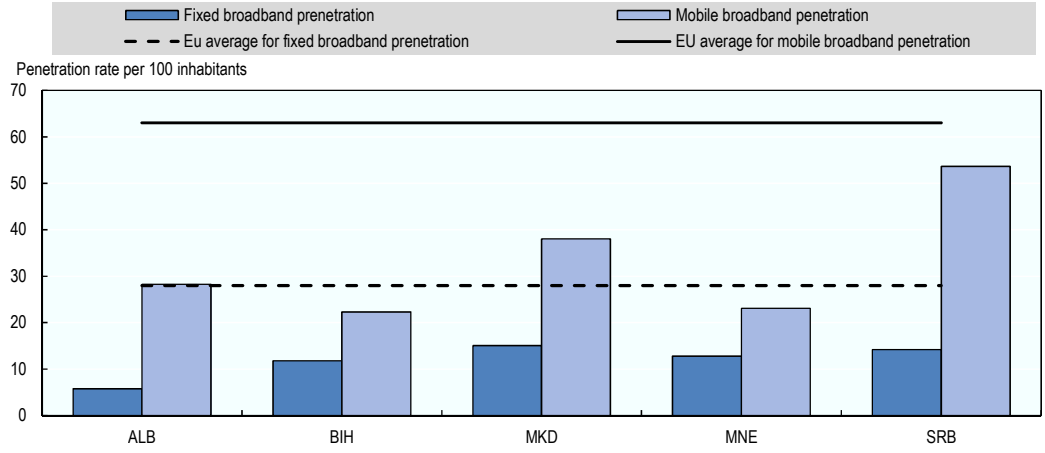
Source: ITU (2014), *ITU World Telecommunication/ICT Indicators Database 2014* (database), www.itu.int/pub/D-IND-WTID.OL-2014; Kosovo Agency of Statistics.

StatLink http://dx.doi.org/10.1787/888933321665

Serbia comes closest to the EU average in mobile broadband subscriptions with a rate of over 50 for every 100 inhabitants. The Former Yugoslav Republic of Macedonia performs well, too, followed by Albania, Montenegro and Bosnia and Herzegovina. As Figure 5.8 shows, there is less variation in fixed broadband penetration, with the SEE region performing, at similar levels, well below the EU average. Fixed broadband penetration rates in Albania are lower than the SEE regional average.

Figure 5.8. **Fixed and mobile broadband penetration rates, 2013**

Per 100 inhabitants



Note: Data for Kosovo not available.

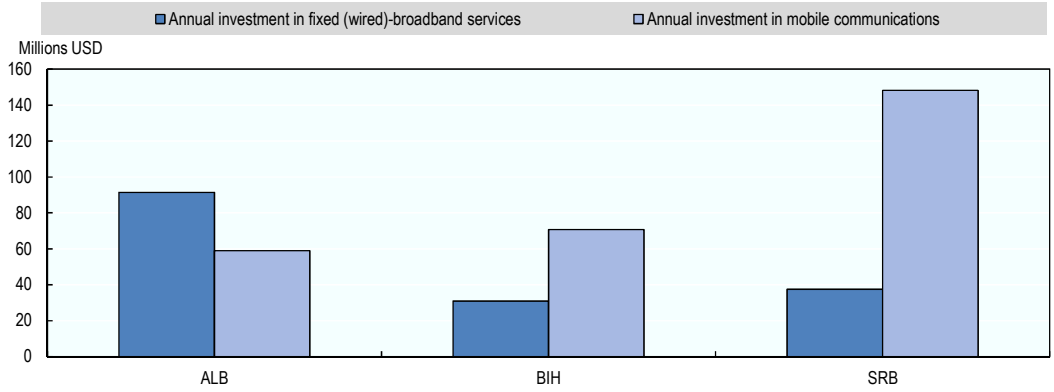
Source: ITU (2014), *ITU World Telecommunication/ICT Indicators Database 2014* (database), www.itu.int/pub/D-IND-WTID.OL-2014.

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When it comes to annual investment in wired broadband services and mobile communications, Albania invests more in fixed broadband development than in mobile communication (Figure 5.9). The reverse is to be found in Serbia and Bosnia and Herzegovina, with Serbia standing out for its particularly high volume of investment.

Figure 5.9. **Annual investment in fixed (wired) broadband services and in mobile communications, 2013**

Millions USD



Note: Data for the Former Yugoslav Republic of Macedonia, Montenegro and Kosovo not available.

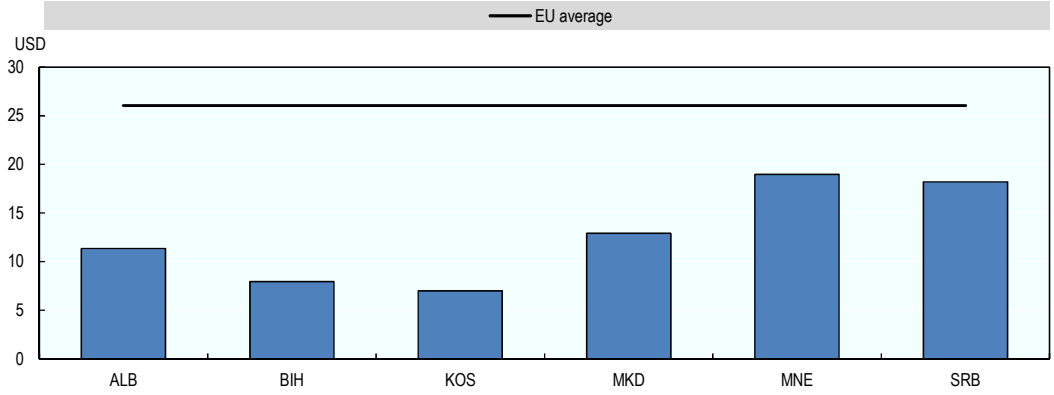
Source: ITU (2014), *ITU World Telecommunication/ICT Indicators Database 2014* (database), www.itu.int/pub/D-IND-WTID.OL-2014.

StatLink http://dx.doi.org/10.1787/888933321681

Subscription charges for fixed broadband services are generally lower in the SEE economies than in the EU (Figure 5.10). The highest charges are in Montenegro and Serbia at a little less than USD 20 a month. The Former Yugoslav Republic of Macedonia and Albania follow with charges between USD 10 and USD 15, and finally Bosnia and Herzegovina and Kosovo where the monthly charge is below USD 10.

Figure 5.10. **Fixed (wired) broadband monthly subscription charge, 2013**

USD



Source: ITU (2014), *ITU World Telecommunication/ICT Indicators Database 2014* (database), www.itu.int/pub/D-IND-WTID.OL-2014; Kosovo Agency of Statistics.

StatLink http://dx.doi.org/10.1787/888933321699

Digital society institutional and regulatory strategic frameworks

Four qualitative indicators assess the development institutional and regulatory strategic frameworks. Two qualitative indicators focus on strategy development and two focus on EU regulation alignment.

Strategies pave the way for information society and broadband development

An institutional and regulatory framework with clear, measurable objectives is a pre-condition for the deployment of digital communication and an integral part of countries' preparations to become information societies (OECD, 2012a). Further, **information society strategies and action plans** exploit the potential of ICT in furtherance of innovation, economic growth and progress.

In accordance with the objectives of the SEE 2020 Strategy and the Digital Agenda for Europe, the SEE governments are urged to put special emphasis on developing broadband infrastructure. Their **broadband strategies** to that end are either part of their information society strategies or they are broadband-specific.

The SEE economies generally have institutional policy frameworks for developing an information society in place (Table 5.1). The degree to which they implement them varies, however.

Table 5.1. **ICT Readiness and Intensity Sub-Dimension: Strategy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Information society strategy and action plan	1.0	1.0	1.5	3.5	3.5	4.0
Broadband strategy	3.0	0.5	1.5	3.0	3.0	3.0

StatLink http://dx.doi.org/10.1787/888933323118

Kosovo, Montenegro, the Former Yugoslav Republic of Macedonia and Serbia have adopted information society strategies, albeit with different timeframes and degrees of implementation. Montenegro and Serbia have aligned their strategies with the objectives of the Digital Agenda for Europe. As for the Former Yugoslav Republic of Macedonia, it adopted its strategy as early as 2005 before the Digital Agenda for Europe was drawn up. The government has, however, established a working group to draft a follow-up strategy in accordance with EU objectives.

Albania has drafted a strategy for the period 2014-20, which it plans to approve in 2015. Bosnia and Herzegovina, has equally drafted an information society policy in 2015, which shall be approved in 2016.

The SEE economies have implemented their strategies to varying degrees, depending chiefly on their financial resources and how long their strategies last. It is generally easier to implement soft measures than financially burdensome ones. While the Former Yugoslav Republic of Macedonia has implemented most of its National Strategy for the Development of the Information Society, Montenegro has put into effect only parts of its ICT Strategy 2012-2016 on schedule because of budgetary restrictions. Similarly, no budget has yet been forthcoming from the government in Kosovo.

Serbia's information society strategy constitutes a regional good practice in monitoring. After the strategy's bi-annual action plan was adopted, it was monitored by a working group with public and private consultations. A monitoring report of the 2013-14

action plan will be published in 2015 and the 2015-16 edition drawn up and re-adjusted according to the findings.

Most economies focus particularly on mobile broadband. Albania and Serbia adopted national plans for broadband development in 2013 and 2014, respectively. Both set clear targets and show both first signs of implementation with regard to the adoption of frequency allocation plans.

Montenegro does not have its own strategy, but does have a broadband development policy pillar aligned with the Digital Agenda for Europe. The Former Yugoslav Republic of Macedonia, for its part, adopted a broadband strategy in 2008, but has offered no information on current updates. While Kosovo's overall ICT strategy theoretically encompasses broadband development, the government has not yet taken any policy action. Bosnia and Herzegovina does not yet have a strategic broadband development policy, it intends however to draw up a broadband strategy in 2016.

Box 5.4. **The Netherlands' strategic approach towards the information society**

In the Netherlands, local municipalities, the provinces and the national Ministry of Economic Affairs are responsible for fostering broadband development in the country. At the national level, the Digital Agenda 2011-2015 sets the strategic framework for clearing any unnecessary constraints and costs, so creating a positive climate for broadband investment and stimulating a healthy competition.

While most out of the broadband infrastructure roll-out is done by private operators working with the government, the Dutch approach also proactively includes local authorities. The 32 biggest municipalities in the Netherlands belong to a special network called "StedenLink" that promotes the optimum usage of ICT in accordance with the local and regional interests and needs.

Currently, provincial governments may seek state aid to roll out broadband in rural areas and technical assistance for local initiatives. It is expected that the state will continue to supply such support for the next five years. On top of that, the national government is currently working on a national broadband portal, which should be active by the end of 2014.

Several mechanisms have been developed to monitor the Netherlands' broadband policy regularly and ensure it is fully in line with the quantifiable objectives of the Digital Agenda for Europe. For that purpose, the government produces a Broadband Monitor Report, first published in 2012, that covers all activities at national and local levels.

Source: EC (2014), *Digital Agenda.nl: ICT for Innovation and Economic Growth*, www.ec.europa.eu/newsroom/dae/document.cfm?doc_id=4217.

Although most of the SEE economies have similarly well-developed strategic approaches to broadband policy, there are differences with regard to their broadband penetration rates (Figure 5.8). In mobile broadband, Serbia – with 53 – comes closest to the EU average of 63 subscriptions per 100 inhabitants. The Former Yugoslav Republic of Macedonia also performs above average while Albania, Montenegro and Bosnia and Herzegovina all have penetration rates of below 30%.

Compliance with EU 2009 regulatory framework and electronic signatures

Most of the SEE economies have brought their ICT legislation broadly into line with the **EU 2009 regulatory framework for electronic communications**. However, they have not yet completed the implementation of secondary legislation.

A central action to build a digital society is sound regulations for stimulating competition, thus helping to improve the supply and affordability of ICT services (EC, 2013). To this end, the EU 2009 regulatory framework for electronic communications (Directive 2009/140/EC) seeks to introduce a harmonised framework for regulating electronic communications networks and services. It includes provisions for computer terminal equipment that facilitates access for disabled users. The directive also contains basic definitions, general provisions relating to national regulatory authorities (NRAs), the new concept of "significant market power" and rules that govern the granting certain essential resources such as radio frequencies, numbers and rights of way.

Electronic communication legislation that complies with the EU *acquis* is in place in Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Kosovo, although those economies have not yet fully implemented the secondary legislation required (Table 5.2). Kosovo would, in particular, benefit from an effort to catch up on implementation. Serbia has aligned its legislation with the EU 2003 regulatory framework and plan to converge with the 2009 *framework* in 2015. Bosnia and Herzegovina is also preparing alignment with the EU 2009 framework.

Table 5.2. **ICT Readiness and Intensity Sub-Dimension: Harmonisation with EU 2009 regulatory framework indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
EU 2009 regulatory framework for electronic communications	3.5	1.5	3.0	3.5	3.5	1.5
Electronic signature law	3.0	2.5	2.0	3.0	3.0	3.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323127

The development and accessibility of electronic services requires sound legal frameworks that ensure **electronic signatures** are legally recognised and enforceable. In line with Directive 1999/93/EC, they should satisfy "the legal requirements of signatures in relation to data in electronic form in the same manner as a handwritten signature satisfies requirements in relation to paper-based data". Ideally, therefore, electronic signatures should be adopted and integrated in other government e-services.

All economies have electronic signature laws in place (Table 5.3). To what extent they have been implemented and how far the necessary institutions for legal and natural persons are in place varies, however. Serbia seems to perform best – four electronic signature providers in its market and an advanced level of integration with other e-government services. Kosovo and Bosnia and Herzegovina have adopted an electronic signature law, its use, however, is still limited.

Table 5.3. **Electronic communications legislation adoption dates**

	ALB	BIH	KOS	MKD	MNE	SRB
EU 2003 regulatory framework	2008	–	–	2005	2008	2010
EU 2009 regulatory framework	2012	– *	2012	2014	2013	–
Electronic signature law	2008	2006	2012	2001	2003	2004

Note: The asterisk (*) denotes that in procedure, with the Council of Ministers deliberating.

StatLink http://dx.doi.org/10.1787/888933323137

Cybercrime legislation is well anchored in penal codes, but policy dialogue on cybercrime remains ad hoc

Network and information security makes an essential contribution to consumer confidence and a stronger online economy which, in turn, boosts growth and jobs and improves competitiveness. As pointed out by the ITU (2011) cyber attacks badly affect the performance of businesses, technology and administration. In a communication on cybersecurity strategy, the EC (2013) identifies the need for the public, the private sector and individual citizens to come together against cybercrime. Cybersecurity could be stronger, if information on cyber-crime attacks would be increasingly shared among the ones experiencing the attacks. Two qualitative indicators, **cybercrime legislation and identification** and **cyber-security policy partnership** investigate progress in establishing a cybercrime legal framework and co-operation with the private sector.

Table 5.4. **ICT Readiness and Intensity Sub-Dimension: Cybercrime legislation and private sector co-operation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Cybercrime legislation and identification	3.0	1.5	3.0	3.5	3.5	4.0
Law in place	✓	–	✓	✓	✓	✓
Cybersecurity policy partnership	1.0	0.0	0.0	1.0	1.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The SEE penal codes have generally incorporated cybersecurity legislation well, with all but one economy ratifying the Council of Europe Convention on Cybercrime (Table 5.4). Investigation bodies and computer incident response teams (CIRT) operate in most economies. Serbia, for example, has created a Special Prosecutors Office for Combating High-Tech Crime which regularly reports to the Ministry of Justice and adjusts the legal framework to allow for new technologies and developments. Bosnia and Herzegovina, has drafted a policy on cybercrime prevention, however, it is not yet adopted. It has signed up to the Council of Europe Convention on Cybercrime.

Co-operation with the private sector on cybersecurity matters remains at an early stage of development throughout the region. The Former Yugoslav Republic of Macedonia and Serbia have taken occasional, ad hoc initiatives on an informal basis, but have not yet established a formal policy dialogue. Both Albania and Montenegro recently developed cybersecurity strategies which envisage institutional co-operation with civil society and the private sector in the future.

E-accessibility remains at an early stage

The term "e-accessibility" denotes action to bring ICT access and skills to people who have neither (e.g. those with disabilities, the rural poor, minority groups). The goal is to narrow the digital divide, so harmful to the development of an information society at all levels (OECD, 2011b). The eSEE Agenda+, which has made e-accessibility a priority, also spells out the importance of widening the benefits of ICT to society's most marginalised groups.

Policy measures should seek to improve e-accessibility and usability, improve digital literacy and skills, and address the needs of groups on the margins of society (OECD, 2001). They should encompass, for example, greater access to ICT infrastructure,

outreach to individuals and households, education and training, and the provision of e-government services. Policy should also address the needs of different groups, such as the elderly and socially isolated, people affected by economic and digital exclusion, and the economically deprived (Helsper, 2008).

The **e-accessibility action plan** indicator does not therefore cover specific policy actions, but measures whether the SEE economies have approved domestic e-accessibility action plans (Table 5.5). Ideally, action plans should include not only the supply side of accessibility, i.e. the provision of e-services, but also barriers to the use of ICT, such as reluctance, costs and access to ICT facilities.

Table 5.5. **ICT Readiness and Intensity Sub-Dimension: E-accessibility action plan indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
E-accessibility action plan	1.0	0.0	0.0	3.0	1.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Policy measures to further e-accessibility are in early-stage development in nearly all SEE economies – only the Former Yugoslav Republic of Macedonia has developed a national e-accessibility strategy, which it introduced in 2011. Its strategy includes 20 measures grouped into 5 pillars, of which 14 have already been implemented, with some fully addressing the needs of the private sector and NGOs.

Although some of the other economies have made room for e-accessibility in their overall ICT strategies, they implement them only on an occasional, ad hoc basis. Serbia, for instance, which does not have its own action plan, has nevertheless drawn up Guidelines for the Development of Websites of Public Administration Bodies that include the issue of e-accessibility. However, no SEE government has yet undertaken an analysis of digital divide lines.

ICT in Education Sub-Dimension

The ICT in Education Sub-Dimension is composed of two qualitative indicators – **ICT in curricula (primary and secondary schools)** and **ICT in vocational education and training** – to assess ICT curriculum in school, whether computers and Internet access are in place, and whether there is sufficient proficient teaching capacity.

A society's readiness to use information and communication technology (ICT) depends not only on ICT access and use, but also – and crucially – on its ICT skills capacity (ITU, 2012). Kozma (2005) argues that ICT can support better education and economic development in several ways. It can improve the delivery of and access to education, so improving efficiency. And, as the subject of learning itself, ICT helps prepare students for the workplace in an increasingly ICT-demanding job environment.

There is still little collection of quantitative indicators on computers and Internet access in schools, with only Montenegro and Serbia providing data on the percentage of students who use computers at school and the learners-to-computer ratio. In both economies, between 90% and 100% of all pupils use computers with Internet access. No data have been received for other economies, though similar proportions are assumed.

However, the Former Yugoslav Republic of Macedonia reports a coverage of 100% with its project, "A Computer for Every Child".

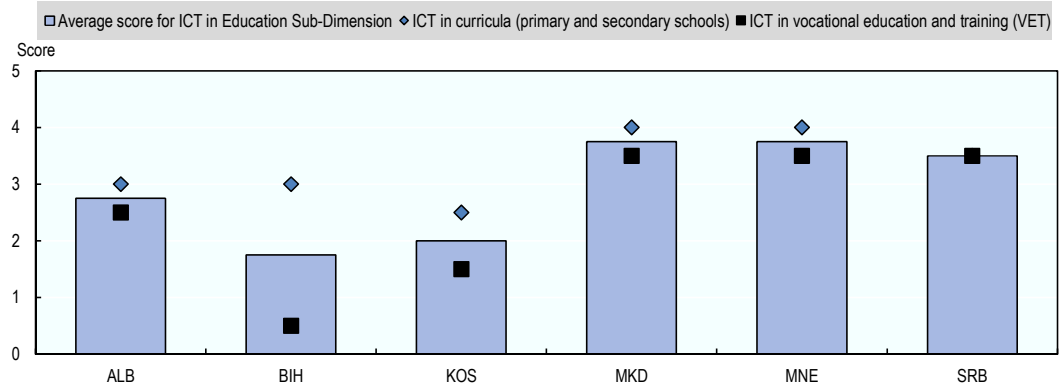
Mandatory ICT standards are in curricula but implementation varies

While the potential of ICTs as a medium for teaching and learning is recognised by many, the implementation of ICT is often a more difficult task. For this reason, clear policies need to be developed by education ministries on how to support the implementation of ICT in the curriculum and standards should be set for students, teachers, professional developers and administrators alike. Work to achieve the standards should be backed by investment in equipment and teacher training (UNESCO, 2012).

Standards ought also to apply to vocational education and training (VET), where ICT should be part of all VET programmes as a general subject (Bello et al., 2013). Governments, employers and professional associations could work together to draw up ICT standards for VET (UNESCO, 2002).

All the SEE economies have set mandatory ICT standards for secondary schools and most in primary education (Figure 5.11). Actually applying standards, though, is a different question that brings varying responses. The economies that fare best in primary and secondary schools also seem to do best when it comes to VET.

Figure 5.11. **ICT in Education: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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ICT in school curricula

In the Former Yugoslav Republic of Macedonia, the Bureau for the Development of Education has flagged certain subjects in the primary school curriculum with the compulsory instruction "work with computer". Montenegro, too, provides partially obligatory ICT subjects in primary and secondary schools.

While standards in ICT curricula seem to be widely established, implementation varies. Albania, Kosovo and Montenegro recently approved new digital competencies in secondary school curricula. They have not yet actually introduced them in all schools. Such uneven implementation is attributable chiefly to low budgets and a lack of ICT facilities.

The Former Yugoslav Republic of Macedonia appears to have made the most progress in implementation with its project, "A Computer for Every Child". Not only was ICT in schools' curricula improved, but also training schemes for all primary and secondary school teachers were organised.

Monitoring the enforcement of ICT standards is still at an early stage. However, the Former Yugoslav Republic of Macedonia, Montenegro and Bosnia and Herzegovina have introduced educational management information systems (EMIS). EMISs enable schools to connect and interoperate and to collect data on ICT equipment and training. Montenegro has also appointed ICT co-ordinators in all schools. They are in charge of all ICT-related management and report to the policy-design level.

ICT in vocational training and education

The economies that have done best in teaching ICT and using it as a learning tool perform equally well when it comes to VET. The Former Yugoslav Republic of Macedonia and Montenegro have introduced ICT in vocational and elective subjects in VET establishments, supported by ample hardware resources. In Serbia, ICT is an optional subject in VET schools and the maintenance of equipment depends heavily on each school's resources. As for Albania, Kosovo and Bosnia and Herzegovina, they have formally started to integrate ICT into VET schools, but full implementation is yet to come.

Teacher training is provided throughout the region, though it is mainly donor-funded. With regard to monitoring and evaluating ICT in VET, the Former Yugoslav Republic of Macedonia and Montenegro have again set the standard by including VET establishments in their monitoring systems.

Table 5.6. **ICT in Education Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
ICT in curricula (primary and secondary schools)	3.0	3.0	2.5	4.0	4.0	3.5
ICT in vocational education and training (VET)	2.5	0.5	1.5	3.5	3.5	3.5

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E-Business and E-Commerce Sub-Dimension

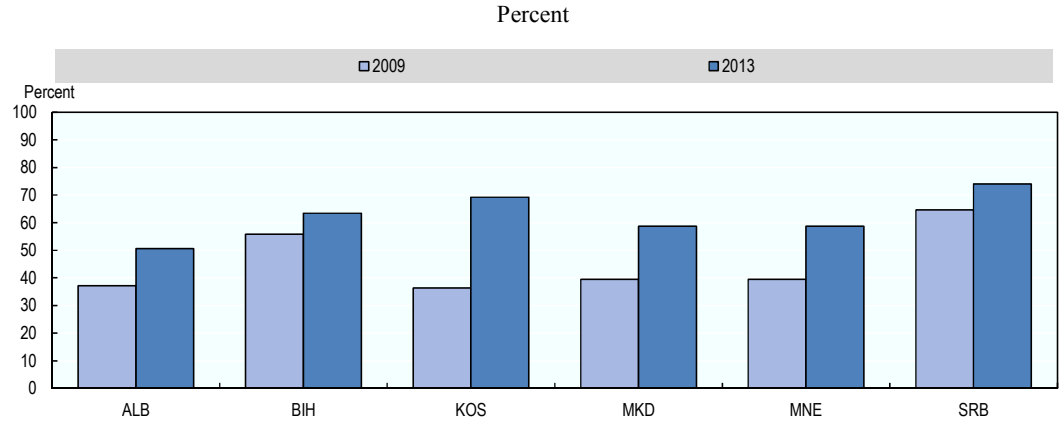
E-business refers to the use of ICT to facilitate business processes. Firms can use ICT to communicate with government organisations, suppliers and clients, or to purchase and sell goods and services online. E-commerce is one aspect of e-business and refers to the sale or purchase of goods or services only (UNCTAD, 2009).

Firms use e-commerce in transactions that are either business-to-business (B2B) or business-to-client (B2C). It widens the scope of the market and lowers operating barriers and costs. As for consumers, e-commerce makes it easier to compare prices and delivery is more convenient (OECD, 2013).

This section looks at the E-Business and E-Commerce Sub-Dimension. Two qualitative indicators assess legal frameworks and measures to facilitate e-commerce – **e-commerce barrier removal** and **e-commerce law**. Three quantitative indicators that gauge the extent of enterprises' use of ICT and their e-commerce practices.

The number of businesses with a web presence increased in all SEE economies between 2009 and 2013 (Figure 5.12). The share of businesses with a web presence in 2013 was highest, at 74%, in Serbia, followed by Kosovo and Bosnia and Herzegovina with over 60%. Albania was slightly behind its regional peers with a share of 50.6%. The overall finding, however, is that at least every other business in the SEE economies – and even more in most of them – have a dedicated company web presence and are thus acquainted with basic ICT technology for e-commerce activities.

Figure 5.12. **Proportion of businesses with a web presence, 2009 and 2013**



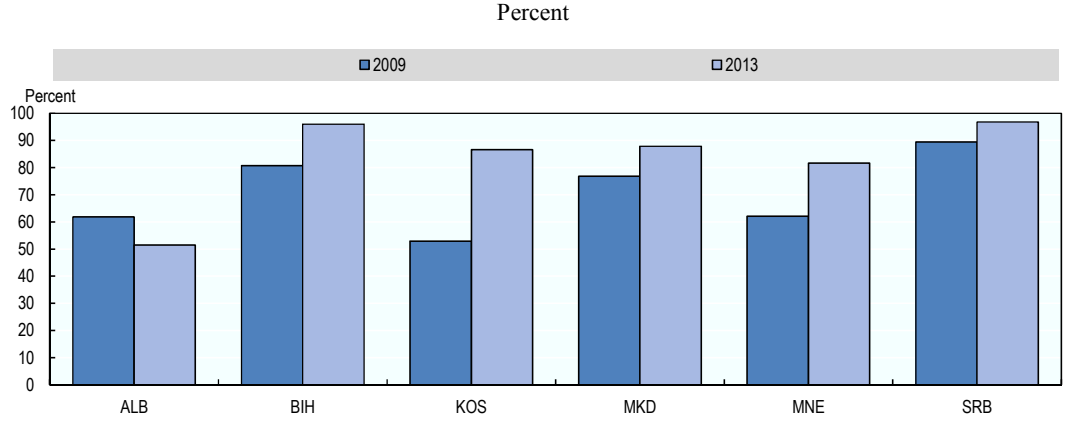
Note: Data for Albania for the year 2009 as of 2007.

Source: World Bank (2015b), *Enterprises Surveys* (database), www.enterprisesurveys.org/data.

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Even higher proportions of businesses in the SEE economies use e-mails to interact with the suppliers and clients (Figure 5.13). Indeed, comparison of the figures for 2009 and 2013 point to an increase in nearly all the economies.

Figure 5.13. **Proportion of firms using e-mail to interact with clients/suppliers, 2009 and 2013**



Note: Data for Albania for the year 2009 as of 2007.

Source: World Bank (2015b), *Enterprises Surveys* (database), www.enterprisesurveys.org/data.

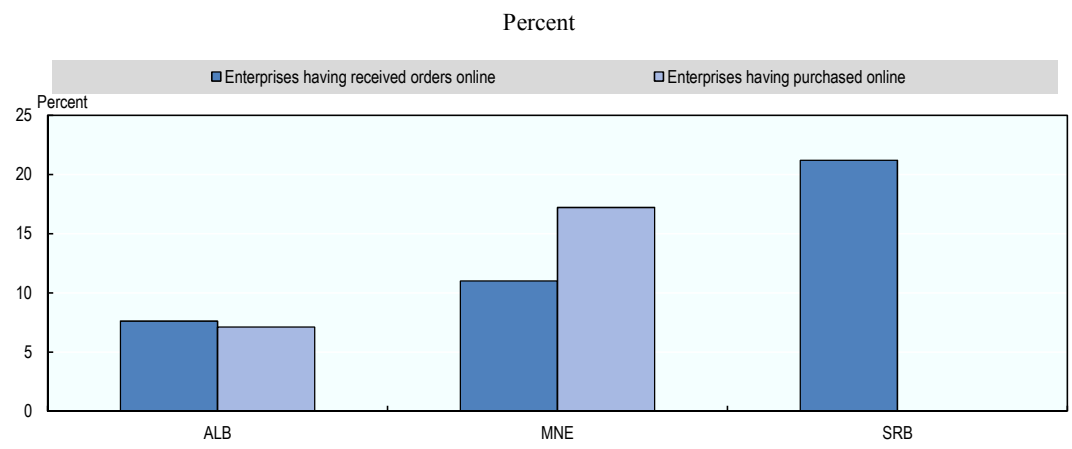
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In Serbia and Bosnia and Herzegovina, nearly 100% of businesses used e-mails, while the vast majority did in the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro. Albania lagged behind its regional peers with 51.5% of firms communicating with e-mails. It was also the only economy where the proportion fell between 2009 and 2013.

The proportions of businesses buying and receiving orders online are indicators that measure e-sales and e-purchases in the SEE economies. The indicators are important in light of the growing economic importance of e-commerce, as online transactions increase potential domestic customer bases and exports, which in turns contributes to economic growth.

Data are available only for Albania, Montenegro and Serbia for orders received online (Figure 5.14). Indeed, when it comes to the share of companies receiving orders online, Serbia has the highest at over 20%. Montenegro appears the most advanced as an active practitioner of e-commerce with 16.5% of its companies purchasing online.

Figure 5.14. **Proportion of enterprises selling online and having received orders online, 2013**



Note: Data for Bosnia and Herzegovina, Kosovo and the Former Yugoslav Republic of Macedonia not available. Data for Serbia for enterprises having purchased online not available.

Source: National Agency of Statistics of Albania, Montenegro and Serbia.

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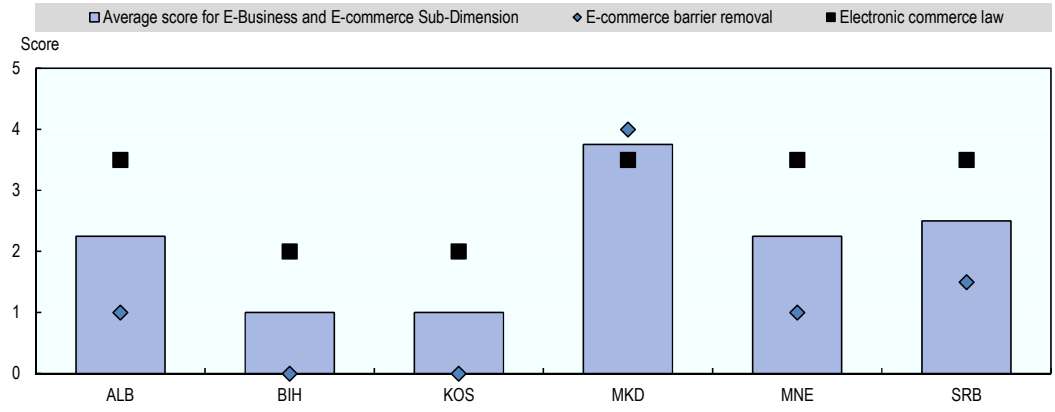
E-commerce law are in place but non-legal barriers persist

The development of e-business should take place within the framework of a well-established e-commerce law. Such a law ideally ensures the proper functioning of the market for information society services – it should facilitate their introduction and free movement within the region. Its aim should be to provide legal certainty for businesses and consumers through harmonised rules on issues such as online service providers' transparency and information requirements, commercial communications, electronic contracts and the limitations of liability of intermediary service providers.

All economies in the SEE region have adopted e-commerce laws. When it comes to putting them into effect (and irrespective of when they were introduced [Table 5.7]) Albania, Montenegro, the Former Yugoslav Republic of Macedonia and Serbia have made the most headway and to a similar extent. Although Kosovo has introduced an

e-commerce law, it is part of the Law on Information Society Services and has not been fully implemented yet. There is a similar picture in Bosnia and Herzegovina which, although it has had an e-commerce law since 2007, it has yet to implement it.

Figure 5.15. **E-Commerce and E-Business: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321743

Table 5.7. **Electronic commerce law adoption dates**

	ALB	BIH	KOS	MKD	MNE	SRB
Electronic commerce law	2009	2007	2012	2001	2004	2009

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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As they seek to develop e-commerce, policy makers can go beyond establishing a legal framework. One of the key ways policy makers can promote e-commerce is by reducing the barriers that hinder its growth. Barriers to e-commerce can be of various kinds – e.g. regulations, procedures, taxation, those created by insufficient knowledge and information. They may also stem from the high cost of adopting of ICT solutions and a lack of adequate funding (OECD, 2013). However, as Table 5.8 shows, the SEE economies have generally given scant attention to non-legal barriers.

Table 5.8. **E-Business and E-Commerce Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
E-commerce barrier removal	1.0	0.0	0.0	3.0	1.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Only two SEE economies have looked at non-legal barriers to e-commerce to date. The Former Yugoslav Republic of Macedonia is an example of regional best practice in that regard, having carried out two analyses of barriers with the help of USAID in 2010

and 2014. It has acted on most of the recommendations from the 2010 analysis. The 2014 analysis, which measures progress in implementation and looks at net developments, is to be published in 2015.

Serbia conducted an analysis in 2010, though it has only partially implemented the recommendations that emerged. Montenegro and Albania have started to collect data on e-commerce – a first step towards more in-depth analysis.

Generally speaking, however, the SEE economies should step up their efforts to collect more data and strengthen analysis of non-legal barriers to e-commerce.

Conclusions

Overall, SEE economies have shown signs of progress in building an information society. Although the strength of the region's ICT sector is not yet comparable the EU's, convergence is progressively taking place. Most economies have adopted the relevant strategic and regulatory frameworks and have taken action to incorporate cybercrime legislation in their penal codes and adopt mandatory standards for ICT in education. Furthermore, e-commerce laws have been adopted in most of the assessed economies.

Despite their achievements, however, the SEE economies still face a number of challenges. They might consider advancing implementation and systematically monitoring their information society strategic frameworks. They could fully align their legislation with the EU 2009 framework on electronic communication. They might consider increasing e-accessibility through a strategic policy approach. It would be beneficial to further develop educational information management systems by allocating budgets that are large enough to enable the implementation ICT curricula in primary and secondary schools. They could foster the development of e-commerce through in-depth analyses of non-legal barriers.

Addressing these challenges would bring the region closer to being a fully fledged digital society, which would, in turn, help it to foster innovation and economic growth.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 6.

Cultural and creative sectors in South East Europe

Cultural industries produce a good or service with a characteristic, use or purpose that incorporates culture. Creative industries use culture as an input, but where products and services are primarily functional. This chapter on the Cultural and Creative Sectors Dimension focuses on three sub-dimensions in its assessment of performance and policy development. The Cultural Heritage Sub-Dimension examines progress in building heritage management models, implementing cultural tourism action plans and adopting a common regional approach advocated by the Ljubljana Process II. The Audiovisual Sector Sub-Dimension gauges the development level of audiovisual strategies, film co-production and co-distribution policy, and film heritage protection strategies. The Design and Creative Industries Sub-Dimension assesses government activities and strategies to promote the industries as key components of local economic development.

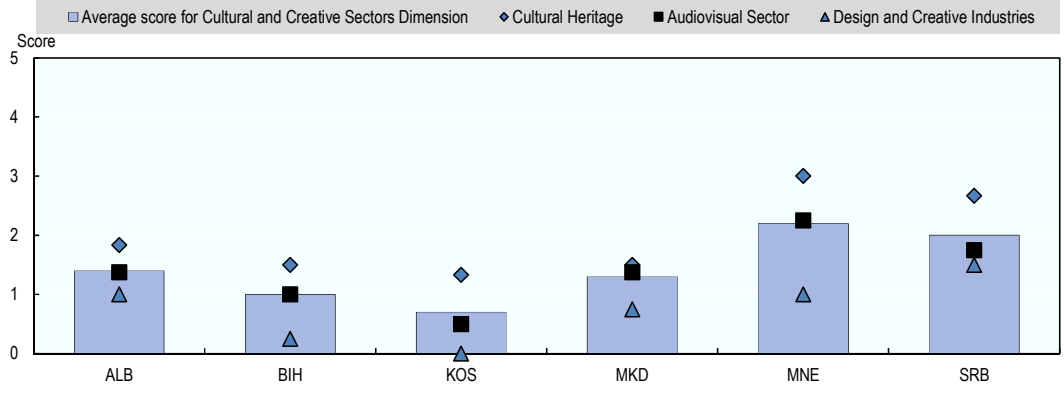
Main findings

In recent decades, the cultural and creative sectors (CCS) have emerged as a new form of economic activity. The demand for cultural products and services, entertainment, creativity and inspiration has been fuelled by social, technological and cultural developments, as well as the increase in overall economic well-being (Power, 2011). The cultural and creative sectors contribute to competitiveness and development in a number of ways – they produce direct value added content, create jobs, stimulate innovation as a source of creativity, and exert a positive effect on social and territorial cohesion (OECD, 2005).

The economies of South East Europe (SEE) have recognised the potential of CCS as smart growth drivers. Accordingly, they have moved to incorporate them into legislative and institutional frameworks. They are also adopting internationally accepted statistics collection methodologies and are engaging in regional co-operation initiatives. The principal challenges that the SEE economies encounter in the cultural and creative sectors concern the implementation of cultural policies and the scarcity of statistical data to support evidence-based policy making. As they look to the future, they might consider improving policy frameworks and intensifying regional co-operation to enable the cultural and creative sectors to make a tangible contribution towards the enhancement of competitiveness.

The assessment of the three sub-dimensions of the Cultural and Creative Sectors Dimension reveals achievements and persistent challenges in policy adoption and execution. The main finding of this chapter is that the SEE economies have yet to apply integrated, coherent approaches to the use of CCS policies as vehicles of growth and development. The underlying reason is the inadequacy of strategic approaches and the lack of data. It accounts for the consistently low indicator scores in all three sub-dimensions – Cultural Heritage, Audiovisual Sector, and Design and Creative Industries (Figure 6.1).

Figure 6.1. **Cultural and Creative Sectors: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321753

All but one SEE economy have average scores under two, which signifies that the SEE economies have policy frameworks or intend to build them. However, they still have significant room for improvement in implementing them, shaping an integrated approach and advancing regional co-operation.

Disparities in scores are found between economies as well as between policy fields. The SEE economies perform relatively well in drafting, approving and implementing cultural heritage rehabilitation and tourism policies, and slightly less well in audiovisual sector policies and strategies. The greatest room for improvement, however lies in policies to promote design and the creative economy.

Achievements

The SEE economies have seen recent improvements in their cultural and creative sectors.

SEE economies prioritise cultural heritage rehabilitation. All SEE economies have made efforts to rehabilitate, inventory and steward their cultural heritage. Engaging in the Ljubljana Process II for the rehabilitation of their common regional heritage is a welcome development in regional co-operation.

SEE economies recognise the importance of cultural tourism for economic growth and competitiveness. The inclusion of cultural tourism in wide-reaching tourism or cultural strategies has become standard practice in the SEE economies.

SEE economies have established basic institutional structures to support cultural and creative sectors. For example, the Statistical Office of Montenegro (MONSTAT) collects statistics on culture, while the Serbian Film Centre supports the domestic audiovisual sector. Furthermore, private initiatives, donor projects and international assistance have substantially contributed to the strengthening of the region's audiovisual, design and creative industries.

Challenges

Despite their achievements, the SEE economies still face a number of challenges that prevent them from fully developing cultural and creative sectors.

The implementation of existing policies is a persistent challenge in the region. Inter-ministerial communication and co-ordination are often lacking, which delay the implementation of legal frameworks. Efforts to promote CCS often originate from uncoordinated policy initiatives rather than explicit national cultural strategies and action plans.

Systems of planning, monitoring and following up on cultural projects are yet to be developed. Implementation bodies could benefit from regular monitoring and follow up on national or regional projects. In fact, planning and funding activities seldom contain provisions for *ex post* evaluation and follow-up.

The lack of reliable statistics inhibits cultural policy making and assessment. Baseline statistics on CCS come mostly from various public sources, which provide only limited information and do not co-ordinate closely with designated government bodies. There is a frequent lack of comprehensive data series on the design and creative industries.

Government support and funding for the promotion of the audiovisual, design and creative sectors is limited. Sustainable funding is often unavailable and regular initiatives to support producers or designers are not part of strategic planning.

Recommendations

In response to the challenges identified above, a number of strategic steps are needed if improvements in cultural and creative sectors are to be achieved.

Implement existing legal frameworks. Policy makers could consider establishing bodies which would adopt clear, measurable and time-bound implementation plans to promote the CCS. They might also form task forces to map the sectors and analyse the economic impact and potential of the creative industries. Qualitative assessments with business surveys could enhance sector analyses. The SEE economies could also set up regional design and creativity incubators to foster co-operation and development.

Develop targeted strategies and action plans to promote the cultural and creative sectors. Currently, cultural strategies – where there are any – tend to be broad-reaching and not elaborate to address the key constraints to the development of CCS. Adopting sector-specific action plans can provide more detail to complement cultural strategies.

Promote public-private partnerships in the strategic planning of cultural tourism. Initial steps could be to prepare and execute cultural tourism action plans. Governments could consult industry and professional associations to assess proposals, draw up budgets, set timelines and choose their partners. The participation of the private sector would provide additional support and competitive financing options.

Improve the collection of statistics on the cultural and creative sectors to enable evidence-based policy making. Up-to-date, reliable, internationally comparable and independently collected statistics would enable better informed policy decisions. To that end, national statistics authorities could upgrade their capacity by integrating datasets from different institutions.

Increase efforts to regionally harmonise cultural policies. The use of common and internationally accepted definitions of the cultural and creative sectors is important for promoting regional co-operation and protecting the South East European heritage. Cross-border comparisons would facilitate regional prioritisation and effective action.

Overview

Analysis in this chapter draws on the following European Commission definitions of the cultural and the creative industries.

> "Cultural industries" are those industries producing and distributing goods or services which at the time they are developed are considered to have a specific attribute, use or purpose which embodies or conveys cultural expressions, irrespective of the commercial value they may have. Besides the traditional arts sectors (performing arts, visual arts, cultural heritage – including the public sector), they include film, DVD and video, television and radio, video games, new media, music, books and press. This concept is defined in relation to cultural expressions in the context of the 2005 UNESCO Convention on the protection and promotion of the diversity of cultural expressions.
>
> "Creative industries" are defined as industries which use culture as an input and have a cultural dimension, although their outputs are mainly functional. They include architecture and design, which integrate creative elements into wider processes, as well as subsectors such as graphic design, fashion design or advertising. (EC, 2010)

The relation between the cultural and creative sectors and an economy's competitiveness has been a topic of limited research in both academic and grey literature. Traditionally considered as matters of enlightenment and entertainment, whose small economic contribution justified public intervention, the CCS have begun to be thought of as drivers of economic development only in the last few decades (KEA European Affairs, 2006). Given that cultural goods are produced with limited resources, have a specific utility and are exchanged just like any other good, they are subject to the rules of economic activity and adhere to market mechanisms (Giannadaki, 2013).

The cultural and creative industries contribute to prosperity and local development through three principal channels (OECD, 2005):

1. By attracting tourists and visitors, they produce added value, create jobs and attract investments, all of which boost local incomes and stimulate the economy.
2. The innovative nature of the new goods and services which they create can bring new revenues and attract investment capital.
3. As a system of values and references, they can foster communication between different groups of people within a territory, the preparation of projects and the sharing of risk. Such an anthropological perspective highlights the role of collective behaviour to development and recognises the interplay between the culture of a territory and the culture of the businesses and economic players operating there.

This chapter offers a qualitative and quantitative assessment of cultural and creative sectors policies in the SEE economies. A broad picture and main conclusions are yielded by analysing macroeconomic indicators such as the cultural and creative industries' contribution to GDP, their share of total employment, the value added that they generate, and the public and private expenditure on their products and services. These outcome indicators, which are usually positively correlated with each other, capture the result of adopted and implemented policies, and reveal strengths and weaknesses at both local and regional levels.

Increases in total spending on cultural goods and services do not only boost GDP. They create employment in the CCS by attracting investment, creative talent and tourism and may also produce broader socio-economic and development benefits achieved through closer social integration and territorial cohesion (KEA European Affairs, 2006). It has been also found in OECD economies that there is a positive correlation between household expenditure on recreation and culture and income per capita (OECD, 2010). In other words, households that spend highly on cultural products and services tend to be the richer ones. UNESCO finds that culture and creativity could ultimately constitute not only a means of economic growth, it could also be a crucial factor in improving social cohesion and human development (van der Pol, 2008).

The increased attractiveness of cultural tourism destinations is another important channel through which CCS stimulates the economy – a point emphasised in the SEE 2020 Strategy (RCC, 2013). To that end, the development of tangible and intangible cultural assets constitutes a means of differentiating products and creating competitive advantages in the globalised tourist marketplace (OECD, 2008). Indeed, the very inclusion of this policy area in the present analysis underlines the growth potential of the culture and creative sectors for tourism and entrepreneurship, while their commercialisation has led to "radical transformations in the way people create, consume and enjoy cultural products" (van der Pol, 2008).

The creative and cultural industries connect with other policy areas addressed in the *Competitiveness Outlook 2016*.

- **Chapter 4. Research, development and innovation** is closely related to the fast-paced nature of innovation in CCS. Innovation in design, for example, creates competitive advantages, which can generate economic benefit.
- **Chapter 1. Investment policy and promotion** includes safeguarding intellectual property rights (IPR). IPR are critical to designers and artists who earn royalties from their work and act as an incentive to creativity. Investment promotion activities and the development of regional arts and design incubators could be mutually reinforcing.
- **Chapter 2. Trade policy and facilitation** encourages cross-border service trade and collaboration which would support performing arts co-productions, tourism and various other forms of artistic co-operation.

Box 6.1. Cultural and Creative Sectors Dimension in the SEE 2020 Strategy

The Cultural and Creative Sectors Dimension is part of the Smart Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Smart Growth Pillar is to promote innovation and foster knowledge-driven growth in the region. The SEE 2020 Strategy specifies three key policy fields in the Cultural and Creative Sectors Dimension: regional heritage rehabilitation through Ljubljana Process II, co-operation between film policy bodies and regional design incubators. The Smart Growth Pillar has a headline target of a 32% increase in average labour productivity over 2010.

The Regional Cooperation Council (RCC) Task Force on Culture and Society is the official SEE 2020 Strategy Co-ordinator of the SEE 2020 Cultural and Creative Sectors Dimension. The RCC Task Force on Culture and Society was established to co-ordinate the Ljubljana Process management and fund-raising activities and to be a platform for stakeholder dialogue.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Cultural and Creative Sectors Dimension assessment framework

This chapter proposes an analysis of the cultural and creative sectors based on the Smart Growth Pillar of the SEE 2020 Strategy. It does not seek to be exhaustive, but to offer insight into three broad sub-dimensions and measure their progress against the objectives of the SEE 2020:

- Cultural Heritage

  Have the economies built heritage management models? Have they drawn up and implemented cultural tourism action plans? Have they adopted the common regional approach advocated by the Ljubljana Process II?

- Audiovisual Sector

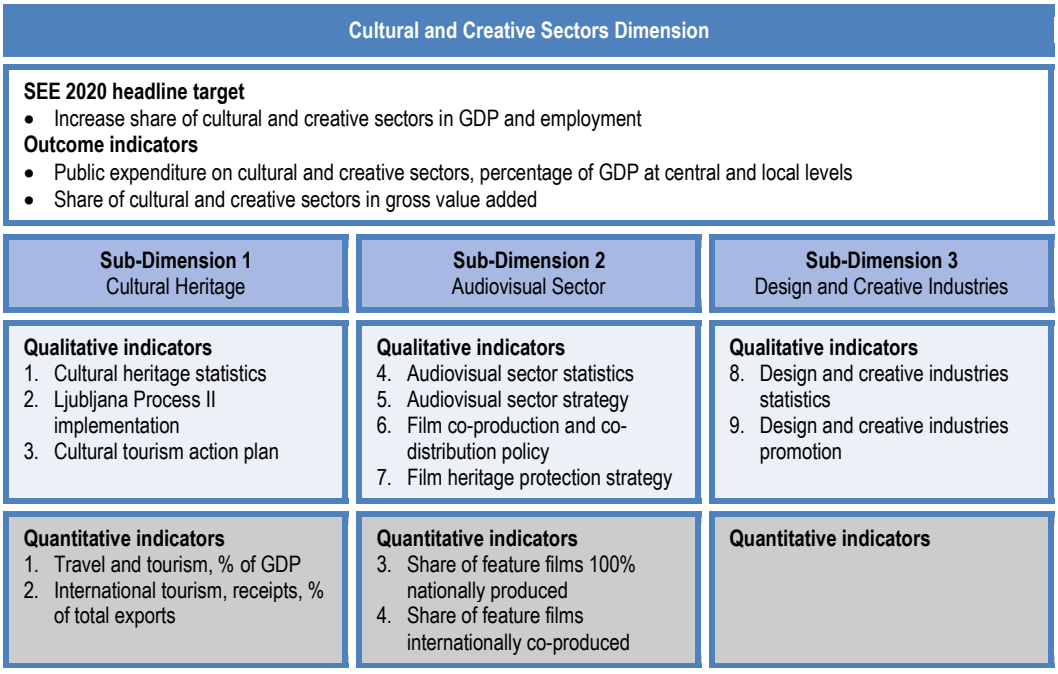
  Are there comprehensive strategies in place to develop the audiovisual sector? Has there been progress towards a regional film fund? Are there policies for using film heritage to create a brand identity and attract investment? Are there co-production and co-distribution strategies in place?

- Design and Creative Industries

  Do the economies recognise the importance of the design and creative professions? Are there any strategies to promote creativity and design? Are there any good practices?

Figure 6.2 depicts how the sub-dimensions constitute the overall dimension and how, in turn, detailed qualitative indicators constitute the sub-dimensions.

Figure 6.2. **Cultural and Creative Sectors Dimension assessment framework**



Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional Cooperation Council (RCC) collected qualitative and quantitative data on the Cultural and Creative Sectors Dimension. Quantitative indicators are based on national or international statistics. Qualitative indicator scores rate performance in ascending order on a scale of 0 to 5.[1]

Cultural and creative sectors performance in SEE economies

The global trade increase in creative goods and services (CSS) outperformed economic growth, averaging an annual rate of 8.8% between 2002 and 2011. In 2008, their average contribution to national output in the EU was 4.5% of GDP. By 2011, it was 6.8%, or EUR 860 billion. Furthermore, the cultural and creative sectors accounted for 3.8% of total EU employment in 2008, a contribution that rose to 6.5% in 2011. That percentage translates into some 14 million jobs, with ICT-related activities claiming a growing share (TERA Consultants, 2014).

The CCS contribution to the economies of South East Europe varies significantly across the region. In Serbia in 2011, they accounted for 10.98% of gross value added (GVA), before declining to 9.8% the following year. In Bosnia and Herzegovina, the CCS share of GDP in 2011 was 5.7% (van der Pol, 2008). According to the Statistics Office of

Montenegro, the creative and cultural industries contributed about 2.03% of Montenegrin GDP in 2012 – all figures below the EU average.

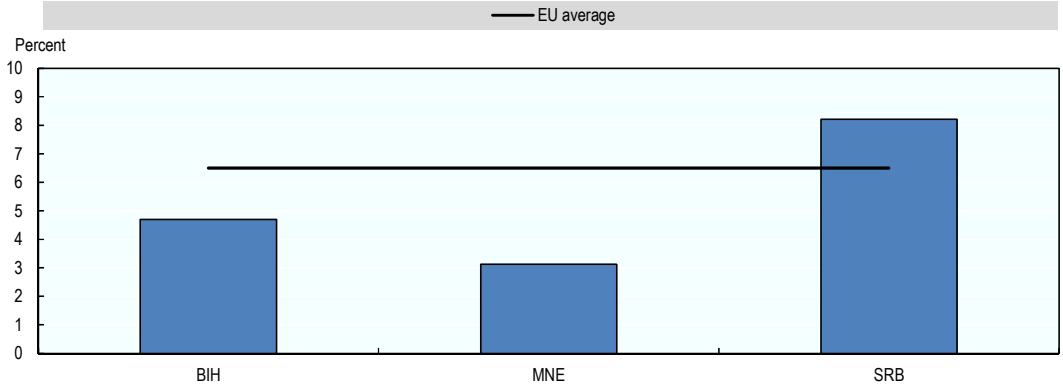
When it comes to government expenditure on the cultural and creative sectors, data are seldom available. In Serbia, government spending on CCS stood at 1.43% of GDP in 2011. By contrast, the OECD countries' expenditure on recreation, culture and religion averaged 1.7% of GDP (OECD, 2014a).

Empirical studies do not find a statistically significant relationship between the size of an economy and the relative size of the creative sector (OECD, 2014b). Of the 25 regions with the highest CCS growth in Europe, most are small and medium-sized (Power, 2011).

Measurement of the CCS' contribution to employment covers all enterprises and the self-employed who produce, disseminate, and mediate artistic and cultural products and services. Although the CCS' share of employment in South East Europe varies widely from economy to economy, it mirrors the trend in their contribution to GDP – which confirms the macroeconomic, labour-intensive nature of the cultural and creative sectors in the SEE region. The percentage of the total labour force working in CCS ranges from 3.12% in Montenegro to 8.21% in Serbia. On that count Serbia is, in fact, the only SEE economy to surpass the EU's 6.5% average (Figure 6.3).

Figure 6.3. **Employment in cultural and creative sectors, 2011**

Percent of total employment



Note: Data for Albania, Kosovo and the Former Yugoslav Republic of Macedonia not available.

Source: Adapted from Mikic (2013), *Kulturne Industrije i Raznolikost Kulturnih Izraza u Srbiji*, www.kreativnaekonomija.com/wp-content/uploads/2012/08/Kulturne-industrije-i-raznolikost-kulturnih-izraza.pdf; TERA Consultants (2014), *The economic contribution of the creative industries to the EU in terms of GDP and employment: Evolution 2008-2011*, www.teraconsultants.fr/medias/uploads/pdf/Publications/2014/2014-Oct-European-Creative-Industry-GDP-Jobs-full-Report-ENG.pdf; UNESCO (2015a), *Culture for Development Indicators Global Database* (database), http://en.unesco.org/creativity/cdis/toolbox/global-database.

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Statistical data is vital for understanding the economic impact of CCS and policy development and evaluation. Despite recent efforts and UNESCO's data collection projects in the region (Box 6.2), the SEE economies lack commonly agreed definitions and data collection methods.

Box 6.2. UNESCO Project – Culture for Development Indicators

The UNESCO Project Culture for Development Indicators (CDIS) is a pioneering research and advocacy initiative. It aims to establish a set of indicators highlighting how culture contributes to national development, so fostering economic growth and helping individuals and communities to expand their life choices and adapt to change. The project contributes to the implementation of Article 13 ("Integration of Culture in Sustainable Development") of the Convention for the Protection and Promotion of the Diversity of Cultural Expressions. It is financed by the Spanish Agency for International Co-operation for Development (AECID) and covers 12 countries. One is Bosnia and Herzegovina. UNESCO initiated its CDIS project, after the pilot phase, in Montenegro in 2015. The expectation is that the results and analyses will be published by the end of 2015.

Source: UNESCO (2015b), *Culture for development indicators* (webpage), www.unesco.org/new/en/culture/themes/cultural-diversity/cultural-expressions/programmes/culture-for-development-indicators.

Undeveloped statistics methodology makes quantitative policy evaluation difficult

Measuring the impact of policies requires available data. In that regard, this chapter is also restricted by the absence of clear and commonly used data collection practices. The statistical methodologies of Albania, Bosnia and Herzegovina, and Montenegro adhere to the NACE Rev. 2 classification of economic activities of the European Commission. Accordingly, they collect data on gross value added, gross income and employment in their cultural and creative sectors. However, the scope of the data often fails to cover all areas of CCS, as they are defined by international standards. Complementary information usually comes from uncoordinated public sources, which impedes analysis.

Similarly, there is little information on the key players in CCS in the SEE region. Yet SEE 2020's emphasis on the importance of a regional approach in promoting design development requires a thorough mapping of key players. In most economies such information is still unavailable.

Albania and Serbia sporadically make various uncoordinated statistics available. Albania's Ministry of Culture collects data on key actors of the cultural economy. However, the approach is not yet regular, comprehensive and transparent. As for Serbia, analysis and mapping of its creative industries was carried out in 2005-6 by the British Council which, for the first time, covered Serbia's design and architectural sectors. It was followed by the German Technical Co-operation Agency in 2011, which compiled reports that provided early data on the creative sectors. International organisations and NGOs have also mapped, classified and analysed initial data on the creative sectors of the Serbian economy. NGO Academica and the Group for Creative Economy have taken steps towards mapping stakeholders and collecting data for economic indicators of the creative sectors. Bosnia and Herzegovina, Kosovo or the Former Yugoslav Republic of Macedonia are yet to develop integrated systems for collecting, publishing and analysing baseline statistics on design and creativity.

Nevertheless, efforts to map the sector, the use of international expertise and the adoption of successful frameworks (such as the 2009 UNESCO framework for cultural statistics) are positive steps in the right direction. Overall, the scarcity of coherent and reliable statistics is most acute in the design and creative industries area (Table 6.1) and slightly less in the areas of cultural heritage and the audiovisual sector.

Table 6.1. **Statistics indicator scores across all sub-dimensions**

	ALB	BIH	KOS	MKD	MNE	SRB
Cultural heritage statistics	1.0	1.0	1.0	1.0	3.0	2.5
Audiovisual sector statistics	1.0	0.0	0.0	1.0	3.5	2.0
Design and creative industries statistics	1.0	0.5	0.0	0.5	1.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Almost all the economies in the region struggle to collect data and, consequently, to conduct quantitative policy evaluations. In Bosnia and Herzegovina, Kosovo, and the Former Yugoslav Republic of Macedonia, statistical agencies collect and publish relevant data only sporadically. There are no systems for collecting, publishing or analysing baseline statistics on design and creativity.

An example of regional good practice in integrated statistics gathering might be Montenegro. MONSTAT, the Statistical Office of Montenegro, and the Agency for Electronic Media collect and publish statistics on the cultural and creative industries in accordance with international classification standards. The agencies store and regularly update statistics in their online portals. And the Film Centre of Montenegro, which is currently being put in place, is a positive step forward for the Montenegrin audiovisual sector and a model for the region. The Serbian Film Fund is also being put in place. Along with the already established Centre for Study in the Cultural Development of Serbia, it intends to bring together an even broader spectrum of audiovisual statistics.

The Montenegrin and the Serbian Statistical Offices, apart from collecting and publishing macroeconomic data on culture and creative sectors, have also extended the scope of collection with data on creativity and design sectors. In line with the principles of the EC's NACE Rev. 2 classification, they also collect data on industrial design, specialised design and architectural activities.

Audiovisual statistical data often concern the number of shows, visitors, performances and readers, but seldom include macroeconomic statistics such as the sector's contribution to GDP or national employment.

A positive step towards a regional approach to promoting CCS in the region could be facilitated by a thorough mapping of the key players in all the SEE economies. Continued efforts to map the design and creative sector could draw upon international expertise and successful frameworks like the 2009 UNESCO framework for cultural statistics.

All SEE economies could include macroeconomic audiovisual sector statistics, e.g. contribution to GDP or national employment.

Bosnia and Herzegovina, Kosovo, and the Former Yugoslav Republic of Macedonia could begin work on developing infrastructure and data collection capacities.

Montenegro and Serbia could fully integrate and implement their film funds, the Film Centre of Montenegro and the Serbian Film Fund. This might be followed by continuing to widen the spectrum of data collection and further extend the collection of statistics on the creative and design sectors.

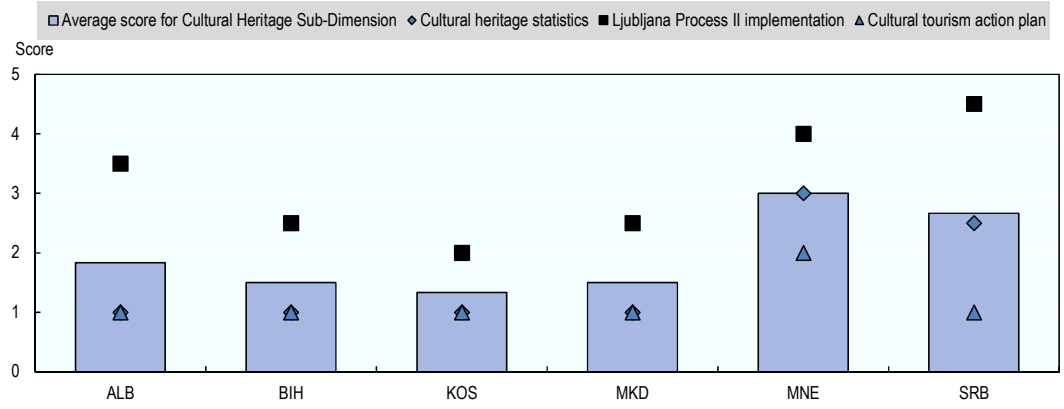
Cultural Heritage Sub-Dimension

The Cultural Heritage Sub-Dimension examines the development of common approaches to the rehabilitation of regional cultural heritage through three qualitative indicators and two quantitative indicators.

The **Ljubljana Process II implementation** indicator assesses the degree of development of the Process. Co-ordinated by the Regional Cooperation Council Task Force on Culture and Society and funded by the European Union, the "Ljubljana Process – Rehabilitating our Common Heritage" recognises that the region shares a common cultural heritage which it seeks to rehabilitate (Box 6.3). Going beyond the field of cultural heritage, this Process also contributes to building capacity and regional stability, preserving cultural diversity, promoting dialogue and co-operation, and allocating national and international funds effectively.

The **cultural tourism action plan** indicator reflects the development of a strategic approach to promoting culture to strengthen a regional brand and attract investment and tourists to the region.

Figure 6.4. **Cultural Heritage: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Analysis reveals commitment to reform and recognition of cultural tourism's great importance. However, apart from the regional success in the Ljubljana Process II implementation, economies' scores in the other two indicators of this sub-dimension leave significant room for improvement (Figure 6.4).

Nearly all SEE economies have taken steps towards compiling priority intervention lists to identify and rehabilitate monuments of cultural and historical importance, and producing reports on their interventions. All SEE economies have formed task forces and most have taken action to build efficient heritage management models.

Serbia, which scores best in the Ljubljana Process II implementation indicator, drew up priority intervention lists and carried out preliminary technical assessments of eight objects. It also developed three business plans, making thus effective use of its EUR 2 million funding. Montenegro and Serbia ran awareness-raising campaigns, which brought the aims of the Ljubljana Process to the attention of the public at large and gave

rise to a new wave of reforms. Hence, the relatively good scores assigned to these two economies (Table 6.2). Kosovo is assigned a lower score in the Ljubljana Process II implementation indicator of challenges with securing the sustainable financing to summarise activities and monitor implementation.

Table 6.2. **Cultural Heritage Sub-Dimension: Ljubljana Process II implementation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Ljubljana Process II implementation	3.5	2.5	2.0	2.5	4.0	4.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Box 6.3. **Ljubljana Process II**

In 2003, the Ljubljana Process was nested in the Council of Europe (COE) Regional Programme for Cultural and Natural Heritage in South East Europe (RPSEE). It was part of the COE's contribution – to bring about stability and the development of democratic, peaceful and free civil societies in South East Europe through the rehabilitation and preservation of the region's cultural heritage. A set of conceptual guidelines was established, underpinned by extensive practical documentation and designed to produce tangible benefits, both for local communities and for the fragile historic environment itself. The Ljubljana Process Ministerial Statement that closed the Ministerial Conference "Rehabilitating our Common Heritage" (Ljubljana, 6-7 November 2009), considered that the Regional Cooperation Council could become a key partner in the next phase of the Ljubljana Process. It would facilitate the on-going process of rehabilitating cultural heritage monuments and sites in the region.

In 2010, the meeting of the Council of Ministers of Culture of South East Europe (held in Cetinje, Montenegro on 23-24 April) adopted a Ministerial Statement on the Implementation of the Ljubljana Process II – Rehabilitating our Common Heritage. It confirmed the 2009 Ministerial Statement at Ljubljana, expressing a firm commitment to the pursuit of cultural heritage rehabilitation in South Eastern Europe after 2010. The RCC, supported by the Council of Europe and the European Commission, accepted the role of heading the initiative. In accordance with the priorities set by the Strategy and the 2011-2013 Work Programme and endorsed by the Heads of State and Governments of the SEE Co-operation Process, the RCC Board adopted a decision on 16 September 2010 on the establishment of the RCC Task Force on Culture and Society (RCC TFCS). It benefitted from the multi-annual financial support from the instrument of accession and was tasked by the Secretariat with the technical management of its activities and initiatives. Ministers of Culture from SEE, the RCC, the EC and the COE appointed their representatives to the RCC TFCS, comprising of 16 members. Participants included Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro, Romania and Serbia, as well as Greece, Moldova, Turkey and Slovenia, who are members of the RCC TFCS and observers of the Ljubljana Process II.

Source: Regional Cooperation Council (2013), *Ljubljana Process II* (webpage), www.tfcs.rcc.int/en/projects/ljubljana-process.

Low assessment scores indicate that strategic approaches to cultural tourism have been developed principally as part of general culture or tourism strategies. Furthermore, they seldom cover it fully and the implementing agencies' mandates are ill-defined.

Montenegro scores relatively better than the others (Table 6.3), thanks chiefly to the recognition of cultural tourism in its 2020 Tourism Development Strategy and the Regional Development Strategy. It is the only economy in the region which has included traditional crafts, cultural landscapes and heritage tours in the Ministry of Tourism and Sustainable Development's latest strategy and action plan to enrich and diversify its tourism offering. One goal of Montenegro's strategy is to boost tourism by modernising and upgrading its museums.

Table 6.3. **Cultural Heritage Sub-Dimension: Cultural tourism action plan indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Cultural tourism action plan	1.0	1.0	1.0	1.0	2.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

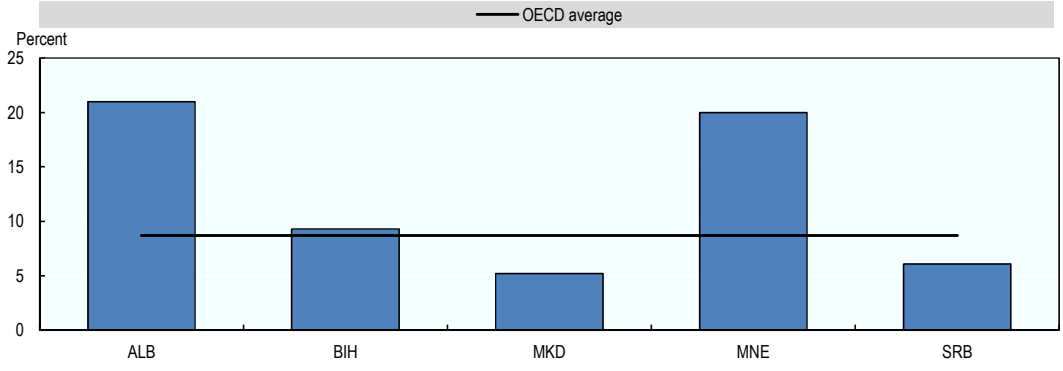
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The other economies are mostly at the drafting stage or consulting with stakeholders. Nevertheless, the region is gradually paving the way for its cultural heritage to become a pivotal competitive advantage of its tourist industry

Comparative analysis of the SEE economies reveals the importance of tourism as the main export "product" of Montenegro and Albania. About half of their export revenues stem from their tourism industries. According to 2014 statistics of the World Travel and Tourism Council (WTTC), tourism revenues accounted for between 5.2% of GDP in the Former Yugoslav Republic of Macedonia and 20% in Montenegro (Figure 6.5). The OECD countries' average was 8.7%.

Figure 6.5. **Travel and tourism, 2014**

Percent of GDP



Note: Data for Montenegro as of 2013. Data for Kosovo not available.

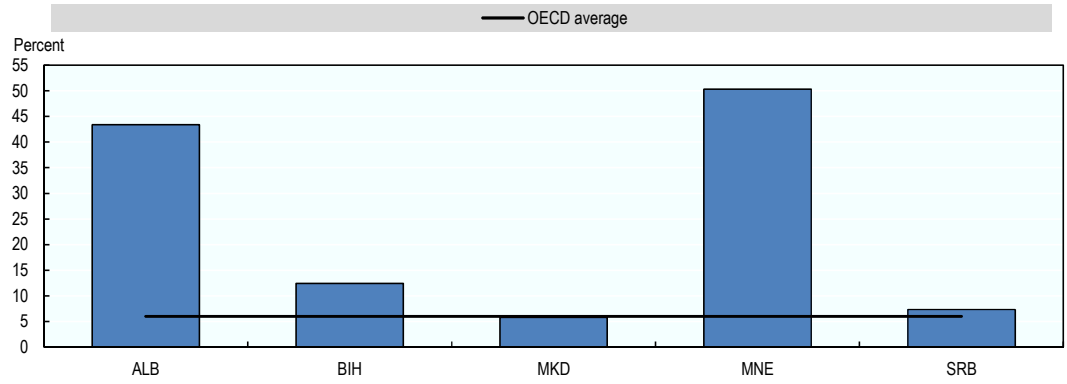
Source: World Travel and Tourism Council (2015), *Economic Impact Analysis*, www.wttc.org/research/economic-research/economic-impact-analysis/country-reports.

StatLink http://dx.doi.org/10.1787/888933321783

Another important factor, which may account for the tourism sector fuelling a higher percentage of exports in Albania and Montenegro than their regional peers (Figure 6.6), is that they have coastlines and coastal tourism is the region's predominant form of tourism.

Figure 6.6. **International tourism, receipts, 2013**

Percent of total exports



Note: Data for Kosovo not available.

Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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The SEE economies' policies are nascent. It could be highly beneficial to continue to upgrade their statistical systems and improve their basic policy implementation. SEE economies do not lack strategies and policies, but they could do more to make implementation and action plans more integral parts of policy agendas.

Audiovisual Sector Sub-Dimension

The European Investment Bank's definition of the audiovisual sector covers film, broadcasting, video and the multimedia industries (Debande and Chetrit, 2001). One rationale for government support and policy regulation in the audiovisual sector is to ensure cultural diversity and television programmes that respect pluralism, despite the market bias towards mass-viewing content (ibid.).

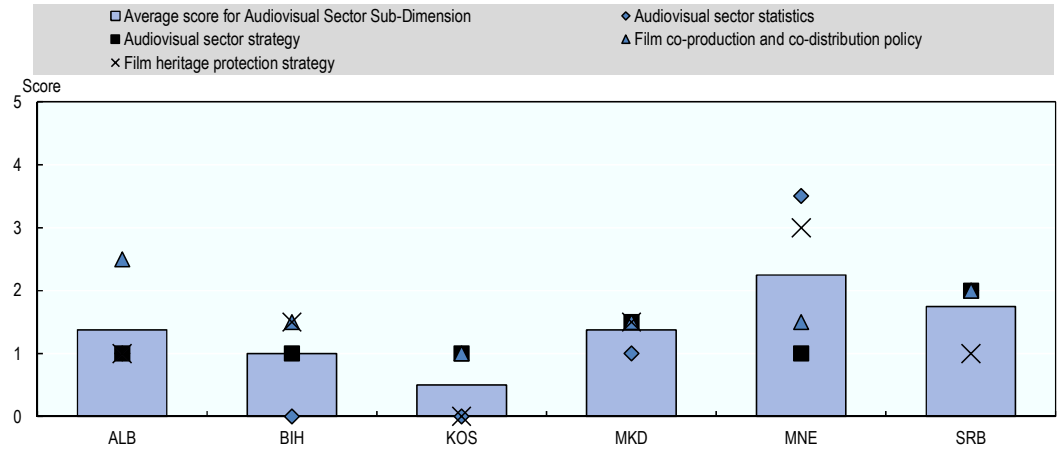
South East Europe has a long and rich tradition of excellence in the film industry which supports building and disseminating a regional identity. Regional co-operation between film policy bodies, public broadcasters, and production and distribution companies can support the creation of a regional film fund.

This section considers the Audiovisual Sector Development Sub-Dimension. Accordingly, it assesses efforts to strengthen the sector and to promote an overarching regional co-operation mechanism in the audiovisual industry. Progress towards that end is assessed by four qualitative indicators (Figure 6.7) and two quantitative indicators.

The **audiovisual sector strategy** indicator assesses the development of a comprehensive audiovisual sector strategic framework. The **film co-production and co-distribution policy** indicator measures policy progress in facilitating new films and the **film heritage protection strategy** indicator analyses efforts to preserve films.

SEE economies have room for improvement in developing audiovisual sector policies. There is variation between each indicator, but on average, SEE economies perform best in film co-production and co-distribution policy. Montenegro leads the way with the only overall average score above 2, representing some frameworks are in place.

Figure 6.7. **Audiovisual Sector: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Comprehensive strategies are yet to be put in place

Comprehensive strategies for developing the audiovisual sector are absent in all SEE economies. Instead, there have been various laws introducing regulatory measures, particularly in Serbia and Montenegro:

- Serbia – the Broadcasting Law, the Law on Public Media Services (2014), the Electronic Communications Law, the Law on Electronic Media (2014) and the Advertising Law (2014).
- Montenegro – the Law on Cinematography (2008), the Law on Copyright and Related Rights (2011), the Law on Optical Discs (2007) and the Patent Law (2008).

Institutions such as the National Centre of Cinematography in Albania, the newly established Macedonian Film Agency (2014), the Kosovo Centre of Cinematography, the Film Centre of Montenegro and the Film Centre of Serbia do the important jobs of managing funds (mainly public) and supporting audiovisual policies. They do not, however, draw up comprehensive strategies and action plans, but rather address audiovisual priorities within broader cultural strategies. These institutions usually intervene directly by subsidising or publicly sponsoring film producers.

It is often the case that SEE economies confine themselves chiefly to approving legislation and signing international conventions without the institutional capacity to implement them. Although South East Europe recognises the audiovisual industry as a smart growth path, its policies are still in the early stages of development, approval and implementation.

Serbia stands out for the strategic planning behind its three most important audiovisual institutions – the Serbian Film Centre, the Yugoslav Film Archive (Cinemateque) and Film News Institute (Institution Filmske Novosti).

Table 6.4. **Audiovisual Sub-Dimension: Audiovisual sector strategy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Audiovisual sector strategy	1.0	1.0	1.0	1.5	1.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323223

The Film Fund of Montenegro in Podgorica could play a central role in the effort to bring about a regionally integrated audiovisual sector. It collects a wide range of statistics and works with the Ministry of Culture in drafting Film Industry Development Programmes. As a member of the European Audiovisual Observatory since 2012 and having ratified the European Convention on Cinematographic Co-Production, the Montenegrin Film Fund could lay the foundations of a strategy for further development and integration.

Indeed, if such a strategy were comprehensive and set clear, measurable goals in pursuit of a strong, regionally integrated film industry, it could yield optimal results. For, as the holistic-thinking SEE 2020 Strategy propounds, collaborative ventures between companies, broadcasters and policy bodies can generate added value, employment opportunities and better quality competition.

In co-productions and film heritage preservation, commitment is stronger than strategy

The film industry of SEE economies relies significantly on government support. The competition and commercialisation of these sectors leaves space for future improvements. Future advancements could come from the mapping, strategic regional approach and evidence based policy making which would consider the comparative and the path dependence advantages that the culture and film heritage of the region has to offer.

When it comes to strategies related to the co-production and co-distribution of movies, Albania seems to perform relatively well (Table 6.5). Due to financial constraints, films produced in Albania are mainly co-productions. All producers are encouraged to apply for funding from Eurimages, the European Cinema Support Fund. The Albanian National Centre of Cinematography (ANCC), which actively supports Albanian film, generally works to develop comprehensive strategies. Prior to their application for support by ANCC, producers are usually required to have completed at least one international co-production already.

Table 6.5. **Audiovisual sector Sub-Dimension: Film co-production and co-distribution indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Film co-production and co-distribution policy	2.5	1.5	1.0	1.5	1.5	2.0

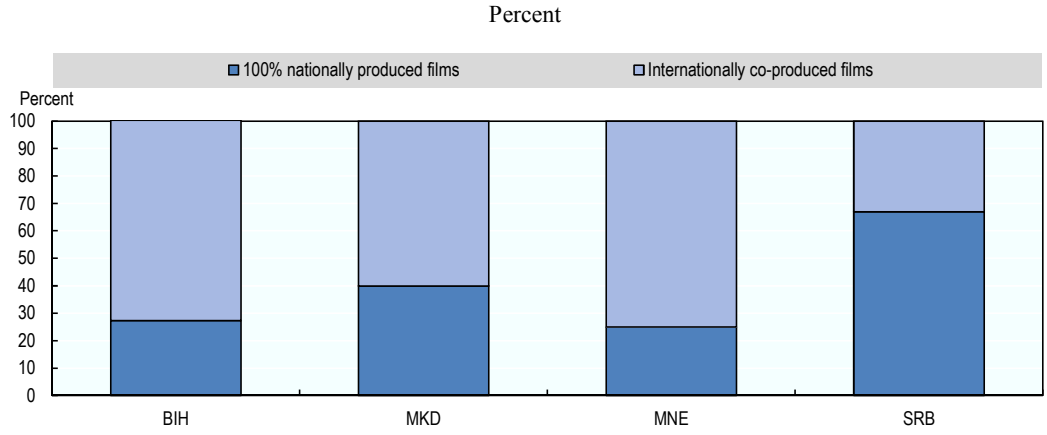
Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All co-productions and co-distributed projects in the SEE economies are government-funded. In Bosnia and Herzegovina, Montenegro and the Former Yugoslav Republic of Macedonia, the majority of films (between 60% and 75%) are international co-productions, while Serbia, with 67% of home-produced films, boasts the highest

percentage in the region (Figure 6.8). In June 2014, Serbia became, in fact the first non-EU country to join the Creative Europe programme.

Figure 6.8. **National film productions and internationally co-produced films**



Note: Data for Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia as of 2010. Data for Montenegro and Serbia as of 2011. Data for Albania and Kosovo not available.

Source: UNESCO Institute of Statistics (2014), *Cinema Statistics* (database), www.uis.unesco.org/culture/Pages/movie-statistics.aspx.

StatLink http://dx.doi.org/10.1787/888933321810

Given the long history of movie making in SEE, the preservation of film heritage is an important challenge for policy making. However, apart from a few efforts to include it in broader cultural policies or occasional laws, it has not yet been addressed strategically in Albania, Bosnia and Herzegovina, Kosovo, or Serbia.

A good regional example of inclusive work in film heritage preservation is done by the Montenegrin Cinematheque, which is also supported by the provisions of the new law on cinematography. The Yugoslav Film Archive and the Institution Filmske Novosti (Film News Institute) in Serbia, the Film Library in Bosnia and Herzegovina, and the Cinematheque in the Former Yugoslav Republic of Macedonia all support film heritage through the researching, recording, classifying and cataloguing of movies. They also conserve and store them.

However, when it comes to addressing issues in the audiovisual sector, there are only occasional, scattered attempts. Systemic approaches are few and far between. Montenegro sets an example, which could be emulated, as it has already laid foundations for developing audiovisual policies. As for Serbia, it exhibits strengths in national film production. While the other economies of the region co-produce more than three-quarters of their films with international partners, more than half of Serbian films are exclusively national productions.

Table 6.6. **Audiovisual sector Sub-Dimension: Film heritage protection indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Film heritage protection strategy	1.0	1.5	0.0	1.5	3.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323245

There is little co-ordination between audiovisual policy making and the collection of statistics. Indeed, a strategic approach to a medium-long term development plan for the sector is missing. Stakeholder action is uncoordinated, while better policy evaluation would require comprehensive empirical data.

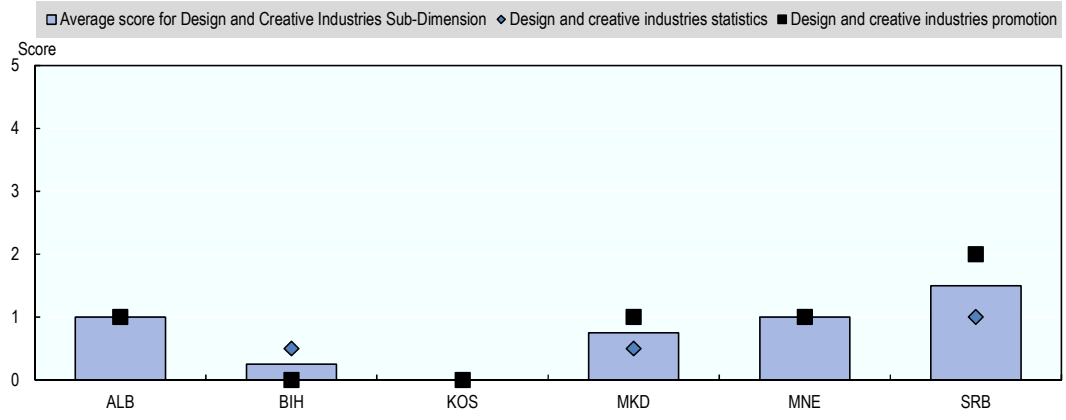
Design and Creative Industries Sub-Dimension

The notion of cultural and creative sectors has been extended to include relatively new areas of economic activity, traditionally not considered in the design and formulation of economic policies. Creativity plays a crucial role in complementing other products and services, because, not only does it enrich them with intangible characteristics, but it also diversifies it in terms of technological content. Furthermore, the development and specialisation of the creative professions have given rise to genuinely new branches of economic activity. By their nature, they are heavily based on the availability and embeddedness of skilled human capital.

This section looks at the Design and Creative Industries Sub-Dimension. Two qualitative indicators assess the SEE economies' efforts to make their creative sectors flourish, strengthen their data collection capacities and strategically draft development plans: **design and creative industries statistics** and **design and creative industries promotion**.

There has been little progress and low or no prioritisation of design and creativity as drivers of smart growth in the SEE region (Figure 6.9). The most significant actions undertaken in the past few years have been by individuals or NGOs, rather than as part of national policies with a strategic approach and objective. Some of the individual initiatives – like the Nova Iskra design incubator in Serbia (Box 6.4) – have given rise to innovative businesses and prompted the development of the sector; yet, they lack a strategic backing from the government.

Figure 6.9. **Design and Creative Industries: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933321823

Box 6.4. **The Nova Iskra design incubator**

Nova Iskra is the first design incubator in Serbia. As a unique meeting point for emerging creative professionals and forward-thinking businesses, it manages design and employs innovation in order to discover new values in the fields of creative business, education, social improvement and the empowerment of local communities. Its multifaceted platform embraces the design process as a starting point for developing problem-solving ideas, projects and services by assigning them tailor-made, cross-disciplinary teams comprised of leading experts, professionals and creative entrepreneurs. Nova Iskra uses progressive ideas and experiences from the creative domain as a tool to empower, update and develop small and medium-sized businesses, as well as to provide creative and business support to entrepreneurs on a local or global level.

The multi-functional workspace was established with the idea of supporting young, creative entrepreneurs from the fields of design, architecture, interior design, visual communications and other related fields. Professionals from design and architecture have a chance to use the spatial and technical resources of Nova Iskra for their individual work, as well as to take part in the numerous projects and programmes which are being developed in partnership with some of the leading local and international companies, schools, institutions and experts. A rundown office space of 350 square metres in the Gavrila Principa Street in downtown Belgrade has been fully reconstructed by the Belgrade-based architecture studio Petokraka. The interior makeover balances intact, rough treatment of the pillars, walls and custom elements specially designed for the space – all with the aim of serving the functionality of the concept. The visual presence of the project is enhanced by graphic design and identity developed by the studio Metaklinika. Nova Iskra's communal workspace also offers facilities for educational and training courses for up to 50 seated participants.

Source: OECD Assessment and Nova Iskra (n.d.), *Nova iskra* (webpage), www.novaiskra.com/sr/o-nama.

Given that the SEE economies are culturally similar and the creative professions are in very early stage of development, an approach based on co-operation could yield synergies and help promote a "regional brand".

Although culture is recognised as one of the most important assets in the region, there has been little government support for the private sector and non-profit groups working in design and the creative professions. Yet, the proper management of culture and creativity could generate substantial economic benefits and comparative advantages.

Table 6.7. **Design and Creative Industries Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Design and creative industries promotion	1.0	0.0	0.0	1.0	1.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323257

So far, the promotion of design development and creativity has relied on informal arrangements rather than comprehensive and transparent national strategies. Uncoordinated and loose links between educational institutions and creative industries can be found in Bosnia and Herzegovina and Kosovo. Neither economy, however, has developed or drafted any plan or strategic programme.

In the Former Yugoslav Republic of Macedonia, the Ministry of Culture has put in place a creative industry council. However, it has run no promotion campaigns or collaborative schemes on an organised footing.

In Albania, support for creative professionals originates mainly from an annual grant from the Ministry of Culture, the Albanian Investment Development Agency (AIDA) and some programmes run by the German Technical Co-operation Agency.

Montenegro has not developed a promotion strategy either, while the support for the creative professions comes from a limited number of donor-funded projects. Nevertheless, a successful government-backed effort launched in 2013 was the Fluid Design Forum, funded by the Ministry of Culture. Conceived as a series of lectures, panel discussions, workshops and exhibitions, its aim was to bring together interested professionals and art and architecture students to promote Montenegro's design community. It sought to raise public awareness while urging local and regional stakeholders to promote design as an important activity in civil society that was in the public interest.

Serbia has achieved relatively better outcomes than the other SEE economies when it comes to promoting design and creativity. Its chief, and most remarkable, success was the design incubator Nova Iskra in Belgrade. It has managed to bring together and foster synergies between designers, creative professionals, SMEs and various enterprises (Box 4). However, Nova Iskra was the initiative of private individuals and NGOs. Policies and strategies to promote and develop design are yet to come.

The economic growth attributable to the rise of the creatively thinking professions in South East Europe requires a better mapping of their systems of value creation and effective streamlining of policies. Such work should be a co-operative venture bringing together creative professionals and policy makers. Strategies should then be developed and implemented through specific, measurable, economically sustainable action plans. That, in turn, would stimulate investment, prompt sustainable growth, encourage co-operation and, ultimately, enhance the region's competitiveness in the European and global marketplace.

Conclusions

The SEE economies have intensified action to deploy their rich cultural and creative assets to further economic growth and competitiveness. Despite significant disparities between the SEE economies and the European Union, the importance of the CCS is now being recognised in South East Europe. Accordingly, governments are developing policies at both national and regional levels.

Most economies have approved strategic and regulatory frameworks and drafted the necessary legislation, particularly in cultural tourism and the audiovisual sector. They still need to reinforce implementation, however, through measurable action plans and better inter-institutional co-ordination.

The achievements in the cultural and creative sectors are evident. They have gained recognition as potential smart growth drivers, have prompted action for regional co-operation, and SEE economies have now included them in their legislation and institutional frameworks. The region's governments are currently adopting international standards in statistical methodologies which they plan to implement with the assistance of the international community in order to enable evidence-based policy making.

However, challenges remain in all the SEE economies. They principally relate to obstacles in the implementation of cultural policies and evidence-based policy making. The most common are encountered in the regional co-ordination of cultural policies, strategic planning in cultural tourism to stimulate private-public partnerships, the development of cultural statistics methodologies, and the drafting of action plans to develop the audiovisual, design and creative sectors. Significant economic benefits are to be generated and the potential of the region in the cultural and creative sectors could be exploited towards this aim.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 7.

Transport in South East Europe

Transport moves people and goods and links regions and countries, thereby integrating them into the global economy. The recently adopted Connectivity Agenda for the Western Balkans further commits SEE economies to prioritising regional transport projects to link them to EU markets. This chapter on the Transport Dimension begins with an analysis of overall performance and usage in road, railway, air, inland waterway and maritime transport. Three sub-dimensions investigate policy development. The Infrastructure Sub-Dimension examines: the scope of transport infrastructure strategies; the use of cost-benefit analysis and project prioritisation; strategies to reduce bottlenecks and non-physical trade barriers; transport telematics strategies. The Governance and Regulation Sub-Dimension assesses road safety strategies, railway sector liberalisation and alignment with the Single European Sky policy. The Sustainability Sub-Dimension describes co-modal transport optimisation strategies and policies to measure and monitor the environmental footprint of transport.

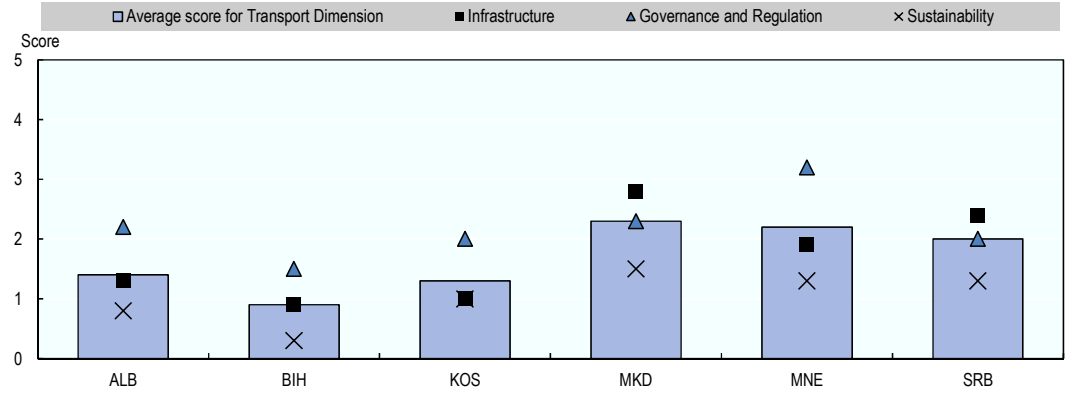
Main findings

Transport moves people and goods and links regions and countries, thereby integrating them into the global economy. Just as the liberalisation of trade can open new markets for developing countries, efficient transport systems and routes can lower costs and increase volumes of trade and movements of workers. Improved regional connectivity plays an important role in fostering economic integration and growth, which includes helping firms integrate into global value chains.

Inland infrastructure has developed significantly in the South East Europe (SEE) region over the past 20 years, boosted by high levels of infrastructure investment that has reduced transportation costs. For example, the cost of importing and exporting one 20-foot container fell by 4% between 2012 and 2015.

Transport policy initiatives have been developed in SEE, but their scope and level of implementation varies from one economy to another. Governments have made the most progress in the areas of governance and regulation followed by infrastructure. However, transport sustainability policies are still to be developed and implemented. Although progress measured by individual indicators in the three sub-dimensions varies greatly, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia score higher overall than their regional peers.

Figure 7.1. **Transport Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have made progress in national and regional infrastructure connectivity.

SEE economies have taken action to improve physical infrastructure and reduce bottlenecks. Transport infrastructure has been upgraded, especially in Montenegro, Serbia and the Former Yugoslav Republic of Macedonia.

SEE economies have increasingly aligned infrastructure projects with SEE regional and European transport network objectives. The South East Europe Transport Observatory (SEETO) Comprehensive Network, recently defined as the Trans-European Transport Networks (TEN-T) Comprehensive Network in South East

Europe, supports the Core Network Corridors and the Regional Core Network. Prioritising and implementing the SEETO Comprehensive Network's infrastructure projects further integrates the SEE region into European and international transport networks and facilitates the transport of goods and people between the East and West.

SEE economies have improved their transport regulations and governance. The SEE economies have continued their integration into the EU's Single European Sky (SES) initiative.

SEE economies have introduced road safety strategies and governments have made considerable efforts to implement them, particularly in Albania, Montenegro and the Former Yugoslav Republic of Macedonia.

Challenges

Despite their achievements, the SEE economies still face a number of challenges in developing transport infrastructure to facilitate the flow of goods and people.

Implementation of national transport strategy co-modal transport solutions is still a challenge. Albania, the Former Yugoslav Republic of Macedonia and Serbia have defined concrete multi-modal transportation nodes, but have not implemented them to date. The share of alternative transport modes in South East Europe – rail lines and inland waterways in particular – is still low compared to OECD countries.

Transport infrastructure maintenance remains one of the major challenges. Although transport infrastructure on the major transportation routes has improved, secondary infrastructure, e.g. roads and railways to smaller villages, has deteriorated. Road and railway maintenance and its relative cost per kilometre are still a serious concern.

Railway network access to private operators is limited. Although railway liberalisation reform has seen limited progress, Kosovo, Montenegro, the Former Yugoslav Republic of Macedonia and Serbia have made efforts to develop and adopt strategies relating to the EU Railway Packages. In practice, however, the railway market in the region is still closed.

Transport sustainability practices are not yet widespread. Sustainability strategies – e.g. the reduction of energy consumption, greater use of electric vehicles and the optimisation of public transport solutions in urban areas – are not yet common in the region and are still to be mainstreamed into infrastructure development plans.

Non-physical barriers to the movement of goods and passengers persist. Barriers such as border-crossing procedures, administrative obstacles and regulatory procedures could be further addressed.

Recommendations

Measures that address the challenges identified can help the SEE economies in their efforts to build more comprehensive regional and global transport networks.

Modernise and improve the efficiency of existing infrastructure. The SEE economies widely see the diversification and extension of their transport networks as key to improving competitiveness. The bulk of necessary transport infrastructure is already in place, however. As they seek to improve transport infrastructure, governments should maintain their focus on developing the SEETO Comprehensive Network, modernising it and further improving its efficiency. Inland waterways, rail freight and modern

multi-modal transportation nodes would make regional transport networks more attractive propositions for carrying goods and passengers.

Prioritise maintenance of the infrastructure network. SEE governments could consider using performance-based maintenance contracts to ensure better quality and improved lifecycle costs. Additionally, assessments of existing maintenance systems and unified best practice proposals for improvement could help increase maintenance efficiency.

Promote long-term thinking to prioritise strategic action. Governments could consider promoting long-term strategic thinking on transport infrastructure projects and implementing cost-benefit analyses to compare transport infrastructure projects. Ideally, such strategic thinking would take into account other policy areas.

Make transport sustainability an integral part of national transport strategies. Governments could focus more on developing a well-balanced transport system which incorporates the competitive advantages of the different modes of transport, environmental concerns and, through inter-modal nodes, usability. Governments could consider integrating into their strategies more outcome indicators to measure, for example, energy consumption, greenhouse gas emissions, the use of renewable energies and modal shifts from road to rail and waterways.

Facilitate high-quality logistics services and international shipments. Although international shipments and the quality of logistics services do not come directly within the public policy ambit, governments play an important role in promoting economic efficiency in the freight transportation sector – by reducing the length and variability of clearance times at borders through simplified procedures and better co-ordination. National logistics capacity plays an increasingly important role in attracting businesses and FDI.

Overview

Transport moves people and goods and links regions and countries, so integrating them into the global economy. Transport policies are necessary because of the extreme importance of transport in virtually every aspect of countries' economic, social and political activities. Transport policy refers to the development of a set of constructs and propositions that are established to achieve particular objectives. Those objectives relate to social, economic and environmental development, and to the functioning and performance of the transport system (Rodrigue, Comtois and Slack; 2013). For the purpose of this publication, modes of transport are confined to road, rail, air, inland waterways and the sea.

The OECD/ECMT paper, *Transport Infrastructure Investment and Economic Productivity* (2007), points to two important consequences of improvements in transport systems. The first is that the new EU member states are better connected to the rest of the EU and that manufacturing bases relocate to lower-wage regions, so aiding their growth. The second is improved transport systems in new member states which further in-country co-operation, mobility, and flows of goods and passengers.

The Prime Ministers of the Western Balkan economies and European Union representatives met at the Western Balkans 6 summit in Vienna in 2015 within the framework of the "Berlin Process". They committed to improving the connectivity within the Western Balkans as well as between the Western Balkans and the European Union. "Within the revision process of the TEN-T network, the SEETO Comprehensive Network

maps were included in the TEN-T Guidelines, where they appeared as indicative, and moreover, the SEETO Comprehensive Network was defined as the TEN-T Comprehensive Network in South East Europe, and interlinks were determined" (South East Europe Transport Observatory, 2015). For the purpose of this publication, the TEN-T Comprehensive Network in South East Europe is referred to as the SEETO Comprehensive Network.

The Transport Dimension is closely linked with other policy areas which support intra-regional trade assessed in this publication.

- **Chapter 2. Trade policy and facilitation** is enabled by efficient transport systems and routes which can increase volumes of trade and movement of workers. The quality and coverage of transport networks influence the costs of input, production, distribution and, thereby, national competitiveness (Aoki and Roberts, 2006). Improved regional connectivity plays a valuable role in fostering economic integration and growth, which includes helping firms to become more integrated parts of global value chains (OECD, 2015a). It has been estimated that a 10% increase in transport costs reduces the volume of trade by 25% (Limao and Venables, 2001).
- **Chapter 1. Investment policy and promotion**, in particular foreign direct investment, is drawn to areas with efficient transport (Saidi and Hammami, 2011).

Box 7.1. **Transport Dimension in the SEE 2020 Strategy**

The Transport Dimension is part of the Sustainable Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The Pillar's central objective is to boost growth and jobs by supporting a strong, diversified and competitive economic base that is better connected, more sustainable and more resource-efficient. The pillar seeks to support a 12% rise in the creation of new businesses and to more than double per capita export. Transport is set to play an important role in overall regional competitiveness as governments seek to improve connectivity and infrastructure and push for greater rates of use.

The SEE 2020 sets ambitious transport targets:

- reduce the cost of transport per unit of transport service by 20% and bring down TEU[1] transport costs to the EU average
- improve transport infrastructure rates of use to over 40% of designed capacity
- increase energy efficiency through a 20% reduction in energy consumption per unit of transport service
- increase the share of railway and waterborne transport so that they meet the specific targets set out in national action plans
- facilitate air transport.

The official SEE 2020 Strategy Co-ordinator for the Transport Dimension is the South East Europe Transport Observatory (SEETO). SEETO aims to promote regional co-ordination in developing the multimodal SEETO Comprehensive Network and to build local capacity for implementing investment programmes.

In 2015, the SEETO Comprehensive Network was defined as the TEN-T Comprehensive Network in the South East Europe.

Note: 1. TEU stands for twenty-foot equivalent unit of measure. It refers to a cargo volume that is equivalent to that of a standard 20-foot-long container.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE 2020-Strategy.pdf.

Transport Dimension assessment framework

This chapter assesses the Transport Dimension in the Integrated Growth Pillar of the SEE 2020 Strategy. It does not seek to be exhaustive, but to offer insight into three broad sub-dimensions and measure their progress against the objectives of the SEE 2020 Strategy:

- Infrastructure

  Are transport infrastructure strategies comprehensive and do they factor in cost-benefit analysis? Does policy improve physical infrastructure and reduce bottlenecks and does it reduce non-physical trade barriers? Do the SEE economies prioritise projects in accordance with SEETO objectives? Are they introducing intelligent transport systems?

- Governance and Regulation

  Do policies meet the need for harmonisation with the EU's transport *acquis*? Do they optimise efficiency and value for money? Is the private sector involved and are freight and passenger networks open to competition?

- Sustainability

  Are strategies in place to promote and optimise the use of co-modal transport? Does policy measure and monitor the environmental footprint of transport?

Figure 7.2 illustrates how the whole assessment framework is constructed.

Performance in the three sub-dimensions is measured by qualitative and quantitative indicators. The South East Europe Transport Observatory (SEETO), with the support of the OECD, collected qualitative and quantitative data for the indicators.

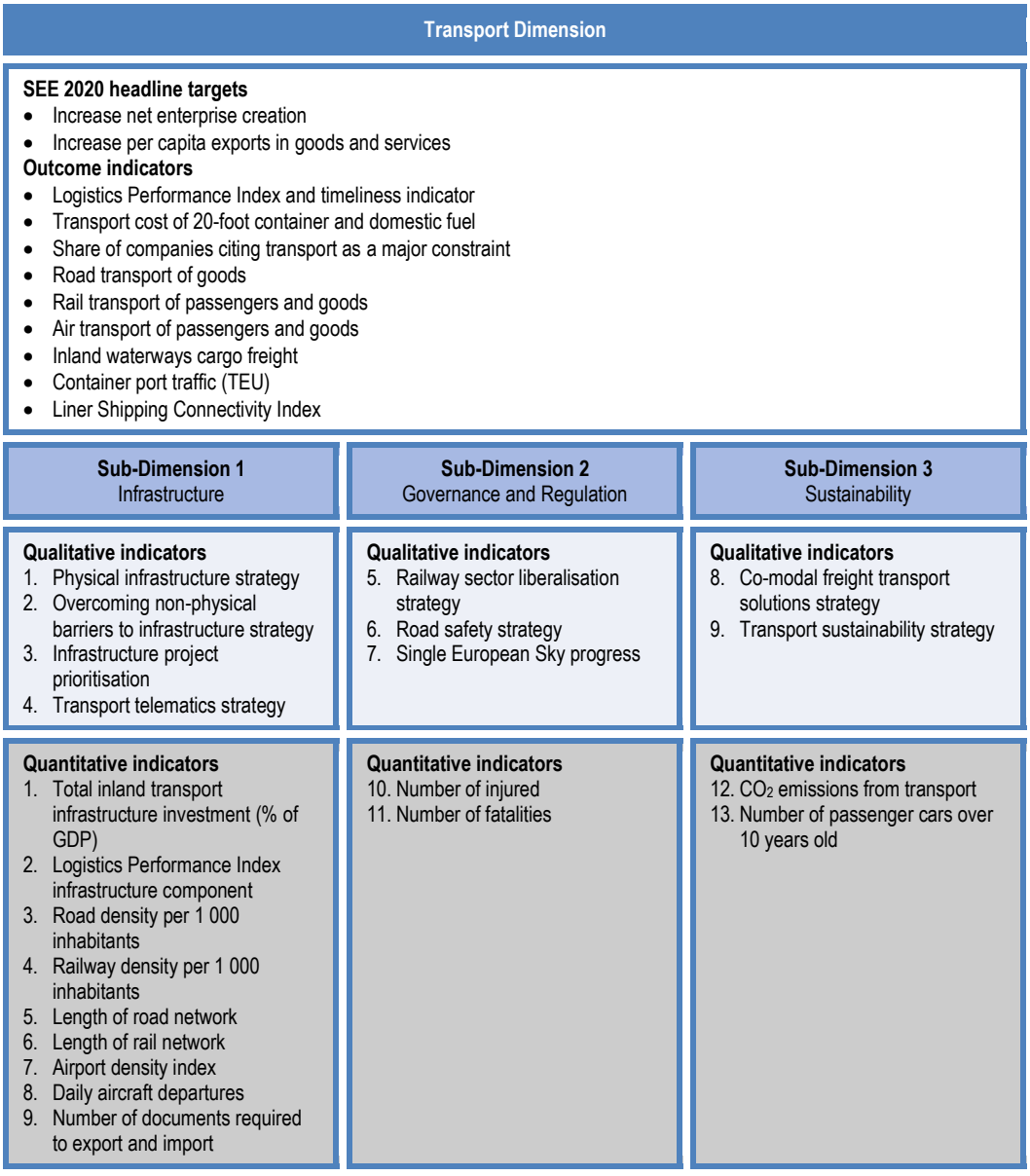
Quantitative indicators are based on national or international statistics. Qualitative indicator scores rate performance in ascending order on a scale of 0 to 5.[1]

Transport performance in SEE economies

An efficient, regionally connected logistics system is the cornerstone of a prosperous economy and an attractive foreign investment environment. The SEE economies adopted the Connectivity Agenda in August 2015 to further commit to co-ordinated regional infrastructure investment project and soft measure prioritisation, management and financing. Five main modes of transport are examined individually in this chapter – road, railway, air, inland waterway and maritime.

The World Bank's Logistics Performance Index (LPI) is a multi-dimensional international benchmarking tool for measuring countries' trade and transport facilitation friendliness. It analyses countries' performances against six areas of logistics – customs, infrastructure, ease of arranging shipments, quality of logistics services, tracking and tracing, and timeliness. They are measured on an ascending scale of 1 to 5 (very good). Foreign businesses use the LPI to identify challenges and opportunities related to the receiving country's transport infrastructure, logistics competence and availability of efficient supply chains. Korinek and Sourdin (2011) find improvements in the general quality of logistics have a stronger trade-enhancing effect on exports than on imports. They estimate that a 10% increase in a typical exporter's overall LPI score increases bilateral exports by more than 69% on average (all other trade determinants being equal).

Figure 7.2. **Transport Dimension assessment framework**

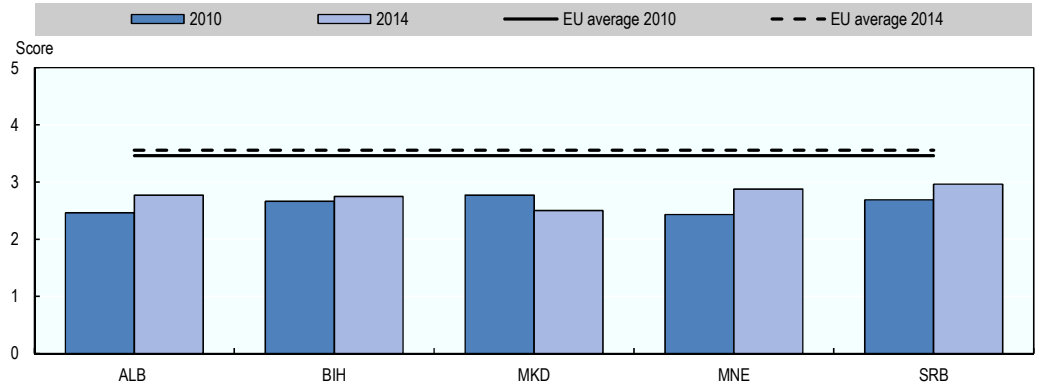


Between 2010 and 2014, the SEE economies improved their overall LPI (with the exception of the Former Yugoslav Republic of Macedonia). The median performance rose from 2.66 in 2010 to 2.82 in 2014. Overall, the SEE economies perform below the EU average and their global rankings in 2014 ranged between 63 (Serbia) and 117 (the Former Yugoslav Republic of Macedonia).

The LPI's timeliness quantitative indicator (Figure 7.4) estimates how often shipments reach the consignee within the scheduled or expected time (Arvis et al., 2014). Almost all SEE economies have improved their timeliness performance apart from the Former Yugoslav Republic of Macedonia. Nevertheless, the region still lags behind the average timeliness scores of the EU.

Figure 7.3. **Overall Logistics Performance Index (LPI), 2010 and 2014**

LPI score



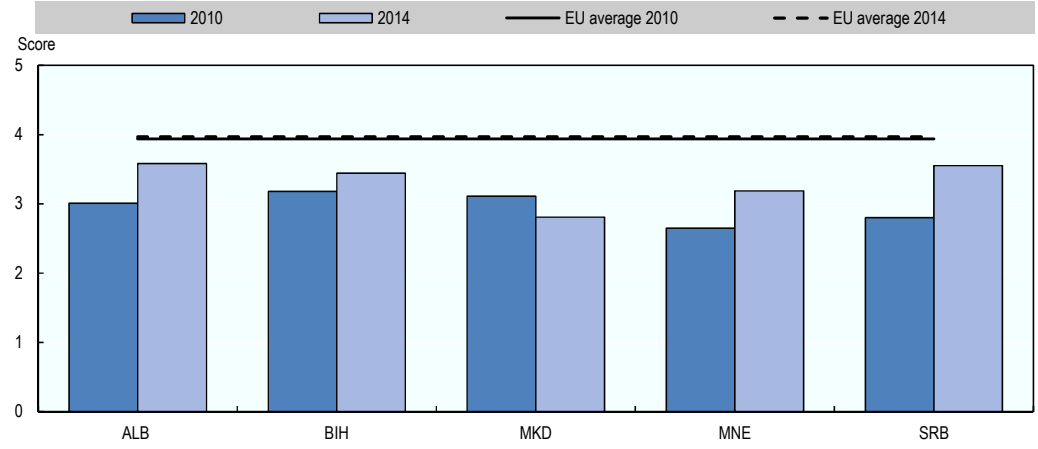
Note: LGI scores range between 1 (lowest possible score) and 5 (highest possible score). Data for Albania for the year 2014 as of 2012. Data for Kosovo not available.

Source: World Bank (2015a), *Logistics Performance Index* (database), http://lpi.worldbank.org.

StatLink http://dx.doi.org/10.1787/888933321840

Figure 7.4. **Logistics Performance Index (LPI) – Timeliness indicator, 2010 and 2014**

Timeliness indicator score



Note: LGI scores range between 1 (lowest possible score) and 5 (highest possible score). Data for Albania for the year 2014 as of 2012. Data for Kosovo not available.

Source: World Bank (2015a), *Logistics Performance Index* (database), http://lpi.worldbank.org.

StatLink http://dx.doi.org/10.1787/888933321858

Improved transport infrastructure seeks to bring down costs. The cost of transport has two components: money and time. Financial cost is determined largely by the price of fuel, tolls, vehicles and vehicle taxes. Time, however, can cost business more dearly. Late delivery may lose transport companies customers and future opportunities – a much higher cost than money wasted on carrying goods and people from point A to point B.

The cost of importing and exporting one 20-foot container has dropped by 4% since 2012. Costs have been falling in all SEE economies since 2009. Nevertheless, there are considerable differences between economies – some are land-locked, some larger than

their peers with longer distances between borders (which increases transport costs) and some have under-developed inter-modal transportation nodes.

The price of petrol in SEE is generally some 15 to 20% lower than in the EU, which yields a competitive advantage. And the wide use of natural gas as the fuel of choice, particularly by taxis, makes the region even more competitive. Diesel prices, though, are comparable with the average EU level.

Indeed, transport is not currently considered a major constraint in the region, according to the World Bank's 2015 Enterprise Survey (World Bank, 2015b). Only 4% of companies across the region considered it a serious impediment to business growth in 2013.

Demand for transport infrastructure in SEE economies is growing as passenger and freight activity has increased over the last two decades. Transport utilisation rates are key outcome indicators of public investment, infrastructure and logistics systems.

Passenger and goods road transport on the rise, despite variations between the SEE economies

Road transport is the most widely used mode for carrying both people and freight over short and medium distances. Two key factors in its success are its cost/quality ratio and the ability to ensure last-mile deliveries. In the SEE economies, though, road transport is generally the only viable option – other modes being underdeveloped – and region-wide demand is clearly on the increase.

The demand is driven by motor vehicle passengers, whose numbers have risen in recent years, and by hauliers. There was an overall increase in goods carried by road from 11 555 million tonnes per kilometre in 2009 to 16 512 in 2013. However, the picture varies from one economy to another, some seeing rises and others falls (Figure 7.5), with the most impressive increases coming in the Former Yugoslav Republic of Macedonia. However, anecdotal evidence suggests that road haulage in Serbia should show considerably higher growth. Figures should, therefore, be seen as expressing a trend rather than an economy's performance. Moreover, methods of collecting data vary from one economy to another.

Railway passenger and freight transport continues to decline

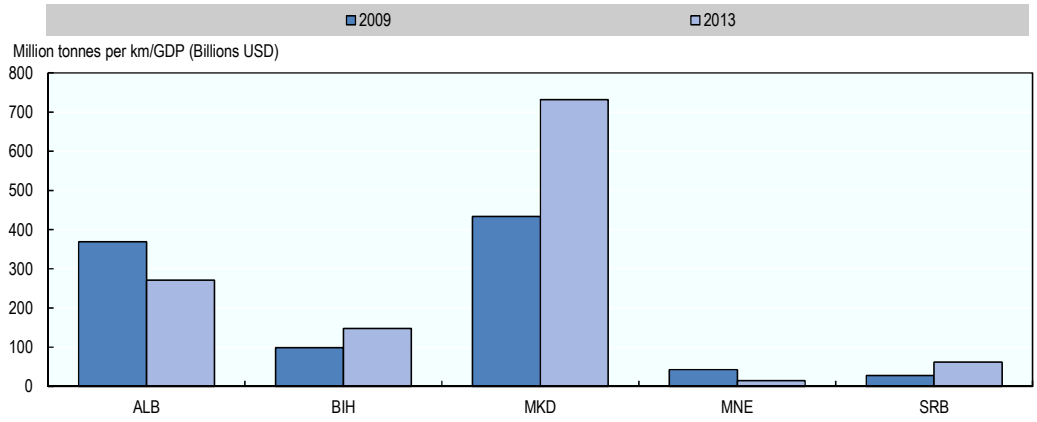
Train passenger numbers have declined over the last 25 years in South East Europe. Since the year 2000, they have fallen per passenger kilometre by over a half and by over 17% since 2010 (Figure 7.6).

If the million km-passenger ridership unit is normalised as a ratio of the millions of inhabitants in each economy, it emerges that people in Montenegro, the Former Yugoslav Republic of Macedonia and Serbia use the railways comparatively more than in Albania and Bosnia and Herzegovina. Only Serbia has seen a steady increase in the million km-passenger indicator since 2010. Compared to the EU, railway ridership is extremely low – even in Montenegro and Serbia.

SEETO ascribes falling passenger numbers mainly to longer travel times, insufficient maintenance and lower speeds. Another factor is the continued development of highway infrastructure, especially routes that run parallel to rail lines, prompting travellers and commuters to switch to cars.

Figure 7.5. **Distance and tonnage of road-transported goods, 2009 and 2013**

Million tonnes per km/GDP (Billions USD)



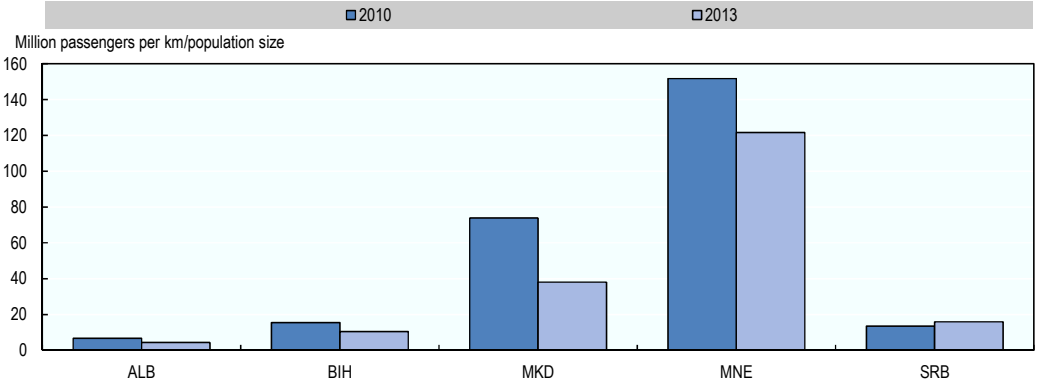
Note: Data for Kosovo not available.

Source: Adapted from OECD (2015b), *OECD.Stat* (database), http://stats.oecd.org; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321860

Figure 7.6. **Rail passengers, 2010 and 2013**

Million passengers per km/population size



Note: Data for Kosovo not available.

Source: Adapted from OECD (2015b), *OECD.Stat* (database), http://stats.oecd.org; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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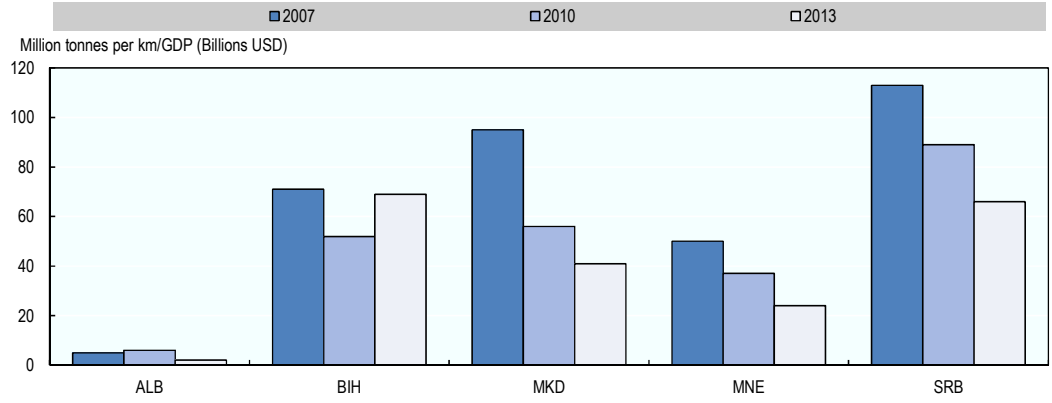
As for railway freight traffic, total tonnage has also declined in the last few years, attributable in part to the drop in heavy industry output (such as steel aluminium works) in the wake of the financial crisis.

Of the SEE economies in 2013, railway freight traffic is highest in Serbia and Bosnia and Herzegovina (Figure 7.7). It is expected that increased exports by automaker FIAT from its production plant in Kragujevac in Serbia through the port of Bar in Albania will revive rail freight volumes.

SEETO (2013a) estimates that Pan-European Corridor X is by far the busiest rail route in the region, accounting for 41% of freight and 67% of passenger traffic volumes in 2012.

Figure 7.7. **Rail freight, 2007, 2010 and 2013**

Million tonnes per km/GDP (Billions USD)



Note: Data for Kosovo not available.

Source: Adapted from OECD (2015b), *OECD.Stat* (database), http://stats.oecd.org; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321888

Air transport, chiefly for business trips, is growing, but interconnections are inefficient

Air transport contributes to the global integration of an economy especially for the international business community and tourism. Volumes of freight carried by air may not be huge, but in value they are significant. Air travel's value proposition is based on time: it is to save time that travellers and freight companies agree to air fares. Easy, rapid access to airports and their intermodal connectivity are as important as point-to-point air route density and airline performance.

From 2009 to 2012, the total number of passengers transiting through the 10 SEE airports rose from 7 to 9.4 million passengers, a 33% increase. Capital city airports saw the largest increases. For example, in just four years, passengers rose from 2.4 to 3.4 million at the Belgrade Airport (SEETO, 2013a).

Although the number of incoming and outgoing flights is growing in SEE airports (apart from Belgrade), they are still not well connected to most European cities. In 2015, Belgrade was the busiest airport with 71 departures per day, while there were between 12 and 24 departures on an average day from the region's other main airports (FlightStats, 2015). There are direct flights to cities like Vienna, Istanbul, Rome and some German and Swiss airports, generally locations with a strong SEE diaspora. The frequency of flights is likewise low, particularly to the major financial and business centres. Business travel and the development of tourism are constrained as a result.

Air transport is only marginally used to carry goods. Despite the 17% rise between 2009 and 2012 from 14 236 to 16 701 tonnes, total tonnage is negligible compared to other countries. For example, Brussels Airport, the EU's tenth busiest, handles

378 000 tonnes of freight annually. Air transport also has potential for carrying high-value products.

Inland waterways traffic has freight transport potential, but needs better intermodal links

Inland waterways are an efficient mode of transport which could play a greater role if they were better linked to other modes. For example, intermodal terminals could connect IWW ports to railways and roads.

Only Bosnia and Herzegovina and Serbia use inland waterways to carry goods and people. In 2012 two Serbian ports on the Danube accounted for 92% of all SEE waterborne freight with 1.4 million tonnes. Novi Sad Port handled high volumes of agricultural produce, while only 23% transited through Belgrade which handled five times more passengers (61 037) than Novi Sad.

According to SEETO (2013a), better navigating conditions, the use of RIS systems and a degree of recovery from the economic crisis have increased passenger and freight traffic through the river ports in the SEETO Comprehensive Network. Novi Sad, for example, reported an 81% increase in tonnage over 2011.

Maritime port traffic continues upward trend, but intermodal connections are still poor

The international shipping industry carries over 90% of the world trade tonnage and has been constantly growing over the last two decades. It is the most competitive mode of transport for large volumes of goods over long distances (International Chamber of Shipping, 2015). The containerisation of trade and access to containerised transport services are important determinants of countries' trade competitiveness.

The port of Durres in Albania is the busiest cargo-handling seaport in the SEETO Comprehensive Network. Together with Bar in Montenegro, it is the only container port in the SEE region. Container traffic at Durres grew 4% between 2011 and 2012 to 95 500 TEU, while Bar accounted for approximately half that. The trend is set to continue, particularly since Albania granted a 35-year operating concession for the Durres container terminal to a joint venture bringing together Turkish steel maker Kurum and Maltese sea operator Mariner.

Demand in the SEETO Comprehensive Network Seaports dropped slightly between 2010 and 2012. While Durres performed well, cargo handled at Vlora Port in Albania fell, so lowering the overall tonnage of the three ports by 4% from 3.82 to 3.68 metric tonnes.

The Liner Shipping Connectivity Index (LSCI), published by UNCTAD since the mid-2000s, captures how well countries are connected to global shipping networks. It measures the quality of service provided by the liner shipping companies.

The LSCI assigns fairly low scores to the SEE region, which suggests that Albania and Montenegro do not have good connectivity between liner shipping and other modes of transport. Between 2010 and 2014, Albania's score fell slightly from 4.34 to 4.11. Although Montenegro's score in 2014 was lower at 2.89, it was up from 2.48 in 2010. One of the reasons for the poor index score is the low volume of containerised trade in the region and the poor connectivity of liner shipping to other modes of transport. Montenegro's lower score is chiefly due to limited containerised shipment handling.

By comparison, Croatia has shown impressive progress in recent years, with its LSCI score climbing from 8.97 in 2010 to 23.47 in 2014. Its performance is due mainly to improved infrastructure and its seaports' better intermodal connections facilities.

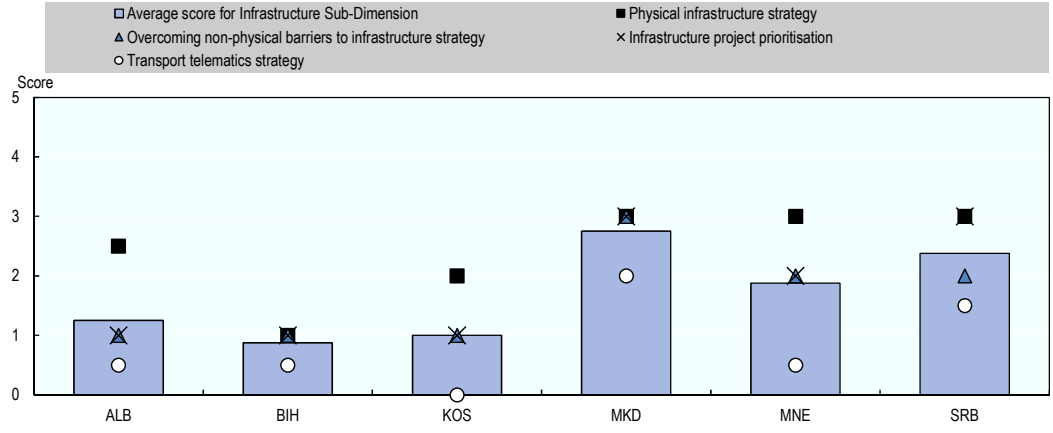
Infrastructure Sub-Dimension

Transport infrastructure has a significant impact on the productivity and the cost structure of businesses (Haughwout, 2001). Better port and hinterland connections, for example, can reduce expenditure on building distribution networks that carry raw materials.

However, transport infrastructure projects are resource-intensive and governments often have to choose between, for example, building a road bridge, an airport extension and creating additional railways link. A comprehensive transport infrastructure strategy that factored in cost-benefit analysis would help make the right investment choices.

This section looks at the Infrastructure Sub-Dimension. Accordingly, it examines what SEE economies are doing to develop strong, efficient transport infrastructure and assesses measures that improve transport systems' rates of utilisation and their costs. To that end, it uses four qualitative indicators (Figure 7.8) and nine quantitative indicators applied to modes of transport.

Figure 7.8. **Infrastructure: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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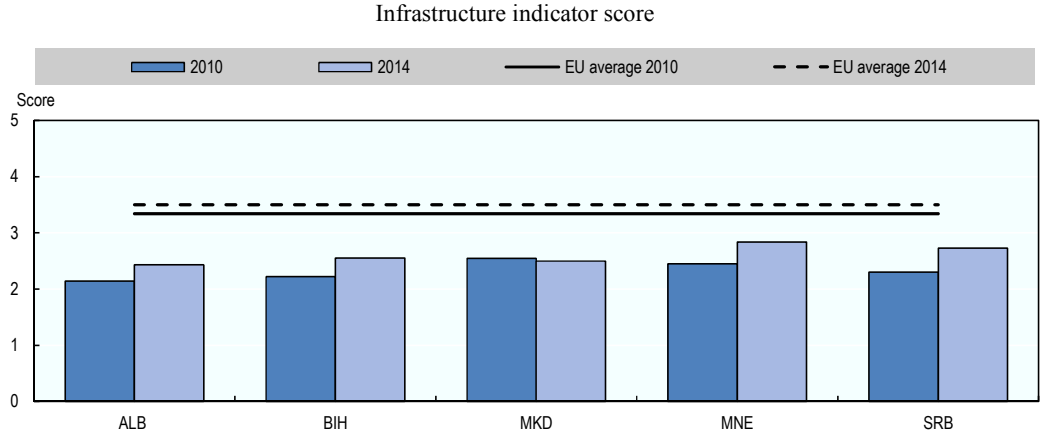
The regional average score in the Infrastructure Sub-Dimension is 1.7. It indicates that most of the economies have adopted strategies to improve the physical infrastructure and remove bottlenecks, but with varying degrees of success.

Two groups are to be distinguished: the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, which score highest, and Albania, Kosovo, and Bosnia and Herzegovina which score below the regional average. All, however, perform poorly when it comes to the transport telematics indicator, possibly because telematics strategies have emerged only recently as a part of transport policy.

Physical infrastructure strategies are largely in place

Physical infrastructure is foundational in transportation. The LPI's infrastructure indicator represents the overall quality of trade- and transport-related infrastructure. All SEE economies increased their score from 2010 to 2014 except for the Former Yugoslav Republic of Macedonia which is almost unchanged (Figure 7.9). Montenegro and Serbia lead the region. On average, SEE economies score about 75% of the EU average value in 2014.

Figure 7.9. **Logistics Performance Index (LPI) – Infrastructure indicator 2010 and 2014**



Note: LGI scores range between 1 (lowest possible score) and 5 (highest possible score). Data for Albania for the year 2014 as of 2012. Data for Kosovo not available.

Source: World Bank (2015a), *Logistics Performance Index* (database), http://lpi.worldbank.org.

StatLink http://dx.doi.org/10.1787/888933321907

The level of funding dedicated to physical infrastructure development is a critical factor in the ability to implement such strategies and the quality of existing infrastructure. Total inland infrastructure investment as the percentage of GDP in the region has increased since 2004 (Figure 7.10). The rise stems from the need to build and upgrade transport infrastructure, particularly in Albania as it has the lowest LPI infrastructure indicator score in the region. Average investment in infrastructure has actually outstripped the OECD average.

The magnitude of investment ranged widely from less than 0.6% of GDP in Montenegro to over 2% in Albania in 2013. Albania has extended its highway network over the past decade, while Montenegro has not, or only very little. Albania's investment in inland transport infrastructure is over four times the EU average, Serbia has slightly higher levels than the EU average, while the Former Yugoslav Republic of Macedonia and Montenegro have the lowest levels of expenditure (Figure 7.10).

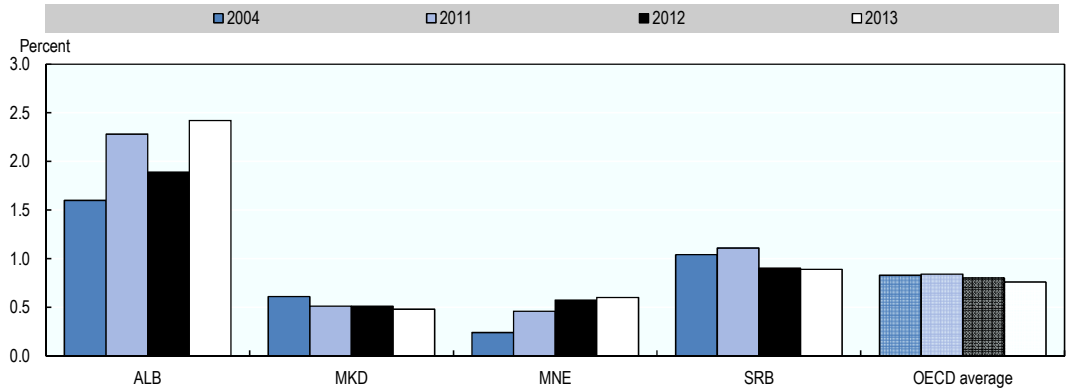
Assessment of investment by mode of transport reveals that roads claim the lion's share – 75% of investment in the region over the period 2010 11. As for individual economies, road infrastructure accounts for over 90% of total transport investment in Albania and Kosovo.

The **physical infrastructure strategy** indicator assesses strategic policy development and implementation in physical infrastructure for all modes of transport including road, rail, air, inland waterways and seaports. All economies except Bosnia and Herzegovina

have a strategy in place. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia are implementing their strategies (Table 7.1).

Figure 7.10. **Total inland transport infrastructure investment, 2004 and 2011-13**

Percent of GDP



Note: Data for 2012 and 2013 are OECD estimates. Data for Bosnia and Herzegovina and Kosovo not available.

Source: OECD (2015b), *OECD.Stat* (database), http://stats.oecd.org.

StatLink http://dx.doi.org/10.1787/888933321914

Table 7.1. **Infrastructure Sub-Dimension: Physical infrastructure strategy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Physical infrastructure strategy	2.5	1.0	2.0	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Road infrastructure is not keeping pace with density

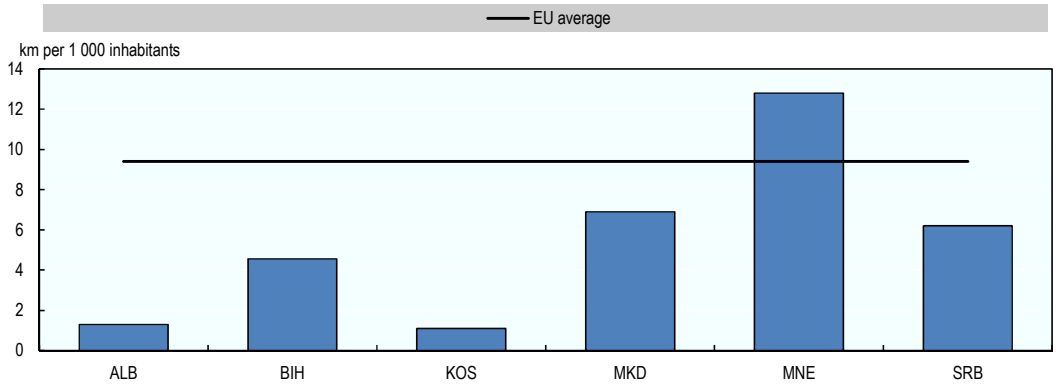
Road infrastructure is crucial to an economy's competitiveness and trade. Continent-wide, most freight and passengers are carried by road, widely recognised as the most flexible mode of point-to-point transportation. Depending on the number of journeys and distances travelled, it is often also the most economical.

There is growing demand for roads from passenger vehicles, as automobile registrations rise fast in the SEE region. The total length of roads and motorways combined grew between 2003 and 2013 by an average of 16%. In Kosovo, the rise was over 60% and in Albania almost 50%. As for the Former Yugoslav Republic of Macedonia, the total length (in kilometres) of its motorways grew by 20% between 2005 and 20% (Eurostat).

However, road infrastructure is still not as developed as it is in the EU, as the road density index shows (Figure 7.11). There is considerable room for improvement in Albania and Kosovo and, to a lesser extent, Bosnia and Herzegovina where, though data relate to 2008, the situation has not substantially changed.

Figure 7.11. **Road density (excl. motorways), 2013**

km per 1 000 inhabitants



Note: Data for Bosnia and Herzegovina calculated by OECD analysts based on the data from the World Bank for the period of 2008.

Source: Adapted from European Commission (2015a), *Enlargement countries – transport statistics* (webpage), www.ec.europa.eu/eurostat/statistics-explained/index.php/Enlargement_countries_-_transport_statistics#Transport_networks; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321921

For years the underfunding of maintenance work has produced roads, especially secondary roads, in a state of disrepair. If poor maintenance continues, it could jeopardise current efforts to rehabilitate and build of new roads, which would affect the SEE economies' competitiveness.

There are little reliable data on road maintenance costs and the criteria, procedures and performance indicators for financing maintenance need to be clarified. A SEETO Comprehensive Network Development Plan 2014 highlights disparities between countries in the cost per kilometre of road maintenance. One reason is the differences in definitions and standards of maintenance.

Currently, maintenance contracts are awarded on a demand-driven basis through open calls to tender or framework contracts. OECD research suggests that maintenance contracts should be performance-based in order to achieve the best value for money rather than simply the lowest price. The result would be better long-term results and lifecycle costs (OECD, 2015c). An EU-funded project is currently underway to provide technical assistance to the public enterprise, Roads of Serbia, in modern road maintenance systems governed by performance-based maintenance contracts (PBMC). A World Bank road rehabilitation programme in Albania, the Former Yugoslav Republic of Macedonia and Serbia includes assistance in the management of roads and maintenance systems.

Rail infrastructure suffers from low investment and poor maintenance

Although rail freight has a better environmental profile than trucking and is cheaper per tonne per kilometre (tonne-km), the rail network in any country is far less well developed than its road network. Many governments have plans to switch traffic from road to rail in order to curb the negative externalities of road traffic such as congestion, accidents and the environmental footprint. To do so, though, countries should have a dense railway network and good multi-modal platforms for trans-shipping. Railways

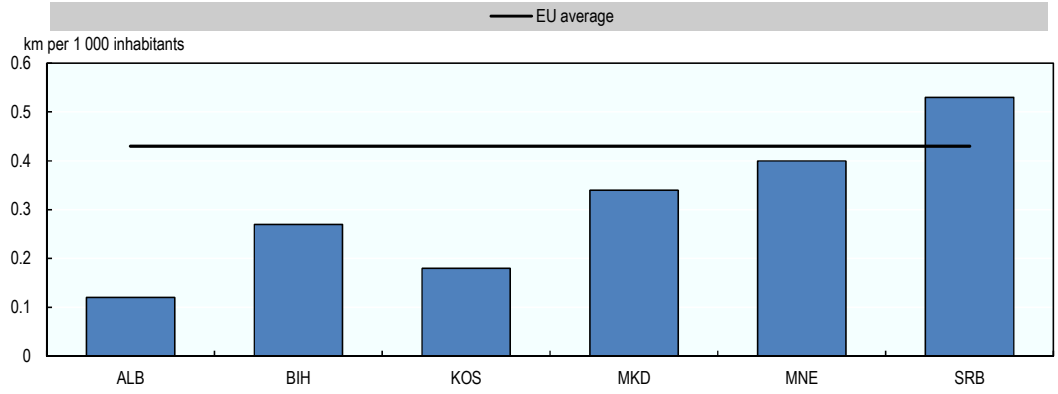
themselves should also be modern to be able to serve as a complementary mode of transport whenever it makes economic sense.

The SEE region's total railway network did not grow between 2003 and 2013. In fact, it shrank by 74 kilometres. Overall, though, SEE railway density (Figure 7.12) is in line with the EU average – with the exception of Albania, Bosnia and Herzegovina, and Kosovo – and in Serbia it is even higher.

The effectiveness and efficiency of the railway network across the region have paid the price of years of maintenance spending cuts. Reliability, punctuality and journey times have all suffered. According to SEETO (2013a) poor maintenance – which meets 11% of yearly needs – has caused extensive speed restrictions on Serbian rail network, with speeds on approximately half of its lines not exceeding 60 km/h.

Figure 7.12. **Railway density, 2013**

km per 1 000 inhabitants



Source: Adapted from European Commission (2015a), *Enlargement countries – transport statistics* (webpage), www.ec.europa.eu/eurostat/statistics-explained/index.php/Enlargement_countries_-_transport_statistics#Transport_networks; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321935

Users have turned to roads which, in turn, have further contributed to neglect of the railway network. Its infrastructure has aged and deteriorated to a point where it requires immediate, costly upgrading. SEETO (2013b) reports that only 4% of the region's railway network was in very good condition, with significant differences between the economies in maintenance expenditure per kilometre.

Multi-annual performance-based contracts could contribute to the proper maintenance of SEE's railway networks. Governments would pay contractors according to how well they were deemed to have complied with a contract's performance specifications and not on the strength of the quantity of works and services performed.

Air transport infrastructure is developing

SEETO distinguishes the following ten airports in six SEE economies that form part of the SEETO Comprehensive Network: Banja Luka, Belgrade, Nis, Podgorica, Pristina, Sarajevo, Skopje, Tirana, Tivat and Ohrid. Until recently, the terminal buildings were relatively small and their technical equipment needed to be upgraded. Major

reconstruction and modernisation work is now underway to build capacity that meets market demand. Skopje, Ohrid, Pristina, Podgorica and Belgrade airports have gone through major refurbishment and are up to the highest international standards.

A country's airport density index measures the number of airports that were the point of departure of at least one scheduled passenger flight per million inhabitants. The index helps to analyse cross-border infrastructure. The SEE economies' scores in 2012 ranged from Serbia's 0.3 to 3.17 for Montenegro whose high score may be explained by its small population. The SEE region boasts a higher airport density index than most other parts of the world, a possible asset for further integration into the global economy.

Inland waterway infrastructure's high cargo-carrying potential is impeded by poor maintenance

Inland water-borne transport infrastructure consists of waterways with associated buildings, navigation machinery, ports and quays. Inland waterways (IWWs) have very attractive commercial potential for carrying large shipments of goods.

In Europe, the ideal IWW navigation system is the Rhine's. It links large economic centres along its course and has a dense canal network in its low-flow stretches, navigable tributaries and several connection points with other large IWWs. The volume of goods it carries, the density of its network and the density of centres with extremely high economic activity provide the economic base for navigation.

Two great rivers in South East Europe could be used as cargo-carrying IWWs. They are the Danube and Sava. The Sava flows through Slovenia, Croatia, Bosnia and Herzegovina and Serbia into the Danube at Belgrade. As for the River Danube, is an international waterway that crosses 10 countries – including Germany, Romania, Hungary, Serbia, Austria, Bulgaria and Croatia. Both rivers have much transport potential.

However, IWWs in the SEE economies are far less developed, with bottlenecks caused by poor maintenance, wrecks, and even unexploded ordnance on river beds and along the banks. Vessels navigating inland waterway in Pan-European Transport Corridor VII, along the 180-kilometre Serbian stretch of the Danube, have contend to with 24 critical bottlenecks. One example is at Apatin on the Croatian border where the fairway is too narrow. Considerable investment would be needed to remove such bottlenecks.

Particularities of the IWW system in the SEE economies are that it provides no cross-links to other important industrial areas, has a low level of inter-modal connectivity and includes no extensive canal systems at any of its sections. Inland waterways could claim a larger share of the transport services market if they could be integrated into the inter-modal transport network. Further gains could be secured by dredging, improving navigability, and building multimodal hubs for transhipment between water, rail and road.

Waterway navigation safety at the EU level benefits from automated River Information Services (RIS) and particularly the vessel tracking system (VTS). Internal waterways are reliable to the degree to which they meet the minimum requirements necessary for cost-effective navigation.

Seaports need to improve intermodal connections to compete internationally

Although three economies have coasts, the SEETO Comprehensive Network includes seaports only in Albania (Durres and Vlora) and Montenegro (Bar). Most Bosnia and Herzegovina freight transits through the Croatian port of Ploče, which has a direct railway connection to Sarajevo and the rest of Bosnia and Herzegovina.

Durres is the busiest seaport in the SEETO Comprehensive Network and its importance is growing steadily. Work to upgrade it is continuing after the recent overhaul of the terminal building. The port is especially important as it lies on Pan-European Transport Corridor VIII. Currently (2015), it is 25% cheaper, 300 kilometres shorter and saves 10 hours in travel time to travel from Skopje (the capital city of the Former Yugoslav Republic of Macedonia) from the Italian port of Bari through Durres rather than through Igoumenitsa in Greece. Yet most shippers prefer the route through Greece. To make Durres more attractive, the Albanian government is planning action a set of measures. They include improving multi-modal connections and logistics, which are key to making the port more competitive and smoother-functioning.

Durres and Bar (in Montenegro) are the only ports in the six economies of the SEE region that can take container ships. Any plans to develop them should factor in hinterland connection capacity, since poor links are often cited as bottlenecks that hamper the movement of goods in and out of ports.

SEETO (2013a) calls on the SEE economies to modernise and upgrade their ports in order to attract global cargo flows and compete with Mediterranean and other Adriatic ports. To boost growth and gear port activities to the market economy, the Albanian government has formed partnership with private operators as an alternative way of managing the Durres and Vlora oil terminals and Durres Container Port.

SEE economies support regional infrastructure project priorities

Defining strategic priorities is the first step in the process of planning, enabling and funding infrastructure projects. As public finances are increasingly squeezed, prioritising and delivering projects in the right order is critical to meeting economic and social demands. Accordingly, the SEETO Comprehensive Network has set regional targets and infrastructure priorities for regional growth and increased competitiveness. The qualitative indicator, **infrastructure project prioritisation**, assesses whether governments are setting and prioritising projects in line with SEETO as established strategic practice.

Table 7.2. **Infrastructure Sub-Dimension: Infrastructure project prioritisation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Infrastructure project prioritisation	1.0	1.0	1.0	3.0	2.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323276

All SEE economies do, in fact, prioritise their transport infrastructure investment projects in accordance with the objectives of the SEETO Comprehensive Network and the TEN-T priority areas. Albania, Bosnia and Herzegovina, and Kosovo have yet to set up formal systems (Table 7.2).

Transport telematics does not appear to feature strongly in infrastructure strategies

Transport telematics applies information and communication technologies (ICT) to transport to make it cleaner, more efficient, safer and more secure, and to facilitate interaction between users, infrastructure and transport modes (EC, 2007). Intelligent transport systems (ITS) are being developed for applications like road traffic tolling, signalling and interoperability on the railways, air-traffic control and on-board telephony in aviation, and maritime navigation and communication. Furthermore, such technological updates optimise safety and transport as outlined by SEE 2020 commitments. The **transport telematics strategy** indicator assesses the roll-out, if any, of telematics to manage transport infrastructure more cost-efficiently.

Table 7.3. **Infrastructure Sub-Dimension: Transport telematics strategy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Transport telematics strategy	0.5	0.5	0.0	2.0	0.5	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323283

Transport telematics strategy and use are nascent across the region (Table 7.3). Serbia has just developed a draft strategy and action plan for deploying telematics and approved 134 intelligent transport system technical standards. Its national strategy for 2008-15 explicitly includes the use of transport telematics and ITS for monitoring transport parameters like flows and speed. The Former Yugoslav Republic of Macedonia and Montenegro also have telematics strategies in place. Albania, Bosnia and Herzegovina and Kosovo would benefit from taking their first measures to introduce transport telematics.

The way forward in removing physical barriers, prioritising and increasing the use of telematics in infrastructure policy

As the SEE economies look to the future, they could give thought to interventions that would improve their transport infrastructure and availability of multi-modal nodes. They could continue implementing their strategies. Initially, they could identify priority projects in the SEETO Comprehensive Network and ensure sufficient funding is available. They could prioritise maintenance over new extensions. They could consider carrying out comparative impact analyses when faced with the dilemma of prioritising transport infrastructure investment options.

Albania, Bosnia and Herzegovina, and Kosovo would all benefit from adopting a formal strategy or methodology incorporating SEETO prioritisation.

All SEE economies would benefit from developing and adopting holistic transport telematics strategies.

Box 7.2. Some principles behind public governance of public-private partnerships

A. Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities.

- The political leadership should ensure public awareness of the relative costs, benefits and risks of public-private partnerships and conventional procurement. Popular understanding of public-private partnerships requires active consultation and engagement with stakeholders as well as involving end-users in defining the project and subsequently in monitoring service quality.
- Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, public-private partnerships units, the central budget authority, the supreme audit institution and sector regulators are entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability.
- Ensure that all significant regulation affecting the operation of public-private partnerships is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.

B. Ground the selection of public-private partnerships in value for money.

- All investment projects should be prioritised at senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project. There should be no institutional, procedural or accounting bias either in favour of or against public-private partnerships.
- Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a public-private partnerships option further.
- Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.
- The procuring authorities should be prepared for the operational phase of the public-private partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the public-private partnerships, as the actors on the public side are liable to change.
- Value for money should be maintained when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparently and subject to the ordinary procedures of public-private partnership approval. Clear, predictable and transparent rules for dispute resolution should be in place.
- Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the public-private partnerships programme so that there is an on-going functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.

Box 7.2. **Some principles behind public governance of public-private partnerships** (*continued*)

C. Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process.

- In line with the government's fiscal policy, the central budget authority should ensure that the project is affordable and the overall investment envelope is sustainable.
- The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of public-private partnerships covers the whole public sector.
- Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.

Source: OECD (2012a), *Recommendations of the Council on the Principles for Public Governance of Public-Private Partnerships*, www.oecd.org/governance/budgeting/PPP-Recommendation.pdf.

Policy development in addressing non-physical barriers in infrastructure vary

Ten years ago, transport infrastructure was one of the chief barriers to trade and the flow of goods through South East Europe. However, recent interviews have revealed that, in the wake of numerous infrastructure investment projects, only 4% of respondents still believe it is. Today, non-physical barriers like regulatory, institutional and administrative formalities are much more of an impediment to the performance of the regional transport network than physical barriers. They can take the form of required customs physical or documentary inspections, the absence of cross-border electronic data exchange, or even out-of-date national customs websites and IT systems at border crossings. Non-physical barriers might also be poor private-sector involvement and a lack of competition, or fees and charges on imports and exports, all of which increases transport costs. Furthermore, "variability is one of the main factors of efficiency of the customs and border clearance" (Ojala and Çelebi, 2015). Unpredictability and variability in clearance times are issues for international shippers and deter them from using certain routes. They prefer established, predictable procedures, even if they are lengthy, because they are able to plan accordingly.

Although progress has been made in recent years, there is still room for improvement. According to the World Bank report, *Doing Business 2014*, SEE economies require six to eight documents per shipment to export goods. The high-income OECD countries require 3.8 on average. There is a similar pattern in import documents – between five and eight in contrast to 4.3.

With the objective of further identifying and analysing physical and non-physical barriers to efficient operation of its Comprehensive Network, SEETO commissioned the *Regional Balkans Infrastructure Study* (REBIS) in 2013. It also plans to produce transport demand, forecasting and transport planning models for the region. It will then draw up a priority action plan to address the study's findings. It will include time and cost estimates for any interventions that are required. National strategies and measures should build on those findings and similarly adopt action plans regarding investment in new infrastructure and maintenance of old infrastructure.

The **overcoming non-physical barriers to infrastructure strategy** indicator measures progress in reducing non-physical trade barriers – i.e. administrative documentation, customs procedures and fees – to cut transport costs and facilitate trade. The indicator considers a range of non-physical barriers and focuses on integrated border management strategies. For a complementary analysis on barriers to trade, please see Chapter 2 in this publication.

Table 7.4. **Infrastructure Sub-Dimension: Overcoming non-physical barriers to infrastructure strategy indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Overcoming non-physical barriers to infrastructure strategy	1.0	1.0	1.0	3.0	2.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323291

All SEE economies have taken some action in border formalities in accordance with SEETO's 2012-14 Strategic Work Programme. Similarly, they have all, to varying degrees, addressed integrated border management strategies. Although all the economies have taken measures to address non-physical barriers, they are individual initiatives rather than part of a coherent regional strategy, which explains the difference in scores Table 7.4. Individual measures include setting up one-stop shops across the region to promote swift border crossings for road traffic.

The Former Yugoslav Republic of Macedonia has made the most headway with an integrated border management strategy in place since 2003. It has also adopted further strategies and action plans, such as the Customs Administration Interoperability Implementation Strategy, the Customs Administration ICT Strategy, and Strategy for the Implementation of a New Computerised Transit System.

Kosovo has signed one-stop shop border agreements with Albania, Montenegro, the Former Yugoslav Republic of Macedonia and Serbia. And it is currently in negotiation with Italy over scrapping the tax on tracks from Albania that transit through the port of Durres. As for Serbia, it has developed a strategy to remove non-physical barriers and bottlenecks in its inland waterways.

The way forward for removing non-physical trade barriers

As the SEE economies look ahead, they could consider a number of interventions to reduce non-physical trade barriers. Albania, Bosnia and Herzegovina, and Kosovo could develop a coherent strategy or action plan to tackle key non-physical bottlenecks in accordance with the recommendations of SEETO and the Central European Free Trade Agreement (CEFTA). Montenegro, the Former Yugoslav Republic of Macedonia and Serbia could further advance the implementation and monitoring of measures to reduce non-physical barriers.

Governments could not only progress with regulation and legislation, but also pay special attention to the managerial aspects of clearance. For example, customs procedures could be simplified and automated to increase productivity gains due to improved IT capability and improved management and human resources.

All the SEE economies could take timely action to prevent the new requirements of the EU's transport *acquis* from initially generating non-physical barriers, such as new truck and train licences and special permits.

In addition, the SEETO Flagship axes initiative, through an EC Technical Assistance, could create an Action Plan for addressing targeted non-physical barriers on selected corridors and routes from the SEETO Comprehensive Network.

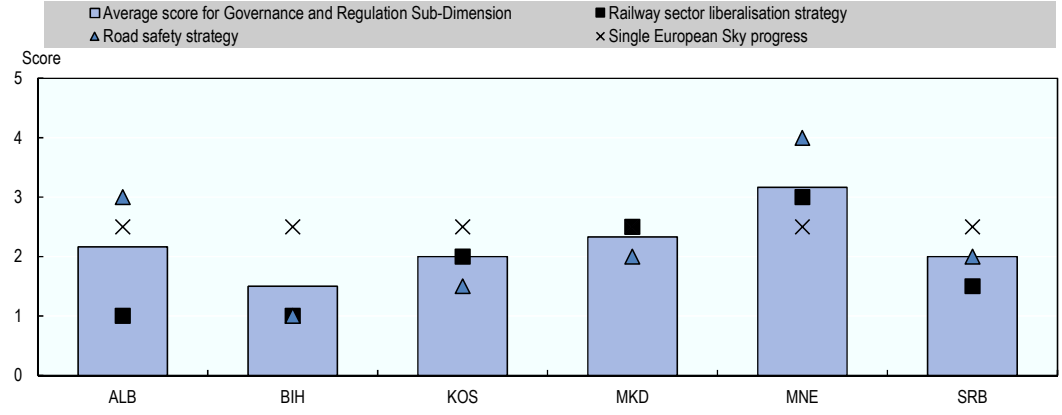
Governance and Regulation Sub-Dimension

Good governance in transport is critical to sustaining its development and economic growth, which makes it important to regional competitiveness. The challenge of improving transport infrastructure in response to growing activity and demand can be met by optimising the sector's efficiency and getting the most out of constrained government budgets. Efficiency in road and railway construction can be gained by reducing cost and time overruns on civil works contracts, reducing over-engineering in road and rail design, and inviting the private sector to participate in infrastructure financing. Regulation includes ensuring competition in passenger and freight carrier markets in all modes of transport and delivering a safe, sustainable transport sector.

The Governance and Regulation Sub-Dimension examines how well transport infrastructure and networks are regulated and operated. In the SEE context, it relates in particular to harmonisation with the EU transport *acquis communautaires* as part of the effort to create market conditions common to the EU and South East Europe. Harmonisation with the EU regulatory framework is a prerequisite for full integration into the common market.

This section assesses the policy sub-dimension as of June 2015 through two quantitative indicators and three qualitative indicators, which are: railway liberalisation strategy, road safety strategy and Single European Sky (SES) progress.

Figure 7.13. **Governance and Regulation: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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With a regional average of 2.2, the SEE economies score highest in the Governance and Regulation Sub-Dimension with varying scores by indicator (Table 7.5). Most of the governments already have strategies in place and are implementing them. Some, like

Montenegro's Road Safety Strategy, are well advanced in implementation and are now monitoring and integrating findings.

Table 7.5. **Governance and Regulation Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Railway sector liberalisation strategy	1.0	1.0	2.0	2.5	3.0	1.5
Road safety strategy	3.0	1.0	1.5	2.0	4.0	2.0
Single European Sky progress	2.5	2.5	2.5	2.5	2.5	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Railway liberalisation is at different stages in the region, but still remains a closed shop

Although all economies have started out on the path to railway liberalisation, there is a still long way ahead. The SEE 2020 Strategy emphasises liberalisation in railway services and opening up the rail market to competition as key strategic action. However, as SEETO points out, railway reform is an area where most economies have so far achieved little (SEETO, 2013a).

Railway liberalisation is a slow process (see Box 7.3 on the German experience) and SEE is no exception. Nevertheless, there has been progress in the transposition and implementation of EU legislation over recent years reflected in the **railway sector liberalisation strategy** indicator. Some SEE economies, for example, have drafted or extended safety and interoperability legislation to transpose the EU rail *acquis*. Still, the railway market remains closed. There have been virtually no new entrants in the region, so setting back what has been achieved in alignment with the *acquis* and detracting from efforts in institutional reform.

All SEE economies have started engaging with reform to liberalise their railways. They have all adopted legislation as part of harmonisation with the *acquis*. The sole exception is Albania, which is finalising the process and has not yet formally adopted a railway liberalisation strategy. By contrast, three economies – Montenegro, the Former Yugoslav Republic of Macedonia and Serbia – are further advanced in liberalisation than their peers.

Governments have made efforts to develop railway oversight. All, apart from Albania, have established regulatory, licensing and safety authorities. However, not all those bodies are fully independent, which decreases their indicator scores. It should also be noted that the economies with small rail sectors are seeking ways to reduce the financial burden of introducing and running all the railway regulatory bodies in EU rail provisions.

Montenegro has almost completed alignment with the EU rail *acquis*. Separate companies have run infrastructure (IM) and operations (RU) since June 2008 and independent operators have also taken charge of cargo and rolling stock maintenance.

Kosovo has made progress since 2011 when it adopted its new Railway Law. Since then it has vertically separated its railway company and in 2012 drew up a new institutional framework. It has created a regulatory authority with four separate units – the Licensing, Safety, Market Regulatory, and Interoperability and Notified body.

Serbia is prioritising implementation of the EU's Fourth Railway Package, intended to unbundle the ownership of infrastructure and the operation of passenger and freight. Implementation takes years, but Serbia has already completed the third EU railway package, designed to open up international passenger services to competition.

Montenegro, the Former Yugoslav Republic of Macedonia, and Serbia have also adopted safety and interoperability legislation to bring their bodies of law increasingly into line with the EU's rail acquis. To tighten the safety of passengers and freight, the law in those economies will now further regulate driver licensing and certification, safety management systems, accident and incident investigation.

The SEE economies still have strides to make when it comes to implementing reform, particularly in the liberalisation of railway services, where there have still been virtually no new market entrants.

As they look to the future, the SEE economies could consider a number of directions in which to advance harmonisation once they have passed all key rail reforms. Albania could formally adopt a railway liberalisation strategy.

Bosnia and Herzegovina, Kosovo, Montenegro, the Former Yugoslav Republic of Macedonia, and Serbia could continue to develop regulatory, licensing and safety authorities through measures including adequate training and staff levels.

Box 7.3. **The Deutsche Bahn experience**

OECD experience shows the benefit of opening up the railway market to competition. In Germany for instance, reform has improved serviced and reduced subsidies and overall costs. It has also made the incumbent operator, Deutsche Bahn, which was loss-making 20 years ago, into a profitable firm today.

To take reform forward and organise competition in the railway market, the government could create a separate infrastructure entity that would charge trains for access. It could also liberalise the train operating market, awarding licences to new operators to run trains on existing tracks and pay a toll for access to infrastructure. Operators would compete on ticket prices, on-board services, rolling stock attractiveness and timetables.

However, railway liberalisation is a lengthy process and in Germany it took over 20 years.

Source: Deutsche Bahn (2012), *1994 to 1999: Years of change* (webpage), www.deutschebahn.com/en/group/history/chronology/1994_2000.html.

Road safety has improved, but casualties in traffic accidents are still high

Road safety in the region is still a major concern that calls for action. The SEE 2020 Strategy emphasises the importance of alignment with EU *acquis* in the area of road safety, where there is substantial room for progress across the SEE region.

It is a transport policy priority in the EU, whose 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, and promoting the use of safety equipment and policies to protect vulnerable transport users such as pedestrians, cyclists and motorcyclists (EC, 2011).

According to statistics collected by SEETO's GIS application, SEETIS III, 43 645 people were injured on the roads in 2012 in the six SEETO economies – a very high number, even though it constituted a drop of 8%.

However, when analysing the number of road fatalities per million of population, the regional trend is downward (Figure 7.14).

The qualitative indicator, **road safety strategy**, examines whether or not economies have comprehensive road safety strategies in place and how far they have taken implementation and alignment with EU regulatory policy.

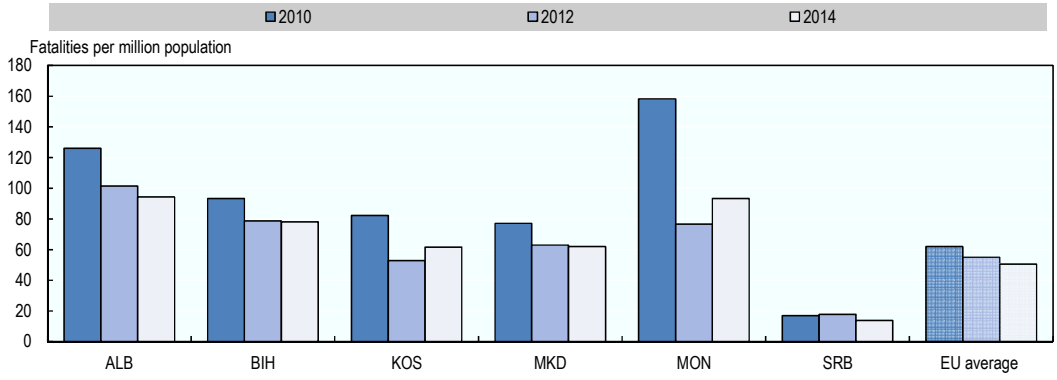
Most economies in the region have made efforts to draw up, approve and implement strategies to improve road safety. It remains a grave concern, however, and the economies have generally laid solid foundations for improvement by adopting national road safety strategies or programmes.

The EU has given support to SEETO's Strategic Working Programme 2012-2015. It has drawn up new curricula and guidelines and provided training to road safety auditors from the SEE economies.

Road safety strategy should focus on impacts and involve all relevant stakeholders. It should not only list activities and strategic goals, but plan proper road safety budget allocations at national and regional levels. Finally, the economies should share regional good practices in order to promote effective approaches.

Figure 7.14. **Number of road fatalities, 2010, 2012 and 2014**

Per million population



Source: European Commission (2015b), *How safe are your roads? Commission road safety statistics show small improvement for 2014* (press release), www.europa.eu/rapid/press-release_IP-15-4656_en.htm; South East Europe Transport Observatory (n.d), *SEETIS* (webpage), http://webseetis.seetoint.org/seetis.home; OECD/ITF (2015), *ITF Transport Outlook 2015*, http://dx.doi.org/10.1787/9789282107782-en; World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Montenegro has made great strides in road safety. It launched its National Strategy for Road Transport Safety Improvement in 2010 and is scheduled to run to 2019. It then followed up with the creation of a co-ordination body which monitors the implementation of strategy on a regular basis – a factor in Montenegro's high score. By 2013, 6 objectives had been fully achieved, 17 partially so and 6 not yet.

Albania, too, has made substantial progress. It is currently implementing its 2011-15 National Road Safety Strategy and Action Plan. It has established a number of bodies that are up and running to oversee different aspects of road safety. Examples are the Inter-ministerial Committee on Road Safety, the Albanian Road Authority and the Directorate of Road Traffic and Safety.

Serbia has approved a Road Traffic Safety Law and, more recently, launched its Road Safety Strategy covering the period 2015-20.

As the SEE economies look ahead, they could consider a number of interventions to further road safety. Bosnia and Herzegovina and Kosovo could adopt coherent domestic road safety strategies. The Former Yugoslav Republic of Macedonia and Serbia could intensify the implementation of domestic strategies. Albania and Montenegro could improve road safety monitoring mechanisms and adjust them to regional and EU best practices.

Single European Sky legislation transposition has begun

Single European Sky (SES) comprises two legislation packages: SES I and II. SES I, adopted in 2004, established the framework for creating the Single European Sky, the provision of air navigation services and the organisation and use of airspace. SES II extended the scope of the regulation in order to improve the performance and sustainability of the European aviation system. The programme, Implementation of a Single European Sky in South East Europe (ISIS), is funded by the European Commission which supports SES implementation in the region's economies.

ISIS I (2010-12) supported economies in transposing EU law into their domestic legislation and building the capacity of national supervisory authorities. ISIS II builds on that and seeks to facilitate and monitor implementation with special emphasis on the SES performance scheme and cross-border co-operation aspects.

The **Single European Sky progress** indicator thus measures SEE economies' progress towards full single sky implementation, as evaluated by ISIS I and II. The SEE economies' long-time commitment to putting SES in place accounts for their good scores in the Single European Sky progress indicator. Their rapidly developed aviation infrastructure has been matched by their adherence to international and EU regulations on navigation, safety, security and market liberalisation. The SES is an important element of the European Common Aviation Area Agreement (ECAA) signed in 2006. Under the terms of the ECAA, the SEE economies undertake to align their aviation legislation with the EU *acquis* – thereby gaining full access to one of the key areas of the common market and taking a step towards further economic integration.

However, economies did not score higher because the process of transposing SESII has only recently begun. One of the main institutional obligations in the air transport sector is the establishment and operation of accident and incident investigating bodies. In some cases, economies appoint a single institution for several modes of transport, as does Kosovo, where the Aeronautical and Railway Accident and Incident Investigation Commission answers to the Office of Prime Minister. Albania, for its part, has established a National Investigation Body, while in the Former Yugoslav Republic of Macedonia the Committee for Investigation of Aviation Accidents and Serious Incidents is independent.

All SEE economies have made headway in SES, transposing the SES I package into domestic legislation. The ISIS programme has proven an effective instrument to that end.

As they look ahead, all SEE economies should consider completing the transposition of the SES II regulations and implementing them. They could further improve the performance and capacities of the national supervisory authorities. They could further strengthen cross-border co-operation and share good practices.

Sustainability Sub-Dimension

The goals that the SEE 2020 Strategy pursues include lower energy consumption per unit of transport and the switch of freight from roads to rail and waterways. Meeting those goals would help cut overall transport costs and so boost exports and imports.

Transport intermodality and sustainability go hand in hand. In many OECD member countries, policy advice considers the promotion of intermodal practices as an important part and objective of sustainable transport strategies that often include modal shift action – i.e. measures to divert freight-carrying from road to rail and, where feasible, to coastal shipping and waterways.

Moreover, driven by environmental concerns and sustainability objectives, green transport policy is assuming greater importance in policy formulation in OECD countries (OECD, 2012b). They have set some ambitious targets for increasing the use of low-impact inland modes of transport. One example comes from the Port of Rotterdam which plans to use inland waterway for 45% of its transport needs by 2035, road for 35% and rail for 20% (OECD, 2010). Measured in total tonne-kilometres, roads accounted for 75%, inland waterways 6.9%; and rail 18.6% of freight transport across the EU in 2012. In order to achieve green transport targets, it is not enough to act on energy efficiency alone. Modes of transport that complement each other should be promoted, too.

Box 7.4. **Regulatory Enforcement and Inspection, a valuable reference document from the OECD**

The OECD publication, *Regulatory enforcement and inspection*, was developed to share good practices in governance and regulatory enforcement. It seeks to assist countries in reforming inspection practices and developing cross-cutting policies on regulatory enforcement. It sets out principles for building overarching frameworks that support better regulatory enforcement through inspections, making them more effective, efficient, less burdensome for those inspected and less resource-demanding for governments.

Regulatory enforcement and inspection offers valuable guidance that is relevant to transport policy. One chapter, for example, considers co-ordination and consolidation. It offers advice on how to improve the efficiency of inspections, reduce their costs and ease the burden they represent by restructuring regulatory enforcement agencies to consolidate their functions and eliminate duplication and overlaps.

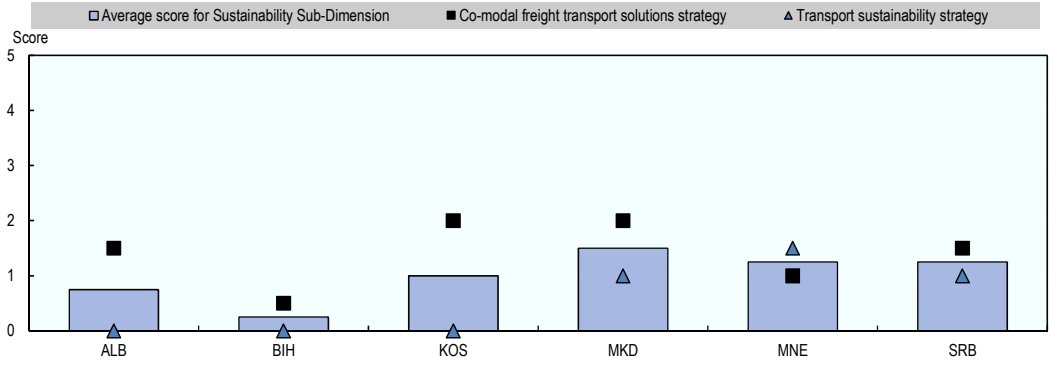
One specific recommendation is for a "lead agency" which would inform others of the results observed on the ground, for instance. Such an approach could be taken by agencies working in different regulatory areas, such as transportation safety, occupational safety and health, and environmental inspections.

Another issue addressed in *Regulatory enforcement and inspection* is one that causes considerable confusion, duplicates resources and controls, and generates enforcement gaps because of unclear mandates and communication breakdowns. It occurs when agencies at national and local levels share enforcement duties in a given field. Governments should very careful to clearly delineate agencies' mandates, inform bodies and businesses, and support the introduction of information systems that link the players in the enforcement "chain" so that they share critical information efficiently and effectively.

Source: OECD (2014), *Regulatory Enforcement and Inspections*, http://dx.doi.org/10.1787/9789264208117-en.

The section assesses the Sustainability Sub-Dimension through two quantitative indicators and two qualitative indicators – **co-modal freight solutions strategy** and **transport sustainability strategy** (Figure 7.15). They measure progress towards resource efficiency, environmental protection, reduced health impacts and greater transport safety.

Figure 7.15. **Sustainability: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

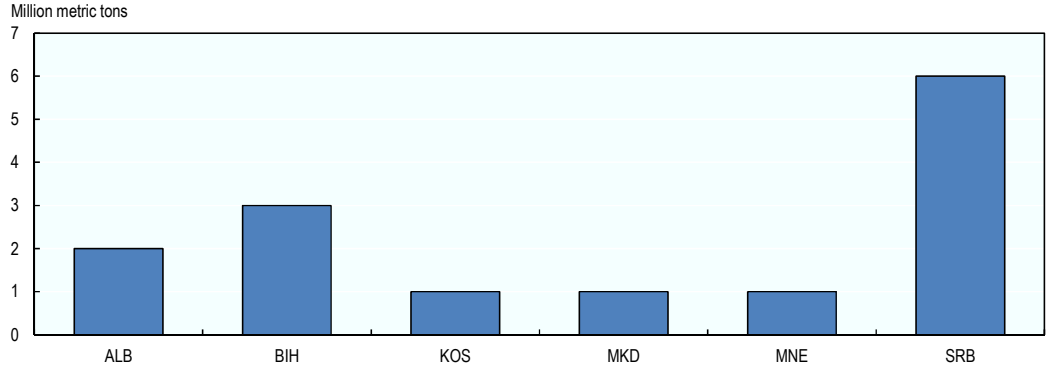
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The SEE economies have considerable scope for improvement in the Sustainability Sub-Dimension – none scores over 2 against either indicator. In the transport sustainability strategy indicator, half the economies score zero and the other half score below 2, which suggests that sustainable transport strategies are not yet common SEE practice (Figure 7.15).

CO_2 emissions from transport in the SEE (Figure 7.16) are still lower than in the EU. However, vehicles are considerably older and as demand for transport from both passengers and freight has been growing there is a need for a comprehensive approach to tackle transport sustainability. According to Eurostat, more than 70% of passenger cars were over 10 years old in the Former Yugoslav Republic of Macedonia in 2012.

Figure 7.16. **CO_2 emissions from transport, 2011**

Million metric tons



Source: World Bank (2015c), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933321979

Not only are SEE CO_2 emissions from road traffic much lower than the average OECD level, they have been constant for the last few years. Total CO_2 emissions in the six economies were just over 13 million metric tons in 2011, comparable to half of Belgium's in the same year. Although the SEE region's environmental footprint is reasonable, the SEE 2020 Strategy seeks to further reduce it.

A number of other measures could also contribute to improved transport sustainability – e.g. introducing natural gas in commercial road and waterborne transport, increasing the share of electrical transport with electricity recuperation, increasing the share of public transport in urban areas and facilitating cycling. Other measures could be to carry larger volumes of freight and people jointly to their destination, then use individual transport to cover the "last mile". Sustainable transport policies have their greatest impact in cities where it is easiest to persuade passengers to use public transport or even switch to cycling.

As demand for both passenger and freight transport rises, there is a growing need for a comprehensive approach to transport sustainability. Although all the components in such an approach contribute to greener transport, one essential element is intermodal solutions.

Sustainable, intermodal transport solutions remain little developed in the SEE region

Although increasing road transport initially produces considerable productivity gains, the resultant negative externalities are, in the long run, high. They include local pollution, noise and fumes. The SEE 2020 Strategy's Transport Dimension considers as key strategic action the optimisation of individual modes of transport to create co-modal solutions.

Co-modality is a term which relates to finding the right complementary combination between one or more modes transport (short sea shipping, rail, inland waterways and road) in a particular transport corridor. The purpose is to maximise efficiency and the use of resources for most sustainable journey possible.

Co-modal solutions optimise use and minimise environmental impacts. However, they are also reliable, limit congestion and lower operating and administrative costs (EC, 2015). Co-modality could thus help boost the SEE region's competitiveness and the sustainability of transport.

On the regional level, SEETO, assisted by the RCC, has commissioned a Study on Intermodal Transport for SEE. It will assess the intermodal potential in the SEETO region and identify the most promising main intermodal corridors and freight logistics centres. The study will examine how optimising the existing infrastructure may improve intermodal transport and efficiently combining different modes of transport will yield an integrated transport system. A coherent network of effective transfer points and terminals throughout SEE is vital to effective South East European intermodal transport. The study, it is hoped, will lay the regional foundations and propose a comprehensive action plan for developing intermodal transport in the region.

Transport sustainability strategies are not yet common and several economies do not specifically address the transport sustainability issue in their national strategies. Nevertheless, sustainability-related questions are increasingly becoming part of infrastructure development plans and all the economies have individual projects promoting transport sustainability.

Table 7.6. **Sustainability Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Co-modal freight transport solutions strategy	1.5	0.5	2.0	2.0	1.0	1.5
Transport sustainability strategy	0.0	0.0	0.0	1.0	1.5	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323310

Policy frameworks for promoting co-modal freight solutions and transport sustainability strategies are still low priority for SEE governments. Indeed, the share of alternative transport modes – inland rail and waterways, in particular – is still very low and sustainable transport measures are few. There has been little progress in implementation despite all national transport programmes referring to them. However, building co-modal infrastructure is a resource-intensive process, which may explain delays in implementation. Clear action plans and funding are challenges common to all the economies.

Four economies have developed or are developing concrete proposals to set up co-modal nodes in major transport corridors. The largest projects to date are:

- Trubarevo in the Former Yugoslav Republic of Macedonia
- The sea port of Durres in Albania
- Belgrade in Serbia
- Sarajevo and Tuzla in Bosnia and Herzegovina.

The Former Yugoslav Republic of Macedonia has addressed co-modality as a strategic priority in its National Transport Strategy (2007-17). It commissioned a feasibility study into strategic multimodal transport nodes which addressed multi- and inter-modality. Analysing costs and benefits, it identified at least four locations – Trobarevo, Jurumleri, Bunardzik and Kichevo – where road and rail transport corridors could link.

Albania has advanced co-modal solutions in its National Transport Programme and, in the short term, is developing logistics around the port of Durres. As part of Pan-European Transport Corridor VIII, it has also drawn up an action plan to build a major railway connection linking the port of Durres to the airport. And it is currently negotiating an EBRD loan to start work on implementation.

Serbia, in its National Strategy for Development of Rail, Road, Water, Air and Intermodal Transport (2008-15), has provisions for co-modal transport solutions and sustainability measures in transport. The General Master Plan for 2009-27 includes a chapter on projects in intermodal terminals. Serbia's most advanced action plan is the first modern intermodal transport terminal in Belgrade. Work has not yet started, however.

Kosovo has adopted a Multimodal Transport Strategy (2012-21) where there is a chapter on the multi-modal transport strategy and measures to promote complementary combinations between transport modes.

Montenegro addresses the issue of co-modality in general strategic documents, but has drawn up no action plan or strategy – all of which explains it lower scores in the Sustainability Sub-Dimension. Its transport development strategy does, however, refer to

sustainability, as do the Spatial Plan for Montenegro and local development plans. The Podgorica Plan, for example, promotes measures to reduce car usage and lay down cycling corridors.

As for Bosnia and Herzegovina, recent strategic documents consider sustainability, but neither government nor parliament has approved them yet. A study on co-modal transport solutions in 2008 proposed a physical plan for two inland terminals in Sarajevo and Tuzla. Little, however, has been done.

The way forward in making transport more sustainable

As the SEE economies look to the future, their policy makers could consider ways ahead in developing and approving sustainable transport policies and action. All SEE economies could integrate outcome indicators into policies in order to reduce energy consumption, greenhouse gas emissions, and to promote the use of renewable energies and modal shifts from road to rail and waterways.

Box 7.5. **Promotion of sustainable transport solutions, case of Copenhagen**

By 2025, Copenhagen will be the first capital city in the world to become carbon neutral. To reach this ambitious goal, the city council has adopted a comprehensive, targeted carbon reduction master plan that aims to take the city's CO_2 consumption from its current level of around 2.5 million metric ton to under 1.2 in less than two decades.

Carbon-free transportation solutions include pedestrian city zones, miles of cycling lanes and routes, support for public transportation, and plans for EV charging stations and free car parks. Public transport will be driven by electricity only, not fossil fuels.

The first "bicycle superhighway" – designed to connect outer districts and suburbs to the city centre, with 26 more set to be developed over the coming years. To improve traffic conditions and encourage cycling, the city is carrying out work in nine focus areas:

- more cycle tracks and reinforced cycle lanes
- green cycle routes
- improved cycling conditions in the city centre
- combining cycling and public transport
- bicycle parking
- improved signal intersections
- better cycle track maintenance
- better cycle track cleaning
- campaigns and information.

In Copenhagen, 34% of commuters use their bicycles for going to and from work (OECD, 2012c). The proportion of all journeys made by bicycles is among the highest in major European cities and makes an important contribution to the city's relatively favourable traffic and environmental situation. An analysis of the socio-economic consequences of investing in cycling showed cost-benefit ratios much higher than normally expected from transport projects. Concerning health benefits, studies have shown that people who bike to work have a 28% lower mortality rate than the population average.

Source: C40 Cities (n.d.), *Copenhagen CPH climate plan 2025* (webpage), www.c40.org/profiles/2013-copenhagen; OECD (2012c) *OECD Better Life Index* (webpage), www.oecdbetterlifeindex.org.

Albania, Kosovo, the Former Yugoslav Republic of Macedonia and Serbia could further advance the implementation of projects to promote co-modal freight and monitor their implementation. Bosnia and Herzegovina could intensify the focus on addressing co-modality in its strategic documents. Serbia could start work on the action plan and its implementation for the intermodal transport terminal in Belgrade. Montenegro could draw up a strategy with action plan to address the issue of co-modality in general.

Conclusions

The SEE region has taken action to improve physical infrastructure and produce relevant transport regulations and strategies. Yet policy makers could consider placing a greater focus on modernisation, maintenance and the improved efficiency of existing infrastructure.

Efficient inland waterways, rail freight and a modern multi-modal transportation provision would make regional transport networks more attractive propositions for flows of goods and passengers.

The economies could further promote the provision of high-quality logistics services, seek to facilitate international goods shipments, and improve access to the SEETO comprehensive network and the priority corridors of the Trans-European Transport Networks (TEN-T).

Finally, SEE policy makers could seek to embed sustainability more deeply in national transport strategies.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 8.

Environmental policy in South East Europe

Environmental policies seek to meet sustainability objectives by ensuring that critical input factors, such as human and natural resources, remain available over time. This chapter on the Environmental Policy Dimension considers three sub-dimensions in its assessment of environmental performance and policy development. The Capacity for Climate Change Adaptation Sub-Dimension assesses how economic and social systems adapt to changes in the environment attributable to climate change. The Environmental Protection Sub-Dimension examines the efficiency, consistency and enforceability of environmental legislation, institutions and policy. The Natural Resource Management Sub-Dimension investigates policies to balance the use of natural resources as an economic asset while safeguarding their long-term sustainability.

Main findings

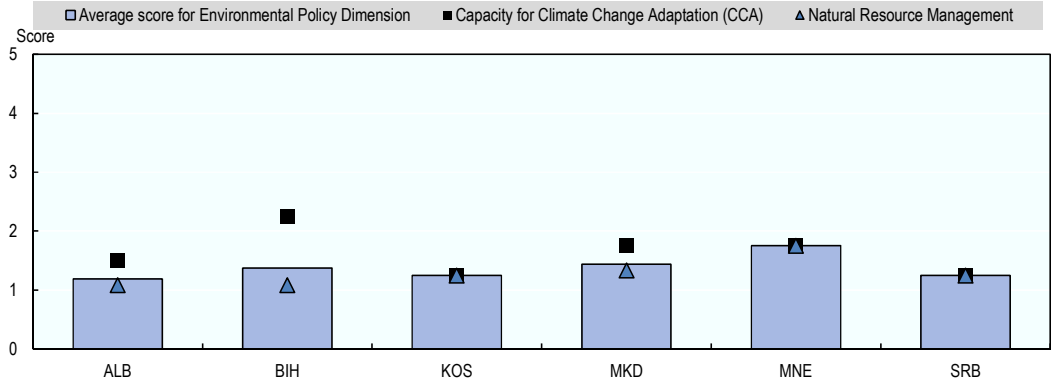
Environmental policies address sustainability objectives by ensuring that critical input factors, such as human and natural resources, remain available over time. Environmental policy frameworks can provide incentives for innovation, support the differentiation of product portfolios, enhance resource efficiency and, therefore, have a significant impact on competitiveness over a long time horizon.

In spite of its economic relevance, environmental protection remains a challenge in South East Europe (SEE). Air pollution, for instance, is problematic across the entire region, with a greater proportion of the population exposed to higher levels of fine particulate matter than in the EU or the OECD (Hsu et al., 2014).

Another important challenge is the protection of natural resources. Although SEE economies have increased the coverage of terrestrial and marine protected areas as a percentage of total land, such areas are still proportionally smaller than the EU and OECD averages. Analysis of SEE environmental frameworks reveals scope for improvement in areas such as capacity for climate change adaptation (CCA), environmental protection and the sustainable management of natural resources. Future efforts in all those areas could draw on the achievements of recent years.

Most SEE economies are in the process of either drafting or adopting strategies and legislation to protect the environment. They are still seeking to make further progress in implementing and institutionalising their environmental frameworks.

Figure 8.1. **Environmental Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have made progress towards developing environmental policies.

SEE economies are introducing sustainable forest management systems. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro have developed a formal sustainable forest management strategy and started to implement it.

SEE economies are conducting public awareness activities, training and education related to CCA, particularly in Albania, Bosnia and Herzegovina, and Serbia.

Challenges

Despite their achievements, the SEE economies still face a number of challenges in addressing all the facets of environmental policy.

Environmental frameworks are still in the early stages of development. While the greatest potential for improvement lies in the sustainable management of natural resources, SEE economies could strengthen their performances in all assessed indicators, including capacity for CCA and sustainable management of natural resources.

Air pollution deserves attention. The population of the SEE region is exposed to higher levels of fine particulate matter than people living in the EU or OECD. Furthermore, levels of air pollution have increased over recent years.

Natural resources conservation practices are not systematic. The protection of natural resources could be institutionalised. Further progress could be made by systematically applying practices such as sustainable irrigation, sustainable forest management and agri-environmental measures.

Agri-environmental measures are still to be implemented. Montenegro has made headway in planning and implementing a range of agri-environmental support measures designed to strengthen sustainable agriculture. The other SEE economies are still to develop a framework to support agri-environmental policies. They might consider directing their efforts towards drafting strategies and planning and implementing agri-environmental measures.

Policy frameworks for improving sustainable irrigation remain at an initial planning and implementation stage. Almost all SEE economies have taken steps to develop and adopt either single sustainable irrigation strategies or sets of strategy-setting documents. A number of SEE economies have actually implemented irrigation projects. However, they are frequently stand-alone rather than part of a larger strategic perspective on sustainable irrigation and, as a result, their impact remains limited.

Private sector participation (PSP) in water infrastructure is limited. Water infrastructure projects with PSP are still an exception, even though most SEE economies (Albania, Kosovo, Montenegro and Serbia) have adopted relevant legal frameworks to enable PSP. The explanation may lie in the fact that the frameworks do not set clear enough targets or spell out measures specifically to foster and enable PSP in the water sector.

Approaches that draw on the water-energy-food nexus are still in early stages of development. Albania, Bosnia and Herzegovina, Montenegro and Serbia have either planned or initiated projects that take a nexus approach to comprehensive sustainable management across economic sectors. Kosovo and the Former Yugoslav Republic of Macedonia have yet to apply this approach.

Recommendations

In view of the identified challenges, the following measures could be beneficial in strengthening environmental frameworks across the region.

Strengthen agri-environmental measures. Agri-environmental measures can contribute to economic competitiveness by making agriculture more sustainable. Measures to avert the adverse impacts of agricultural land use, such as soil and water pollution and the loss of wildlife habitats, could also have positive effects on other sectors like tourism. While most SEE economies have developed agri-environmental measures, they could take implementation further and monitor it more closely.

Develop and put in place policy measures to increase sustainable irrigation. Rehabilitating and improving irrigation systems can increase the productivity of existing agricultural land, thus lessening the need for additional land resources. Well-functioning sustainable irrigation systems can also help safeguard natural habitats as less land is needed for agriculture.

Design and implement strategies to enable PSP in water infrastructure. PSP in water infrastructure – e.g. in the form of concessions or public-private partnerships – could be a valuable way of financing new water infrastructure and making water usage more efficient. Several SEE economies have, as a first step, adopted a legal framework to allow PSPs in water infrastructure. As a next step forward, they could develop, adopt and implement strategies for PSP in water infrastructure.

Adopt policies to advance the water-energy-food nexus approach. A nexus approach that helps understand the inextricable interaction between water, energy and agricultural land could be useful in helping the SEE economies to identify and address unsustainable practices in natural resources management, potential trade-offs, conflicts of interest and externalities. They could develop and adopt nexus strategies and then advance in planning and implementation.

Adopt CCA strategies. CCA strategies are the framework for assessing threats from climate change, monitoring its effects and reacting to extreme weather. Furthermore, they incorporate assessments of the economic costs and benefits of CCA. While SEE economies have generally started developing CCA strategies, they could intensify their efforts to adopt them. Bosnia and Herzegovina, which has adopted such a CCA strategy, could take implementation further by planning in detail and securing the required resources.

Overview

The environmental policy framework refers to the laws, regulations and other policy mechanisms that address environmental issues and sustainability (McCormick, 2001). Environmental issues and sustainability are wide-ranging and often affect a country's economic development. They include air and water pollution, waste management, ecosystem management, safeguarding biodiversity as well as the protection of natural resources, wildlife and endangered species.

An effective environmental framework can help create a sustainable economic context by ensuring that critical input factors, such as human and natural resources, remain available over time. Against that background, this chapter evaluates environmental policy frameworks in SEE economies, assesses their policy environment and illustrates findings with specific outcome indicators.

An effective environmental policy framework can also drive innovation, product portfolio differentiation and resource efficiency. Additionally, it can have positive spillover effects on economic sectors such as tourism or agriculture.

This chapter also considers that environmental policies can be linked to other areas and chapters. For example, energy considerations are seen as part of the water-energy-food nexus. SEE economies are, for instance, building a number of hydropower plants to ensure stable, affordable energy supplies. However, by interrupting natural watercourses, the plants may jeopardise irrigation and wildlife habitats.

- **Chapter 7. Transport** policies also interact with the environment. Emissions from motor vehicles, for instance, are significant contributors to the heightened levels of air pollution in the SEE region.
- **Chapter 13. Health policy** is affected by environmental risks such as pollution as well as frameworks and practices.

Box 8.1. **Environmental Policy Dimension in the SEE 2020 Strategy**

The Environmental Policy Dimension is part of the Sustainable Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The Pillar's central objective is to boost growth and jobs by supporting a strong, diversified and competitive economic base that is better connected, more sustainable and more resource-efficient.

By fostering a sustainable environment, protecting natural resources and incentivising innovation, environmental policies can contribute to the SEE 2020 Strategy's headline targets of increasing region-wide net enterprise creation (new businesses) from 30 107 to 33 760 per annum and exports of goods and services from EUR 1 780 to EUR 4 250 per capita.

The SEE 2020 Strategy also sets specific objectives for adaptive capacity, share of irrigated agricultural land and volume of annual forestation. It has further objectives for advancing the water-energy-food nexus approach in environmental policies and boosting PSP in financing water infrastructure.

The official SEE 2020 Strategy co-ordinator for the Environmental Policy Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and enhance regional co-operation in SEE and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Environmental Policy Dimension assessment framework

This chapter proposes an analysis of environmental policy in the SEE region. It does not seek to be exhaustive, but considers three broad policy areas based on the Sustainable Growth Pillar of the SEE 2020 Strategy:

- Capacity for Climate Change Adaptation

  How adjustable are economic and social systems to changes in the environment attributable to climate change? Are measures to mitigate climate change by controlling greenhouse gas emissions in place?

- Environmental Protection

  How efficient, consistent and enforceable are environmental legislation, institutions and policy? What are the outcomes of environmental protection?

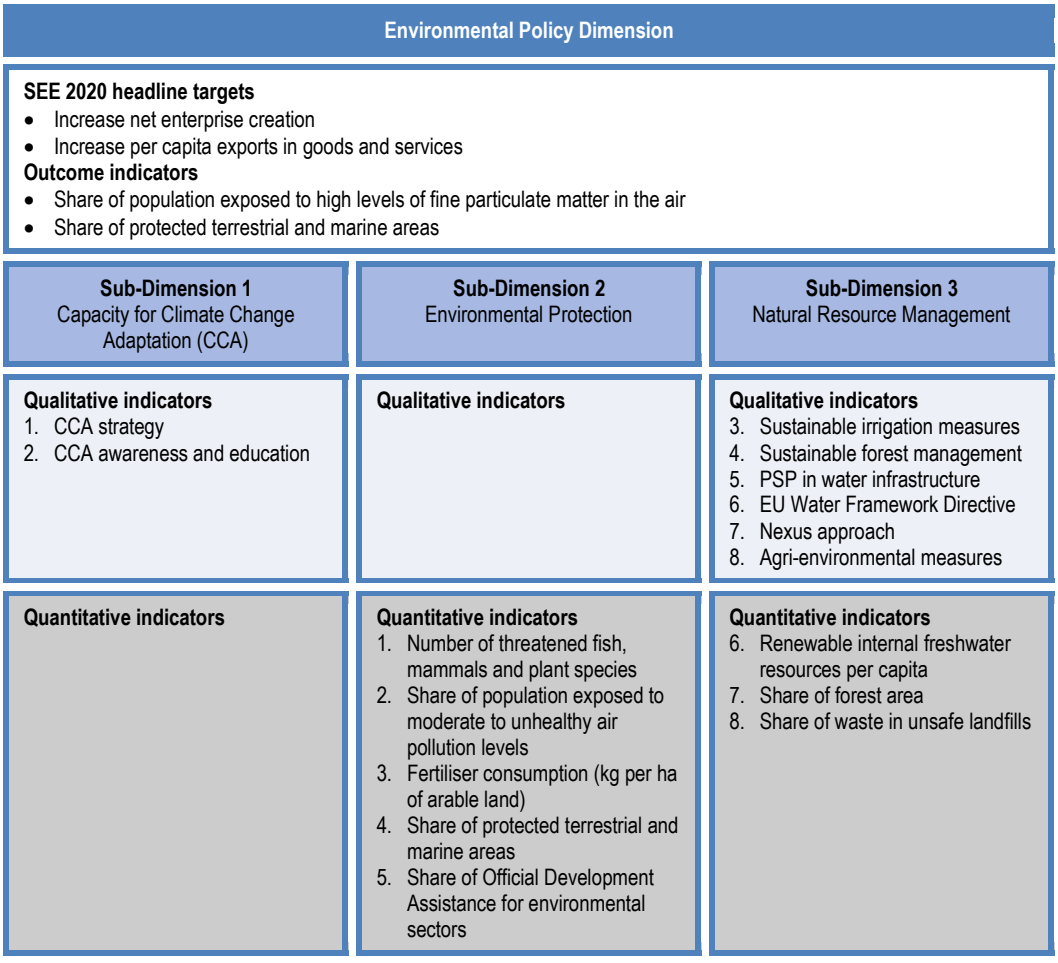
- Natural Resource Management

  How effective is natural resource use as an economic asset? Is the long-term sustainability safeguarded?

Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the RCC collected qualitative and quantitative data on environmental policy.

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.[1]

Figure 8.2. **Environmental Policy Dimension assessment framework**



Environmental policy performance in SEE economies

Air pollution and the protection of natural resources are still challenges in the SEE region. The proportion of the population exposed to high levels of fine particulate matter in the air is higher in all SEE economies than in the EU and OECD – for example, 36% in the Former Yugoslav Republic of Macedonia, compared to 20% in the EU and 17.5% across the OECD (Hsu et al., 2014).

When it comes to the protection of natural resources, the SEE region has increased the percentage of its total land area covered by terrestrial and marine protected areas. However, it is still below EU and OECD levels. Montenegro has the highest coverage of protected areas in the region at 12.8%, but that is around half of the EU average of 25.1% and slightly less than the OECD average of 13.6%. The lowest protected area coverage at 1.5% is in Bosnia and Herzegovina (World Bank, 2015).

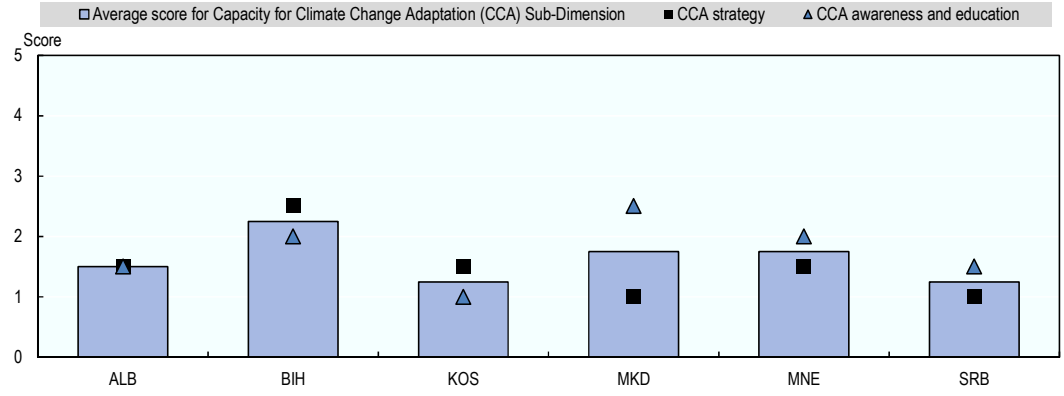
Capacity for Climate Change Adaptation Sub-Dimension

The Capacity for Climate Change Adaptation Sub-Dimension measures the SEE economies' ability to adjust their economic and social systems in response to climate change. Adjustments include monitoring of changes and preparing for the effects of extreme weather events. The dramatic floods of 2014 illustrated the region's vulnerability and highlighted the importance of adaptation capacity. The floods revealed, too, that there was room for further adaptation capacity-building across SEE (Lausevic, Jones-Walters and Nieto, 2008). Indeed, it is set to become an even more critical need as extreme weather events grow ever more frequent.

Action to protect the environment could help mitigate the incidence and consequences of extreme weather events such as floods, windstorms and droughts (World Economic Forum, 2013).

The SEE economies' overall scores on the Capacity for Climate Change Adaptation (CCA) Sub-Dimension point to potential for improvement (Figure 8.3). Bosnia and Herzegovina performs best on average, while Kosovo, Serbia and Albania have the most room for improvement.

Figure 8.3. **Capacity for Climate Change Adaptation (CCA): Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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SEE economies could strengthen policy climate in change adaptation and awareness raising

Climate change is a severe threat to the competitiveness of the region (EC, 2013). It is expected to lead to more frequent, more severe floods, droughts and heat waves. They will negatively impact the particularly vulnerable productive sectors, such as agriculture

and fisheries. A strategic, action-oriented approach to adapt to climate change can help offset its adverse effects.

Measuring progress in CCA is challenging given that there is no single metric of success and the effectiveness of measures may only become apparent over time (OECD, 2015a). This analysis therefore uses two process indicators as proxies for progress towards the overall goal of improved adaptive capacity: the CCA strategy indicator and the CCA awareness and education indicator (Table 8.1).

The **CCA strategy** indicator assesses whether the economies have adopted comprehensive national strategies and how far advanced implementation is. Comprehensive CCA strategies can provide the basis for determining threats from climate change, monitoring and reacting to extreme weather events, and assessing the economic costs and benefits of adaptation measures. They enable government bodies to co-ordinate more closely with other policy areas such as agriculture, forestry and management of water resources. Effective CCA policy frameworks are not necessarily contained in a single formal strategy and can be co-ordinated across policies.

The **CCA awareness and education** indicator examines how policy addresses changes in behaviour in order to better deal with challenges arising from heat, drought and floods. Awareness-raising and education target a wide range of stakeholders and include climate change research, action plans and adaptation strategies. However, awareness-raising activities and education have little effect if they are not communicated adequately. The awareness and education indicator thus measures whether SEE economies have developed strategies for making information easily accessible, initiating dialogue with key stakeholders and seeking to change behaviours through incentives and by overcoming individual barriers to adaptation.

Table 8.1. **Capacity for Climate Change Adaptation (CCA) Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
CCA strategy	1.5	2.5	1.5	1.0	1.5	1.0
CCA awareness and education	1.5	2.0	1.0	2.5	2.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Relatively advanced CCA practices can be identified in Bosnia and Herzegovina which has adopted a strategy that sets key priorities for adaptation. However, more efforts are needed to develop action plans and ensure implementation. Regionally speaking, it is has also made relatively good progress in awareness-raising through several projects.

The Former Yugoslav Republic of Macedonia has established a CCA information service and introduced a climate change communication strategy.

As for Albania and Serbia, they are in the process of drafting a CCA strategy. Both economies have also conducted a number of awareness-raising activities, though they are often donor-funded and not fully co-ordinated by the government.

All SEE economies have started drafting CCA strategies or addressed the issue in other strategies. It is therefore important that they look at adopting and implementing them through a participatory approach. All SEE governments might bear in mind the importance of systematically planning CCA awareness-raising activities and education and ensuring that they are financially sustainable.

Environmental Protection Sub-Dimension

This section looks that the Environmental Protection Sub-Dimension. Five quantitative indicators seek to assess the SEE economies' environmental policies and the efficiency, consistency and enforcement of environmental legislation. To that end, it considers environmental protection policies, the institutions that enforce them and their outcomes.

Box 8.2. Good practice example: Local climate change adaptation in Scotland

Taking a participatory approach to the development of CCA strategies can improve effectiveness through increased stakeholder awareness and strengthened commitment to implementation. In line with this objective, the Highland Council of Scotland developed an integrative approach to informing and engaging stakeholders in developing a CCA strategy and planning for its implementation.

The Highland Council's integrative process to develop a CCA strategy included a series of 25 adaptation workshops conducted over two years. The workshops saw the participation of multiple stakeholders such as community interest groups, land owners and land management organisations, as well as environmental groups and other interested organisations or individuals. In the workshops, discussion focussed mainly on designing effective strategies for climate change avoidance and mitigation as well as enabling the relevant parties to contribute to the efforts.

The participatory approach taken by the Highland Council improved effectiveness in a number of ways. First, it improved understanding of the impact of climate change on different sectors and stakeholder groups. Second, it allowed the Council to identify potential adaptation actions by drawing on lessons from existing initiatives. Lastly, stakeholder involvement improved the understanding of current and likely future climate change impacts and helped to identify and prioritise possible adaptation actions across issues such as water, health, transport and biodiversity.

The resulting CCA strategy sets out a broader perspective and specific actions, implementation timescales and responsibilities, as well as indicators and benchmarks for monitoring and measuring progress. Since the strategy development took the views of key stakeholders into consideration, implementation is well on the way and closely monitored by the stakeholders.

Source: EC (2013), *Climate change adaptation practices across the EU: Understanding the challenges and ways forward in the context of multi-level governance*, http://dx.doi.org/10.2834/59739.

Environmental protection contributes to economic development by maintaining the quality and quantity of natural capital assets and providing valuable ecosystem services, such as natural resources for economic activities like agriculture, forestry and tourism (Millennium Ecosystem Assessment, 2005). Investment in the protection of natural capital also enables the provision of ecosystem services, such as buffering and filtering of water, gases and chemicals which help regulate climate, flooding, air and water quality, disease and waste.

Such services contribute to the reduction of health costs and lessen the need for investment in engineered infrastructure to provide equivalent services. Furthermore, environmental protection also serves the objective of improving quality of life by offering recreational, aesthetic and spiritual benefits, as well as maintaining biodiversity and supporting ecosystem services, such as soil formation, photosynthesis and nutrient

cycling (ibid.). Globally, the economic value of ecosystem services is considerable and worth understanding in order to inform decision making (OECD, 2013).

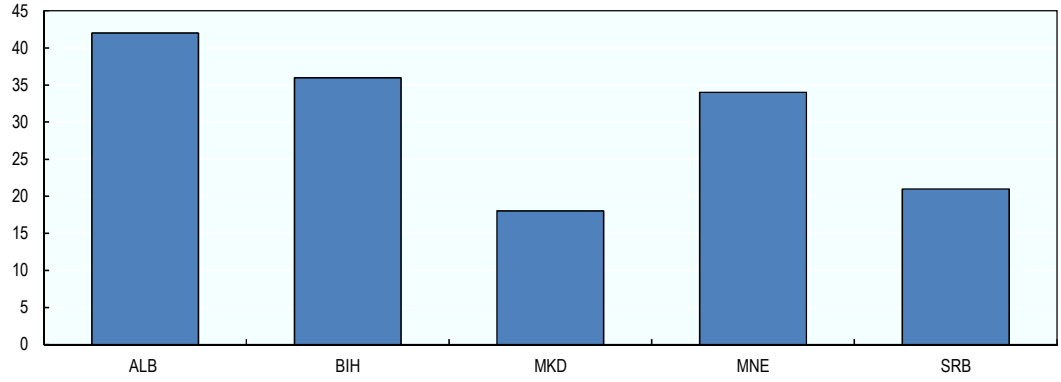
In spite of substantial progress in preparing and adopting environmental legislation, the SEE economies' performance in environmental pollution and investment in environmental protection is still short of EU averages (UNECE, 2007). The economies could benefit from further adopting, implementing and enforcing relevant EU legislation on environmental protection and considering the costs and trade-offs of not doing so.

SEE economies can further improve biodiversity conservation, air pollution control and wastewater management.

Biodiversity is relatively high

Biodiversity in the region is relatively high, but so is the number of threatened species. In Europe, the threat to biodiversity is greatest in the Mediterranean Basin (where part of the SEE region lies), across mountain zones, coastal areas and in densely populated floodplains. Enforcing nature conservation legislation and increasing the area of protected forest and other landscapes can help reduce the number of species under threat (Lausevic, Jones-Walters and Nieto, 2008).

Figure 8.4. **Number of threatened fish, mammals and plant species, 2014**



Note: Data for Kosovo not available.

Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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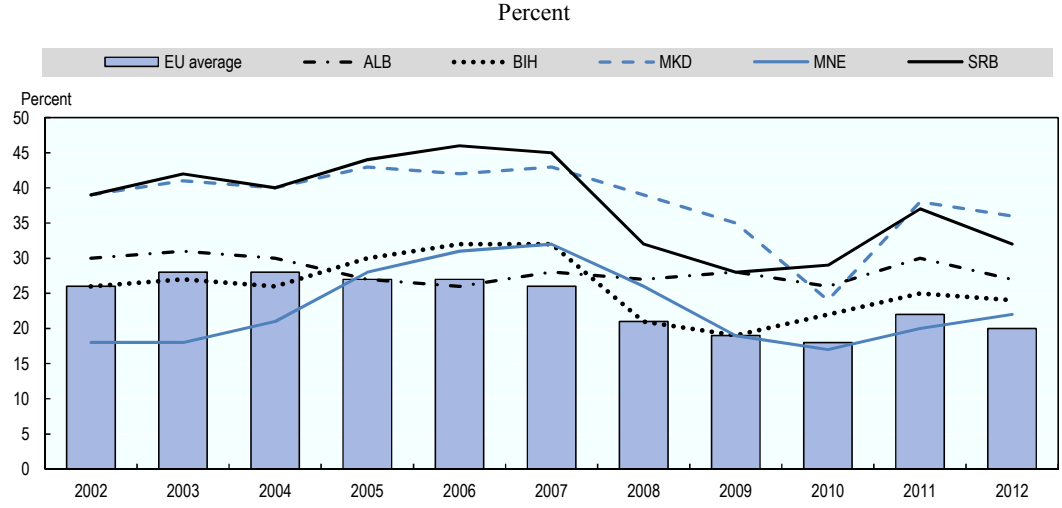
Air pollution is a public health risk

Air pollution is still higher in the SEE region than in the OECD and the EU due to intensified industrial activity and comparatively little environmental regulation. Although substantial improvements were observed between 2007 and 2010, they stemmed largely from the economic slowdown following the financial crisis (World Bank, 2015). In 2010, the economic trend reversed, prompting a return to higher levels of air pollution that posed a threat to public health. Over 25% of the population in the Former Yugoslav Republic of Macedonia, Serbia and Albania are on average exposed to moderate to unhealthy levels of air pollution compared to the EU average of 20%[2] (Hsu et al., 2014).

Wastewater management is a challenge

Similarly, most economies in the region still struggle with wastewater management (EEA, 2013). One of the main reasons lies in the substantial investments needed for delivering, operating and maintaining sustainable water and sanitation services (OECD, 2011). Albania, for instance, currently has only five operating wastewater treatment plants. Sustainable water management, in the form of river basin management plans (RBMPs), is in its early stages in the region and there have been no new cross-border agreements in that field since 2011. However, most SEE economies have voiced their political will to engage in a regional approach to sustainable water management.

Figure 8.5. **Average proportion of population overly exposed to air pollution**



Note: Air pollution is defined as 10 µg of particle matters per cubic meter as an annual mean. Data for Kosovo not available.

Source: Hsu et al. (2014), *The 2014 Environmental Performance Index*, www.epi.yale.edu/files/2014_epi_report.pdf.

StatLink http://dx.doi.org/10.1787/888933322011

Fertiliser use is efficient

The region, however, performs well when it comes to fertiliser use. In fact, the SEE economies are generally less fertiliser-intensive than the EU or the OECD average. Serbia, with 175kg per hectare of arable land per year, is the only economy in the region with an average fertiliser use that is higher than the EU's (149kg per hectare of arable land per year) and the OECD's (129kg). As for the remaining SEE economies, fertiliser use lies between Montenegro's very low 12kg (thanks chiefly to the extensive non-fertiliser-intensive wine industry) and 99kg in Bosnia and Herzegovina. The economies' efficient use of fertiliser reduces the risk of nutrient loading – amount of nutrients going into an ecosystem – and the eutrophication of water bodies – the flow of excess nutrient, e.g. fertiliser, into water bodies so stimulating excessive plant growth and oxygen starvation in the water (US Geological Survey, 2015).

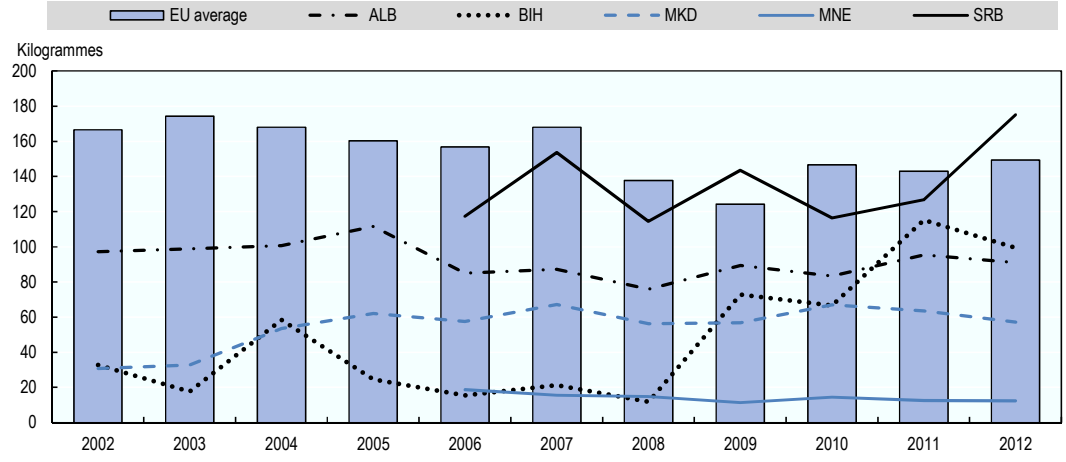
SEE economies are still to embrace, execute and enforce EU environmental legislation

EU environmental protection directives – e.g. the Habitats Directive, Water Framework Directive, Industrial Emissions Directive, Birds Directive, Landfill Directive – aim to protect natural habitats, improve and maintain air and water quality, ensure proper waste disposal, improve knowledge of toxic chemicals and help businesses move towards a more sustainable economy. Sustainable agricultural production is a central objective of all the directives. Even though SEE economies aim to incorporate many of them into national law, they could still improve adoption and implementation. Accordingly, the region does not currently enforce environmental protection as vigorously as most EU countries.

For instance, the share of terrestrial and marine protected areas as a percentage of total land in SEE economies is substantially lower than the shares stipulated in the EU Birds Directive (2009/147/EC) and Habitats Directive (92/43/EEC) (Figure 8.7). Montenegro, for example, which has the highest share of protected areas in the region at 12.8%, has only around half as much as the EU's 25.1% and slightly less than the OECD average of 13.6% (World Bank, 2015). The lowest share of protected areas lies in Bosnia and Herzegovina, at just 1.5% of total land area.

Figure 8.6. **Fertiliser consumption**

Kilogrammes per hectare of arable land per year



Note: Data for Kosovo not available. Data for Montenegro and Serbia available from 2006.

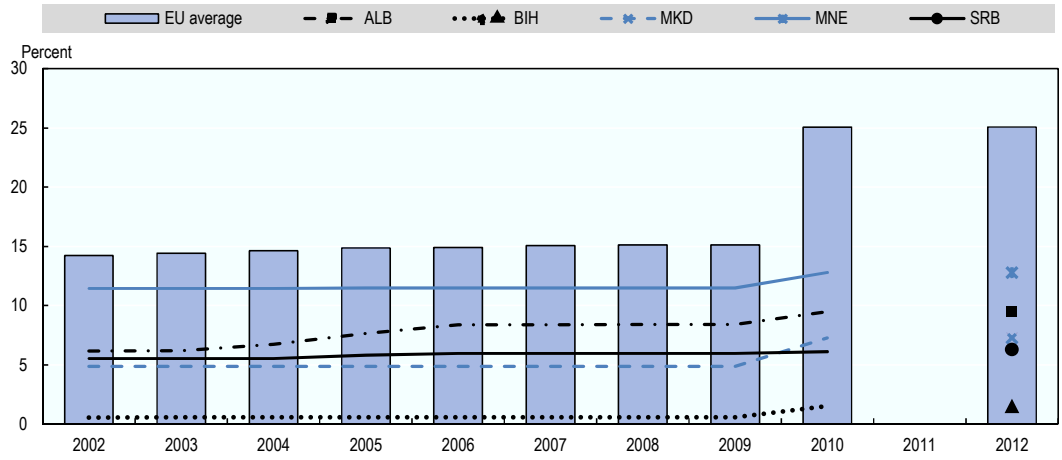
Source: Adapted from World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322024

Yet the safeguard of terrestrial and marine areas in SEE is particularly important against the background of urban sprawl and population growth and the expected rise in tourism (EEA, 2010). However, protected land areas restrict the commercial use of such natural resources as timber and agricultural land and SEE economies have not all made extending them a priority.

Figure 8.7. **Terrestrial and marine protected areas**

Percent of total area



Note: Data for 2011 not available. Data for Kosovo not available.

Source: Adapted from World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322038

All SEE economies, with the exception of Albania (28.2%), have relatively greater forest coverage than the OECD average of 30.5% and, apart from Serbia (32.1%), than the EU (37.7%). The highest shares of forest land are to be found in Bosnia and Herzegovina at 42.8% and Montenegro with 40.4% (World Bank, 2015).

As for investment in the protection of natural resources in the SEE region, the share of official development assistance (ODA) that goes into environmental protection is, at 4.5%, low. There is a wide range within that figure, however. In Montenegro it is 1.4%, but 17.7% in the Former Yugoslav Republic of Macedonia.

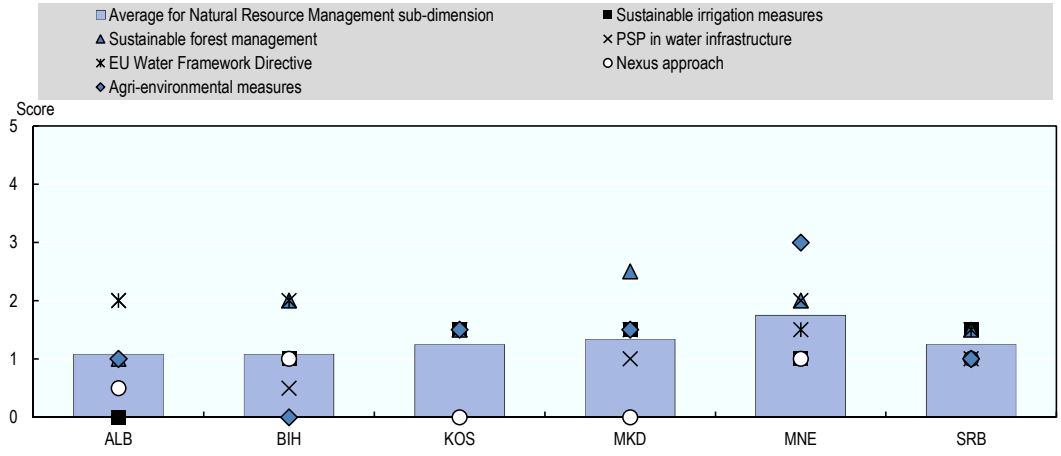
Natural Resource Management Sub-Dimension

The Natural Resource Management Sub-Dimension assesses how effectively and efficiently governments use natural resources for economic activity, while safeguarding their long-term availability for the needs of present and future generations and the environment.

The responsible use of natural resources means the effective management of non-renewable and renewable resources within their regenerative capacity, while at the same time maintaining production costs, ensuring resource availability for future generations and diminishing environmental pollution. This triple objective can be achieved through greater resource efficiency and monitoring of natural asset availability (Cistulli, 2002).

The SEE economies' scores in the six qualitative indicators of the Natural Resource Management Sub-Dimension point to substantial potential for improvement (Figure 8.8 and Table 8.2).

Figure 8.8. **Natural Resource Management: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322044

Table 8.2. **Natural Resource Management Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Sustainable irrigation measures	0.0	1.0	1.5	1.5	1.0	1.5
Sustainable forest management	1.0	2.0	1.5	2.5	2.0	1.5
PSP in water infrastructure	2.0	0.5	1.5	1.0	2.0	1.0
EU Water Framework Directive	2.0	2.0	1.5	1.5	1.5	1.5
Nexus approach	0.5	1.0	0.0	0.0	1.0	1.0
Agri-environmental measures	1.0	0.0	1.5	1.5	3.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323331

On average, the SEE economies score 1.3 out of 5 in the Sustainable Natural Asset Management Sub-Dimension. The indicators show the relatively most advanced features are sustainable forest management and the EU Water Framework Directive (WFD), while the nexus approach holds the most potential for improvement (Table 8.2).

The nexus view of water, energy and food security is that they are inextricably interconnected. The nexus approach offers a means of supporting the transition to sustainability through more deeply integrated resource management across the three sectors (Hoff, 2011).

SEE could further strengthen its policy framework in water management

The sustainable stewardship of water resources is a key element in the protection of natural resources. It seeks to maintain supplies of fresh water of a quality suitable for economic activities, human use and the support of aquatic and other ecosystems – without over-exploiting and degrading them. Supplies of renewable fresh water vary across the SEE region. Some economies are relatively well endowed – e.g. Albania, with 9 284 cubic metres of renewable internal freshwater resources per capita and Bosnia and

Herzegovina, with 9 285. Serbia, by contrast, which has 1 173 cubic metres per capita, may be considered water-scarce (World Bank, 2015). However, water resources are unevenly distributed, which creates issues with availability – even for well-endowed economies. Furthermore, water distribution networks are old and frequently in disrepair due to scarce funds for replacement and maintenance (World Bank, 2003b).

There are a number of lakes and rivers in the region that lie and run across borders. Recognising the complexity of water systems, SEE economies have committed to Integrated Water Resource Management (IWRM), incorporating the management of rivers, groundwater, lakes, and coastal and maritime areas, both nationally and across borders. This makes tracking the SEE economies' progress in adopting and implementing an IWRM strategy important.

An effective IWRM strategy not only improves and stabilises sustainable water resource management, it also contributes to higher productivity and greater soil nutrient value, thus helping to improve food security and boost exports from the region. RBMPs – a component of the EU's WFD (see below) – are at an early stage in the region and no new cross-border agreements have been made in this area since 2011. However, most SEE economies have voiced their political will to engage in a regional approach to sustainable water management (RCC, 2013).

Three indicators assess the implementation of water policies in SEE:

- The **private sector participation (PSP) in water infrastructure** indicator measures what policy actions are in place to enable PSP in water supply and waste management. PSP in water infrastructure – in the form of concessions or public-private partnerships, for example – can be an effective way of raising finance to build and expand water infrastructure and improve supplies and quality. Key areas for policy action are (OECD, 2015b):
  - enhancing and enabling the institutional environment to incorporate PSP
  - setting goals, strategies and capacity at all government levels linked to water infrastructure management
  - enabling public-private co-operation
  - encouraging responsible business conduct.
- The **EU Water Framework Directive** indicator measures how far SEE economies have progressed with incorporating Directive 2000/60/EC (the WFD) into their national bodies of law. The WFD's goal is to achieve "good status" for all ground and surface waters (rivers, lakes, transitional waters and coastal waters) in the EU. Doing so involves complying with a number of biological, hydro morphological, physical and chemical water quality criteria.

  The WFD's centrepiece is the introduction of RBMPs. The directive mandates RBMPs for each river basin district (some of which cross national borders). They are intended to co-ordinate water protection, emission limits, quality standards and water prices. A RBMP includes a detailed account of how to achieve the river basin objectives (ecological, quantitative and chemical statuses as well as protected-area goals).
- The **nexus approach** indicator examines to what extent SEE economies have adopted an integrated approach to resource management that draws on the thinking behind the water-energy-food security nexus. The nexus approach looks

at underlying links in order to spot and address unsustainable practices, trade-offs, conflicting interests and externalities (Stirling, 2015). It thus helps to identify the water needs of agriculture (sustainable irrigation), energy (hydropower generation) and the environment (healthy ecosystem maintenance), and contributes to the development of a holistic approach to water use.

Table 8.3. **Natural Resource Management Sub-Dimension: Water management indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
EU Water Framework Directive	2.0	2.0	1.5	1.5	1.5	1.5
Enabling private sector investment in water infrastructure	2.0	0.5	1.5	1.0	2.0	1.0
Water, energy and food nexus approach	0.5	1.0	0.0	0.0	1.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323340

The way forward in sustainable water management

The SEE region has generally made the most progress in enabling private sector investment in water infrastructure and implementation of the WFD. On the other hand, all the economies could consider starting to draft strategies, taking a holistic approach based on the water-energy-food nexus as the first step.

Albania shows particularly well-developed practices in comparison to its regional peers. It has adopted a law on integrated water resources management in compliance with the EU's WFD. It has put in place the necessary legislative framework to increase PSP in water infrastructure. However, policy implementation is still at an early stage.

The Former Yugoslav Republic of Macedonia has fully incorporated the EU's WFD into its domestic legislation. However, the Former Yugoslav Republic of Macedonia and Kosovo have much potential for improvement in issues related to water management. PSP in the water sector remains limited in both economies, although the legal frameworks permitting public private partnerships are in place. Both economies are also yet to adopt RBMPs. Kosovo and the Former Yugoslav Republic of Macedonia could draft a strategy based on the water-energy-food nexus approach and implement RBMPs. Kosovo could continue efforts to incorporate the WFD fully by adopting amendments, bylaws and administrative instructions.

Montenegro is also relatively advanced when it comes to the necessary legal framework to enable PSP in water infrastructure. Montenegro could ensure that new tenders are planned to encourage competition – such a practice is a strong driver for efficiency and cost reduction (OECD, 2009).

Bosnia and Herzegovina could draft and adopt the necessary legislative measures to allow PSP into the water sector in order to increase efficiency in the provision of water and sanitation services.

Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Serbia could improve PSP legislation implementation by allocating adequate staff and budget.

Serbia and Montenegro could fully incorporate and implement the WFD.

Albania and Bosnia and Herzegovina could ensure that existing management plans are being implemented according to plan.

Sustainable agriculture could be further developed in the SEE region

Agriculture impacts the environment in different ways. For example, it uses water intensively, can cause water pollution and emits substantial quantities of greenhouse gases, mainly from animal husbandry.

In their environmental assessment of SEE economies, Ek and Walter (2012) find that the region is moving towards more intensive agriculture. Sustainable practices are therefore poised to play a particularly important role in balancing the negative environmental impacts with the objective to exploit the sector's economic potential. Sustainable agriculture can also help address water-related issues, thereby ensuring a stable long-term supply of this important input factor.

The **sustainable irrigation measures** indicator assesses the progress of policy in the SEE economies towards the implementation of effective, sustainable irrigation systems. Such systems increase agricultural productivity while ensuring that water resources are adequately protected. Therefore, improving irrigation systems in existing agricultural land can lead to higher biodiversity through increasing productivity in existing agricultural land while protecting areas which are not used for agriculture. However, intensive irrigation can also exert adverse effects such as overexploitation, soil salinisation and the depletion of ground water.

The agri-environmental measures indicator looks at policy efforts to protect and facilitate sustainability of rural areas in accordance with the EU common agricultural policy. Agri-environmental measures contribute to competitiveness by averting the adverse impacts of agricultural land use, such as soil and water pollution and the loss of wildlife habitat.

Table 8.4. **Natural Resource Management Sub-Dimension: Sustainable agriculture indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Sustainable irrigation measures	0.0	1.0	1.5	1.5	1.0	1.5
Agri-environmental measures	1.0	0.0	1.5	1.5	3.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323351

Examination of the region's agri-environmental measures reveals relatively advanced sustainable agriculture practices. Montenegro boasts the region's most highly developed practices, as measured by the agri-environment measures indicator, and is the only SEE economy to provide financial incentives to organic farmers with the aim of protecting rural areas. The Former Yugoslav Republic of Macedonia is also advanced compared to its regional peers, as it has adopted the relevant legal framework and started to prepare for implementing agri-environmental measures. Although it has not yet developed a stand-alone sustainable irrigation policy, it addresses issues in irrigation through a number of policies and is currently drafting a consolidated strategy on irrigation to address its environmental aspects.

Albania and Bosnia and Herzegovina have the greatest potential for improvement when it comes to sustainable agriculture. Drafting a strategy addressing sustainable irrigation is still underway in Albania and agri-environmental measures are in an early stage of operation. As for Bosnia and Herzegovina, it is still looking to establish implementation practices in agri-environmental policies. Similarly, it is only partially addressing the need for sustainable irrigation. Indeed, the two economies are at different stages of progress in this area.

As SEE economies look ahead, they could consider ways of improving their sustainable agriculture policies. Albania, Montenegro and Serbia could draft and implement a sustainable irrigation strategy as part of efforts to improve agricultural productivity while ensuring a sustainable water supply. Bosnia and Herzegovina could adopt and implement a single sustainable irrigation strategy to replace the different disconnected strategies currently used. The Former Yugoslav Republic of Macedonia and Kosovo could adopt and implement the measures in the agri-environmental strategies that they have developed.

Box 8.3. **Good practice example: Agri-environmental measures in Switzerland**

Effective agri-environmental measures can help sustain biodiversity and the natural resource base. To meet those objectives, the Swiss government began implementing its Ecological Compensation Area (ECA) scheme in 1995. They provide farmers with financial incentive to maintain 7% of their land as an ECA. Depending on the region and type of grassland, farmers may receive between CHF 500 and CHF 1 000 per hectare.

To ensure stakeholder commitment, the ECA scheme was developed by a working group that brought together representatives of the agricultural and renewable sectors and other stakeholders from the private and public sectors. Depending on the region and vegetation, farmers receive financial rewards if their land reaches a certain level of biodiversity.

Early implementation of the ECA scheme focussed merely on protecting 7% of farmers' land and did not involve any quality criteria. A review of the schemes, however, showed that much of the land had low levels of biodiversity. In response, the ECA scheme was enriched with quality criteria in 2001 to ensure that ECAs delivered full environmental benefits. The adjustment included an area-oriented payment that favoured extensive grassland, hedges, sown fallow land, etc. and an incremental payment for particularly species-rich habitats in each area.

Studies comparing land under the ECA scheme against land under no environmental agreements show the ECA approach delivers substantial ecological benefits with strong increases in plant and animal species. Analysis also shows that the scheme uptake across Switzerland is almost 44%. It is especially high among farmers who own species-rich grassland – over 5% of Switzerland's total grassland area.

Source: EC (2015), *Preservation and Enhancement of Species Rich Grassland* (webpage) www.ec.europa.eu/environment/nature/rbaps/fiche/preservation-and-enhancement-species-rich-grasslan_en.htm.

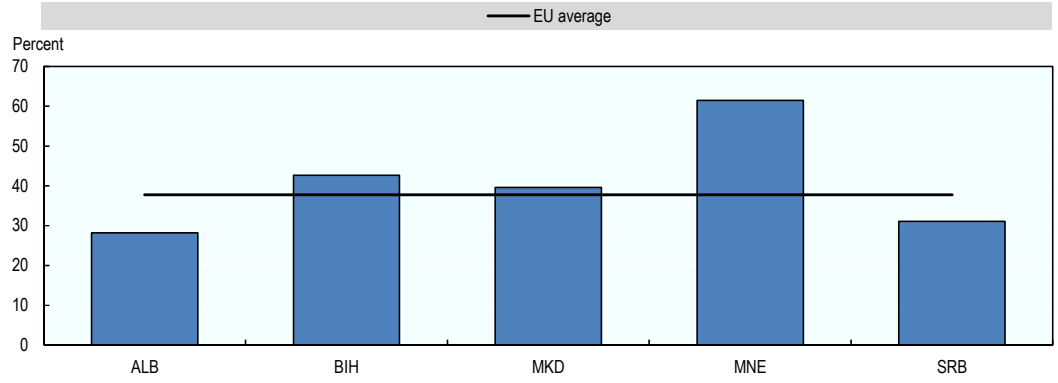
SEE could further strengthen its policy framework to protect forest areas

Forest conservation does not only safeguard the environment, it can also play an important role in ensuring future competitiveness by securing available resources over time. Sustainable forest management addresses soil degradation and deforestation, while managing the resources in an environmentally, socially and economically viable manner for both present and future generations (FAO, 2015).

Forests are homes to a wealth of biodiversity and supply vital raw materials for industries such as furniture production or pulp and paper. Protecting forest areas is, therefore, important to securing long-term inputs for those sectors. Furthermore, forest conservation is crucial for climate change mitigation and environmental protection in forest-rich regions such as SEE, where coverage is between 28% and 62% of total land area.

Figure 8.9. **Forest area, 2013**

Percent of land area



Note: Data for Kosovo not available.

Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322059

In line with these considerations, the **sustainable forest management** indicator evaluates forest conservation, measures such as coppicing taken to regenerate devastated forestland and progress made in reforestation and afforestation.

Table 8.5. **Natural Resource Management Sub-Dimension: Sustainable forest management indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Sustainable forest management	1.0	2.0	1.5	2.5	2.0	1.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323365

Relatively advanced regional practices in the protection and conservation of forest areas are to be found in the Former Yugoslav Republic of Macedonia. It has adopted a sustainable forest management strategy, allocated a budget and is implementing the strategy.

While Albania has taken initial steps to develop a forest conservation strategy, it would benefit from further efforts to ensure that its strategy is eventually adopted and effectively implemented. Albania is the only SEE economy where a slight fall in forest coverage may be observed.

As they look ahead, all SEE economies might consider ways of improving the conservation and protection of their forests and woodlands. Albania could adopt an initial sustainable forest management strategy, while the other SEE economies could advance towards putting their strategies into operation.

Waste management remains a challenge in SEE

Sustainable and efficient waste management can help boost competitiveness by lowering the costs of production inputs. Furthermore, the recycling industry is a potential driver of employment and growth (EEA, 2011). As municipal waste generation in SEE continues to rise, a waste management solution becomes ever more critical.

Up to 90% of waste in SEE economies still ends up in unsafe landfills – i.e. landfills not designed to protect the environment from the different contaminants which may be present in the waste (US Environmental Protection Agency, 2015). A transition towards better recycling, sanitary landfills and other forms of waste management is, therefore, necessary. Sustainable waste management practices such as incinerators that transform waste into energy or the recycling of metal and textile are some examples of waste management systems with economic and environmental potential.

Conclusions

All SEE economies could further improve their environmental policy framework. Although they have made progress – such as the increase in the share of terrestrial and marine protected areas – the region might consider going even further in its efforts to meet EU and OECD standards.

Among the region's relative achievements are the introduction of sustainable forest management systems and the execution of CCA public awareness activities, training and education.

Nevertheless, SEE economies still face a number of challenges. They might still consider the need to implement agri-environmental measures, develop and implement sustainable irrigation practices, strengthen private participation in water infrastructure and further develop a water-energy-food nexus approach.

Addressing these challenges would contribute to a more efficient use of scarce resources and to more robust sustainable development.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has

been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

2. Average percentage of the population exposed to over the World Health Organization limit of 10 µg of particulate matter per cubic meter as an annual mean.

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Chapter 9.

Access to finance in South East Europe

Governments can help facilitate enterprises' access to the external financing that they need to expand their operations or invest in new capacities and capital goods. This chapter analyses policy development and implementation in five sub-dimensions that make up the Access to Finance Dimension. The Regulatory and Institutional Framework Sub-Dimension examines credit information services, movable asset registration systems, cadastres, collateral requirements, and personal and corporate banking procedures. The second sub-dimension, Access to Bank Finance, assesses banking sector competition and consumer protection and credit guarantee schemes. The Access to Equity Finance Sub-Dimension evaluates enterprises' use of stock markets, venture capital and business angel networks. The Alternative Sources of Financing Sub-Dimension evaluates if enterprises have access to leasing, factoring, crowd-funding and micro-finance financing options. Finally, the Financial Readiness Sub-Dimension examines the strategies that are in place to help the general population and entrepreneurs better understand the role of financial markets and how to use them.

Main findings

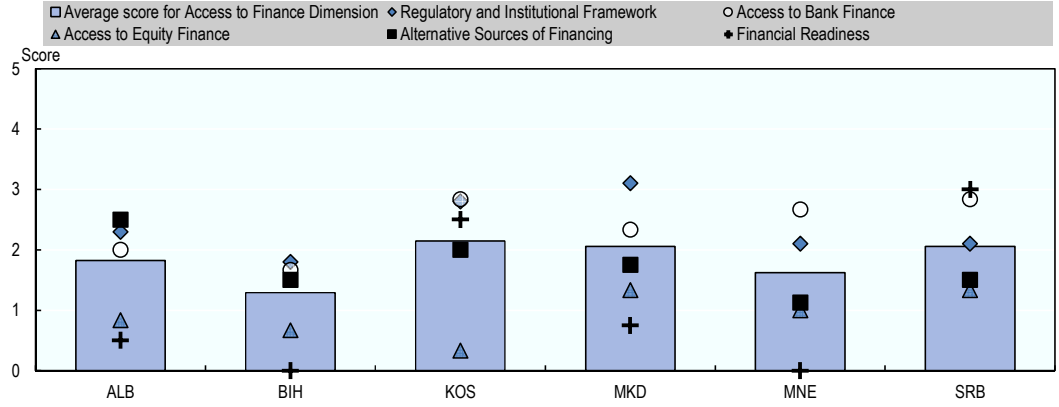
Firms' ability to access finance is of primary importance in building their productive capacity and competitiveness and contributing to job creation, social inclusion and sustainable growth. In spite of government efforts in South East Europe (SEE) to improve access to finance through competition in the banking sector, alternative financing mechanisms and credit guarantee schemes, access to finance remains a challenge. This chapter offers a general assessment of how economies in South East Europe are progressing in their policy frameworks to support access to finance. It also advances some recommendations for further improvement.

Policy reforms have facilitated access to finance in the SEE economies. However, there are signs that domestic credit lending to the private sector has stagnated since the onset of the 2008 financial crisis, prior to which lending levels were on the rise. The cost of access to finance varies between economies, with declines in some since the onset of the crisis and increases in others. Significant efforts are still needed to facilitate access to equity finance and to develop alternative forms of financing.

SEE firms no longer find access to finance a primary constraint to their business development. In 2014, 18% of firms from the region reported that access to finance was a problem as opposed to 20% in 2008. The figure drops to 13% for the region if Kosovo is excluded, as 45% of firms there felt access to finance was a constraint. This figure is similar to the EU average of 17%. At the same time, domestic credit lending has slowly but steadily been on the rise over the last decade, making capital increasingly available to the private sector.

Most SEE economies still have room for improvement in developing the access to finance environment. Although they have made efforts to put policy frameworks in place, implementing policy is still either a challenge or in its early stages, as Figure 9.1 shows.

Figure 9.1. **Access to Finance: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Bank financing is relatively well developed throughout the region and is firms' primary source of finance. In light of the predominantly bank-centred financial systems in South East Europe, it is important to enhance the "bankability" of enterprises, especially

the small and medium ones which often have trouble in obtaining bank loans. SEE economies would benefit from channelling special efforts into improving and further developing equity financing and other alternative financing instruments.

Achievements

The SEE economies have made progress in expanding access to finance.

All SEE economies have taken steps to establish institutional and regulatory frameworks for access to finance. Efforts are also being made to ensure the implementation of the frameworks, which is essential for the development of safe, inclusive and effective financial systems.

SEE economies have reformed banking finance frameworks to facilitate access to finance for corporations and individuals. Existing bank financing policies and frameworks in South East Europe seek to foster competition in the banking sector and ensure that there is an adequate range of financial products available to clients. Moreover, the economies widely recognise the importance of consumer protection in the sector and are progressing with the development of appropriate legislation.

SEE economies have made efforts to improve insolvency laws. Good insolvency laws play a critical role in financial stability by enabling the orderly restructuring and exits of distressed enterprises. Recent measures have focused on clearly defining insolvency procedures and when companies can enter into them. Legislation in most SEE economies encompasses restructuring and liquidation.

Challenges

While SEE economies have laid the foundations for facilitating enterprises' access to finance, there is still considerable room for improvement in most economies.

Credit and collateral information systems are not fully developed. These systems reduce information asymmetries between borrowers and lenders and ensure that the financial markets have the necessary data to assess borrower risk. The current cadastre systems have not been fully documented in all SEE economies and credit information registers in some cases are not regularly updated. Moreover, the data collected are not easily accessible by financial institutions or the public. The capacity of registers in the SEE economies to collect and store property titles and addresses could be improved so that banks can better assess the risk associated with borrowers.

Venture capital activity is not clearly identified or defined in legislation. In SEE economies, this characteristic indicates that venture capital investment does not enjoy an adequate level of legal protection.

Financial literacy and investment readiness programmes are not widespread in the region. Entrepreneurs are often ill-informed on financial markets and the financing options that are available to them. This stems from a lack of financial literacy and investment-readiness throughout the region.

Recommendations

The SEE economies can address the identified challenges to expand enterprises' access to finance.

Regularly update credit register systems, moveable assets registers and cadastres. A priority for the credit registry systems throughout the region is to focus on collecting data on loans (to legal and physical persons) which are greater than EUR 20 000. Economies from the region would benefit from regular, comprehensive data collection and ensuring that the data are available to financial institutions and the public on request. Another positive move in that respect would be to intensify efforts to catalogue any still-undocumented property titles and real estate assets within the cadastre system and make ownership data available through asset registers.

Further develop venture capital to provide new financing opportunities for innovative, high-growth enterprises. Some SEE economies need to explicitly define the legal scope of venture capital (VC) activity. For those economies that have legally determined what constitutes VC activity, they may have to review their tax treatment of formal equity investment – for investors and investment targeted companies – and, more generally, consider adopting a regime to facilitate venture capital.

Put in place investment-readiness programmes targeting a wide range of enterprises. Such programmes could include financial literacy training to educate entrepreneurs in the workings of the financial system, help them understand the different types of financing instruments available and how to access them. Programmes could also include courses on how to design and present proposals for funding from financial institutions and non-bank equity investors.

Improve financial consumer protection. SEE economies would benefit from improving the regulatory and institutional arrangements for protecting financial consumers. They could work to build partnerships with the media and relevant associations to raise awareness of financial consumer protection and promote it. Dispute resolution procedures also need to be timely and affordable.

Overview

Policy makers need to build legal environments and effective enforcement capabilities that help enterprises access the external financing they need to expand operations or invest in new capacities and capital goods (OECD, 2006). Similarly, innovative young firms will have difficulty getting off the ground if they are unable to fund their activity. The World Bank Enterprise Survey (World Bank, 2015a) regularly documents that entrepreneurs find that access to finance is one of the chief obstacles to establishing a firm. It is necessary to fully understand the primary institutional obstacles to accessing finance in South East Europe, especially in light of the financial crisis which has led to a dramatic decline in lending levels.

Research has found that a well-developed financial sector is positively correlated with economic growth (Roubini and Sala-i-Marin, 1995; King and Levine, 1993). A well-functioning financial system can boost competitiveness by effectively channelling funding to productive uses, stimulating saving and investment, and minimising transaction costs.

The constraints that firms face in accessing external finance can manifest themselves in a number of manners – e.g. a limited range of financial instruments, cumbersome regulatory environments, limited collateral or the inability of firms themselves to present project proposals properly to potential investors. The global financial crisis has made it harder to access funding and commercial lending to emerging markets has declined sharply.

This chapter seeks to evaluate whether the SEE economies have the financial markets, banking systems, demand-side knowledge (investment readiness) and institutions to support and regulate access to finance. Analysis is selective in scope and does not endeavour to evaluate access to finance policies comprehensively. It focuses on understanding the obstacles that prevent enterprises from meeting their financing needs.

Access to finance is closely linked to other policy areas and dimensions assessed in this report. For example, small and medium enterprises are especially sensitive to measures to widen access to finance. Institutional support services, national SME strategies and effective policy co-ordination among ministries and agencies need to be reinforced by adequate policy frameworks that give firms the support they need to access financial instruments and so contribute to employment and growth.

- **Chapter 4. Research, development and innovation** (RDI) in the private sector is dependent on access to finance. The ability of researchers, academics and innovators to access the market place is predicated on their ability to obtain project financing. When an economy has laid the foundations for the growth of venture capital investment, business angel networks (BANs), stock markets and crowdfunding, then entrepreneurs will be able to secure the funding they need. And the growth of new enterprises and innovative activity will, in turn, attract further investment opportunities – especially venture capital investment and BANs looking for innovative, promising enterprises.

Box 9.1. **Access to Finance Dimension in the SEE 2020 Strategy**

The Access to Finance Dimension is part of the Sustainable Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Sustainable Growth Pillar is to boost growth and jobs by supporting a strong, diversified and competitive economic base, while helping it become better connected, more sustainable and more resource-efficient. By enacting policies which ease entrepreneurs' and firms' access to finance, economics can contribute to the SEE 2020 Strategy's headline targets of an increase in net enterprise creation (new businesses per year) from 30 107 to 33 760 and a rise in the value of the region's goods and services exports from EUR 1 780 per capita to EUR 4 250.

The SEE 2020 Strategy sets a number of regional objectives to promote access to finance:

1. facilitate regional events for early-stage ventures
2. initiate regional investment readiness actions
3. regional capital market integration
4. start-up training and a culture of new venture creation by interfacing training and mentoring with access to finance and focusing particularly on young people and women.

The official SEE 2020 Strategy Co-ordinator for the Access to Finance Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and improve regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Access to Finance Dimension assessment framework

This chapter provides insights into how policies and institutions related to access to finance have developed in the SEE region. It does not seek to be exhaustive, however. It confines itself to assessing five broad sub-dimensions that constitute the Access to Finance Dimension informed by the objectives of the Sustainable Growth Pillar in the SEE 2020 Strategy. The policy sub-dimensions are:

- Regulatory and Institutional Framework

  Are institutional and regulatory frameworks in place? Do they support or constrain access to finance?

- Access to Bank Finance

  Are policies for facilitating efficient access to bank financing in place?

- Access to Equity Finance

  Do SEE economies have frameworks for developing equity financing – a particularly important form of financing when traditional bank lending is constrained?

- Alternative Sources of Financing

  Do policies promote access to finance through non-traditional means? If so, to what extent?

- Financial Readiness

  Do SEE economies have strategies that help the general population and entrepreneurs better understand the role of financial markets and how to use them?

Figure 9.2 shows how the sub-dimensions and their constituent indicators make up the Access to Finance assessment framework.

Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional Cooperation Council (RCC) collected qualitative and quantitative data on the Access to Finance Dimension.

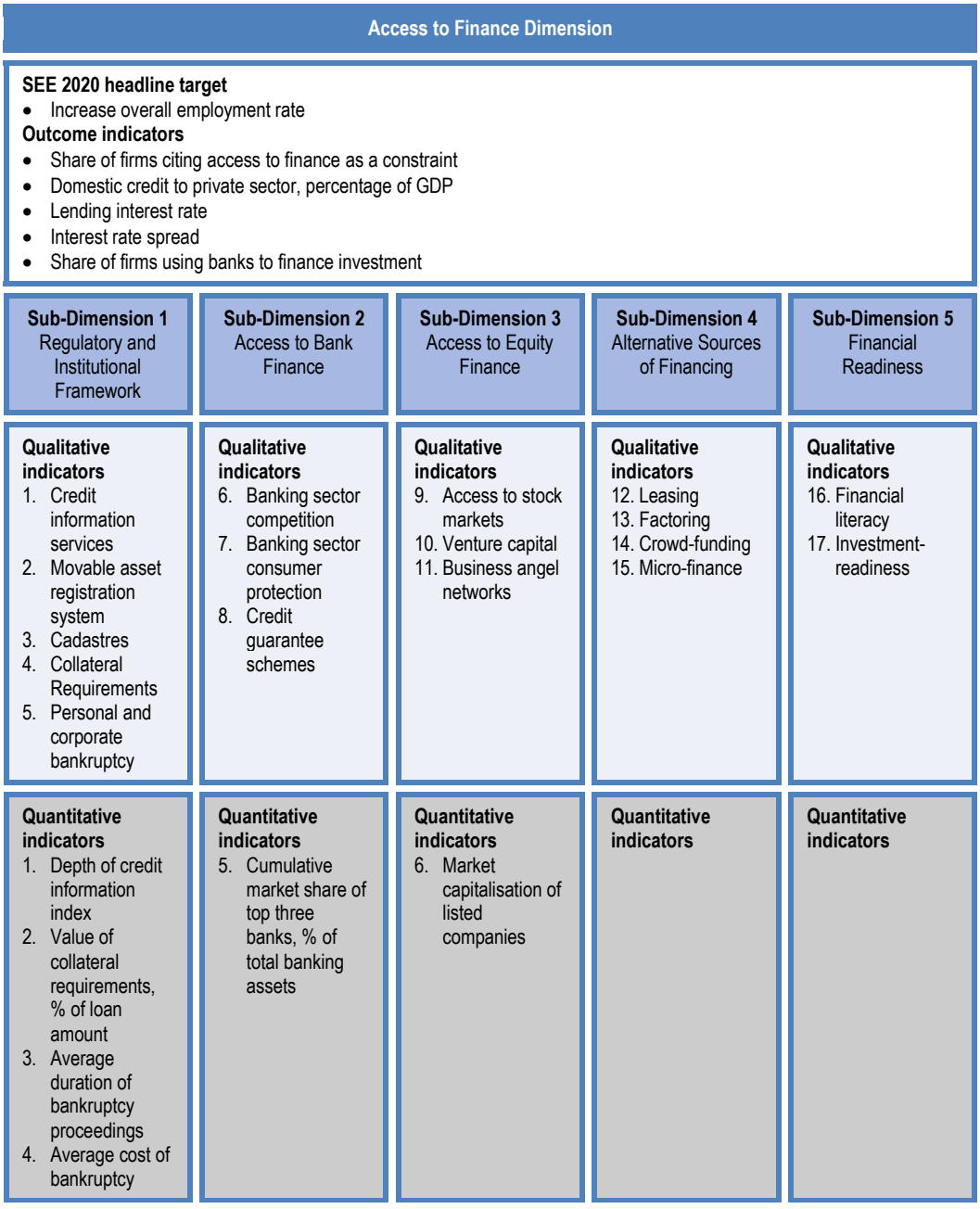
Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Access to finance performance in SEE economies

Entrepreneurs from the region often identify access to finance as a major constraint in enterprise development (Figure 9.3). However, that has been less and less the case since 2009, save in Kosovo, where nearly half of all entrepreneurs still cite it as a major problem. Better developed institutional frameworks for financial intermediaries (such as credit registry systems, documented cadastres and advances in insolvency laws) explain in part why access to finance is not the obstacle it was.

However, SEE economies might well see access to finance as less of an issue than EU countries because other challenges, such as political instability, take precedence. And, although they have developed regulatory frameworks and institutions, the market for financial instruments is not as active as in 2009. That trend could, in part, stem from the downturn in the business cycle prompted by the global financial crisis, with firms reluctant to invest in greater capacity.

Figure 9.2. **Access to Finance Dimension assessment framework**

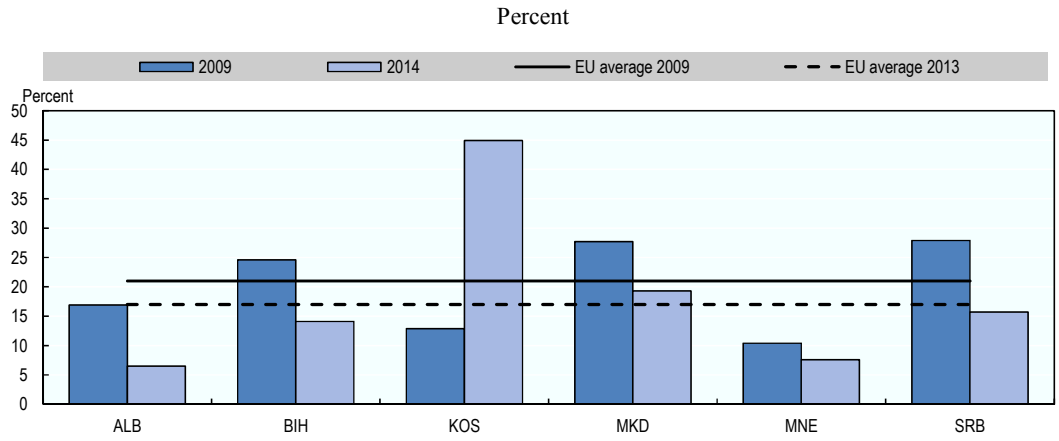


Lending to the private sector has stagnated since the onset of the financial crisis (Figure 9.4). In most of the SEE economies, domestic credit to the private sector as a percentage of GDP has been constant since 2008, though there have been noticeable declines in Bosnia and Herzegovina and (especially) Montenegro.

A similar trend has occurred in the EU, where lending to the private sector, although on a much larger scale, has seen a continuous decline since the beginning of the crisis. The trend is partly attributable to the fact that the financial sector is dominated by foreign-owned banks, which saw their lending activity stagnate as a result of the deleveraging process that began after the 2008 financial crisis. Before then, it is worth

noting, the arrival of numerous foreign banks in the SEE economies saw a parallel rise of capital inflows, which contributed to the steady increase in lending.

Figure 9.3. **Entrepreneurs citing access to finance as a constraint, 2009 and 2014**

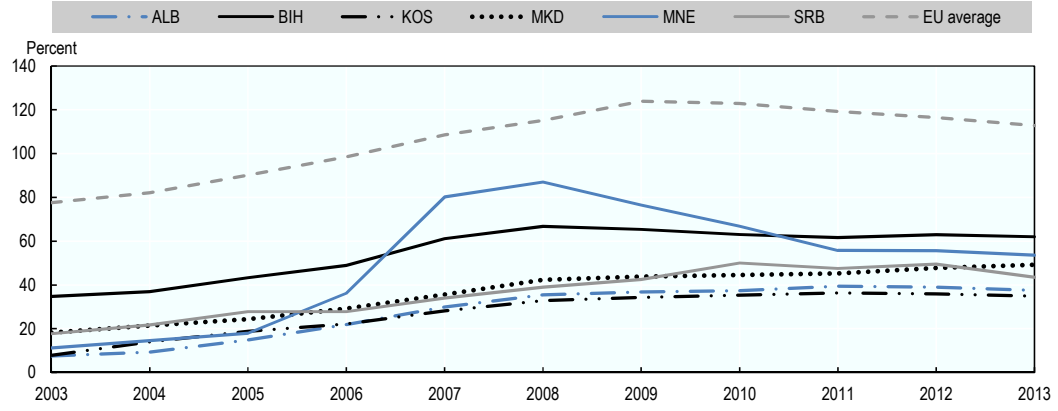


Note: The following EU economies are not included in the calculation: Austria, Belgium, Cyprus, Denmark, France, Italy, Luxembourg, Netherlands, United Kingdom. The reference year for the EU average is 2013. Data for Albania for the year 2009 as of 2007.

Source: World Bank (2015a), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

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Figure 9.4. **Domestic credit to the private sector**



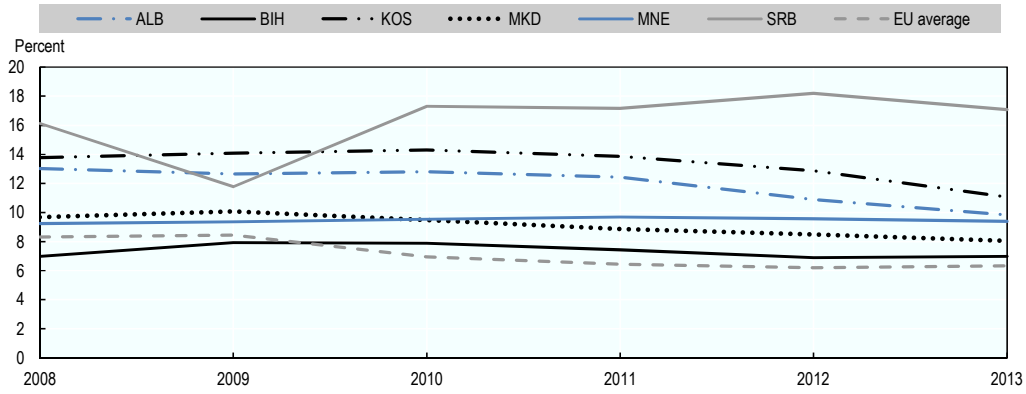
Source: World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322088

However, banks (foreign and domestic alike) continue to apply interest rates that are higher than the EU average of around 6.3% (Figure 9.5). Rates in Serbia, for example, exceed 18%, while in the other SEE economies they hover around the 9% to 10% mark. Accessing formal financial markets has become a costly endeavour for SMEs with such high interest rates, which also damages regional competitiveness.

Figure 9.5. **Interest rates on bank loans**

Percent



Source: World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

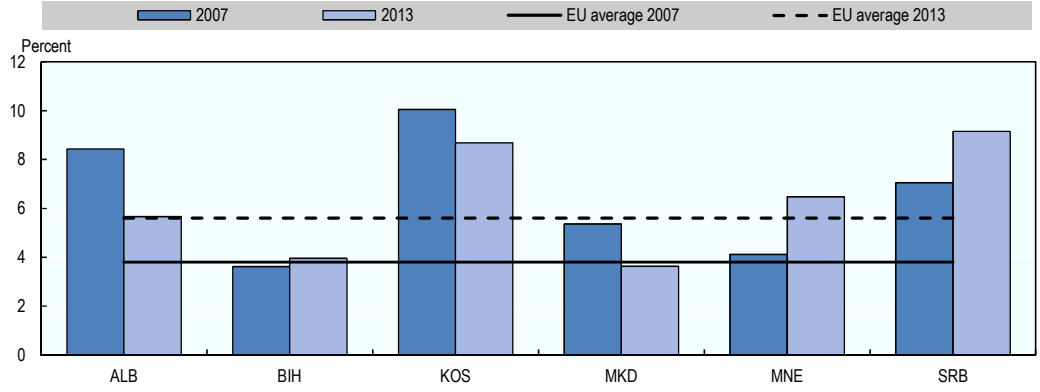
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Also high are interest rate spreads – the rate charged by banks on loans to private sector clients minus the interest rate paid by commercial or similar banks for demand, time or savings deposits. While generally higher than the EU's 5.6% rate, there are wide variations in trends from one economy to another. In Kosovo, Albania and the Former Yugoslav Republic of Macedonia, the interest rate spread has been on the decline since 2007. Indeed, the Former Yugoslav Republic of Macedonia boasted a lower rate than the EU at 3.6% in 2013. As for Bosnia and Herzegovina, its interest rate spread is still well below the EU average, despite climbing from 3.6% in 2007 to 4% in 2007. In 2013, Albania had an almost identical interest rate spread to the EU average.

In the SEE economies where interest-rate spreads are low, lending terms are favourable for SMEs in competitive banking sectors. In those with higher spread levels, SMEs incur higher costs when borrowing from the formal banking sector.

Figure 9.6. **Interest rate spread, 2007 and 2013**

Percent (lending rate minus deposit rate)

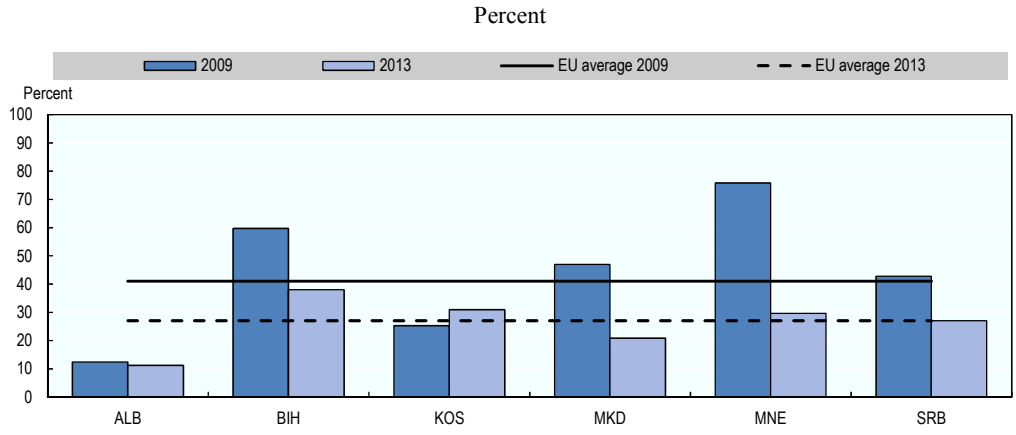


Source: World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Many firms in the region have actually reported using banks less as a source of financing investment (Figure 9.7) since the onset of the financial crisis. In the case of Albania, the borrowing level has historically been low. The underutilisation of the banking sector by enterprises in the region is in part a supply issue, as the region's banks have stopped increasing their lending since the financial crisis. Additionally, lower demand from the private sector is partially attributable to the high costs of borrowing in some economies (Figure 9.5) and lack of investment readiness (i.e. firms' poor skills in accessing banking and financial market instruments).

Figure 9.7. **Businesses using banks as financing source, 2009 and 2013**



Note: Data of Albania for the year 2009 as of 2007.

Source: World Bank (2015a), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

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Regulatory and Institutional Framework Sub-Dimension

An effective regulatory and institutional framework seeks to develop and incorporate a number of underlying laws and information-sharing systems that form the base of effective lending. If banks and other financial intermediaries are to effectively establish the creditworthiness of a potential borrower, the borrower's financial information must be available. Studies have shown a relationship between private credit growth and the existence of information-sharing mechanisms (Djankov et al., 2008).

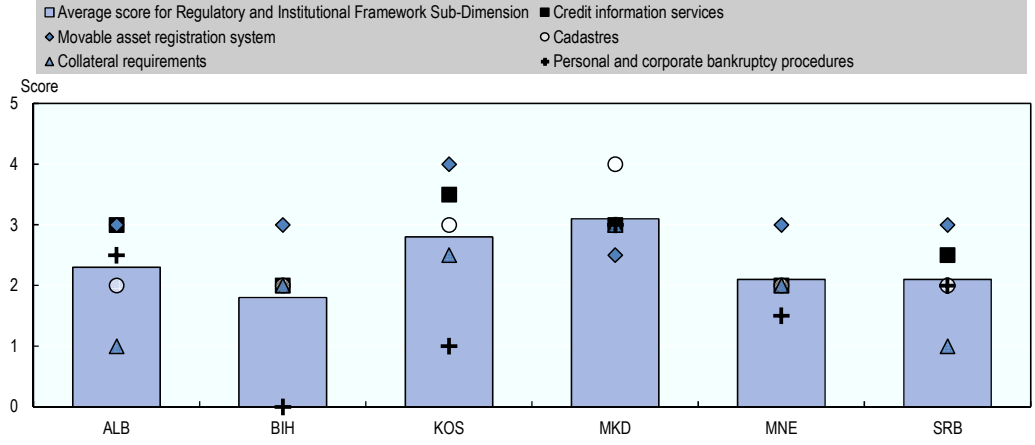
This section looks at the Regulatory and Institutional Framework Sub-Dimension. It assesses the efforts that the SEE economies have undertaken to lay institutional foundations that facilitate access to finance. The regulatory and institutional framework can play a fundamental role in supporting (or inhibiting) businesses' and individuals' access to finance. Accordingly, this section covers the laws and regulations (insolvency legislation, collateral requirement definitions, etc.) that enable the development of well-established, efficient financial intermediaries, markets and services. The overall performances of the SEE economies in the regulatory and institutional framework policy sub-dimension are obtained by assessing how they fare against five indicators.

- Well-functioning public and private **credit information systems** and bureaus provide valuable information on borrowers, be they firms or individuals, and thus reduce information asymmetries between lenders and borrowers. Lenders are able to verify borrowers' indebtedness and repayment history and set the cost of default accordingly.

- C**adastres** are needed because real estate is often the most valuable asset an individual or and firm may own. The use of land titles and property as collateral is limited in many emerging markets due to the absence of well-functioning, accurate cadastres.
- **Moveable assets** such as heavy machinery or production equipment account for a large share of the overall asset portfolio and wealth of many businesses. They are effective forms of collateral, therefore, given that they can be valued and repossessed easily. Here, too, an operational, reliable, accessible registration system is necessary for the effective provision of financing.

  As an economy lays the foundations for reducing information asymmetries between borrowers and lenders, it is helpful if policy makers can strengthen those foundations with legislative frameworks for insolvency procedures and definitions of collateral requirements. Insolvency law helps guarantee and collateral requirement definitions help safeguard financial intermediaries' investments.
- **Insolvency procedures** are followed when borrowers are in default. The absence of laws governing such procedures, or the poor implementation thereof, makes lenders reluctant to extend loans to enterprises as they would have no legal recourse should they fail to repay loans. Empirical studies (La Porta et al., 2000) have revealed a strong, positive correlation between the strength of investor protection and the ease with which firms obtain finance.
- **Collateral loan requirements** are often set by financial institutions on the basis of borrowers' assets and creditworthiness. The optimal value of collateral requirements is often difficult to determine, especially since the task is left to the independent assessment of a financial institution. However, excessive collateral requirements may exclude would-be borrowers from financial markets. The definition of acceptable forms of collateral also affects access to finance, with flexible definitions of collateral facilitating access.

Figure 9.8. **Regulatory and Institutional Framework: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Table 9.1. **Regulatory and Institutional Framework Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Credit information services	3.0	2.0	3.5	3.0	2.0	2.5
Movable asset registration system	3.0	3.0	4.0	2.5	3.0	3.0
Cadastres	2.0	2.0	3.0	4.0	2.0	2.0
Collateral requirements	1.0	2.0	2.5	3.0	2.0	1.0
Personal and corporate bankruptcy procedures	2.5	0.0	1.0	3.0	1.5	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323377

A strong regulatory and institutional framework (Figure 9.8) will include provisions for information-sharing mechanisms to ensure that investors and lenders have accurate, timely information on borrower creditworthiness.

The performances of the SEE economies vary widely when it comes to regulatory and institutional frameworks, as Figure 9.8 shows. Some, like the Former Yugoslav Republic of Macedonia, with 3.1, and Kosovo, with 2.8, have scored relatively well in the Regulatory and Institutional Framework Sub-Dimension. Those good showings suggest that they have developed and are implementing frameworks and legislation that support access to finance. Conversely, the regulatory and institutional framework in an economy like Bosnia and Herzegovina (with an average sub-dimension score of 1.8) is in early-stage implementation or, in some cases, still being drafted.

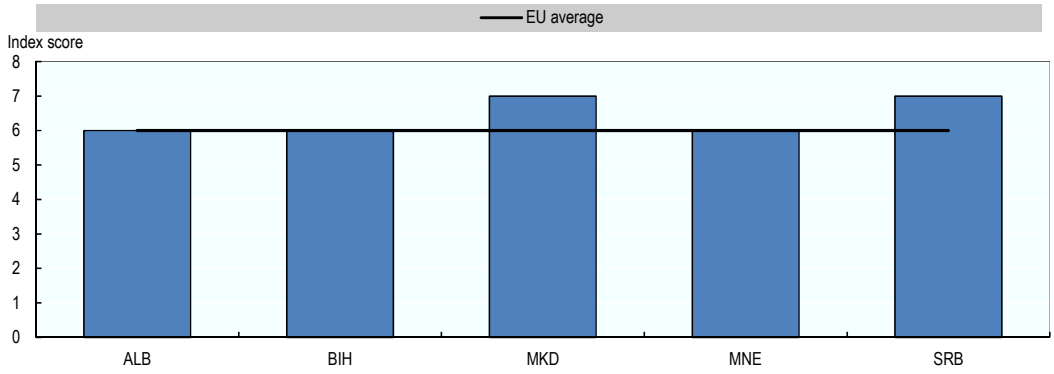
There is considerable variation in the degrees to which the SEE economies have developed the different components of their institutional and legislation frameworks. Most, for instance, have built up their registers for moveable assets, credit information services and cadastres system, which indicates that policy makers have worked to develop information-sharing mechanisms that make it easier for financial intermediaries to assess borrower creditworthiness. By contrast, legislation pertaining to collateral requirements and insolvency laws is generally more underdeveloped.

The SEE economies' relatively well-developed information-sharing arrangements can be partially measured in the World Bank's depth of credit information index (Word Bank, 2015b). It assesses the breadth and accessibility of an economy's credit register and bureaus. It awards an economy a point for each of the eight individual features that characterise well-functioning credit registers and bureaus in an efficient lending environment.

As illustrated in Figure 9.9, the SEE economies' scores in the depth of credit information index are comparable to the EU average of 6. Most economies in the region have a private credit bureau or a public credit register, which records and supplies data to financial institutions. However, the depth of credit information index shows that bureaus and registry offices in South East Europe do not typically support banks and financial institutions in assessing borrowers' creditworthiness, but leave it to their discretion.

Figure 9.9. **Depth of credit information index, 2014**

Index score



Note: Index ranges from 0 to 8, with higher values indicating the availability of more credit information, from either a public registry or a private bureau, to facilitate lending decisions. Data for Kosovo not available.

Source: World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322134

These relatively high scores in the depth of credit information index confirm that every economy in the SEE region has a credit information service framework in place, supported by the requisite legislative framework. These frameworks include both positive and negative information and offer guidelines as to how long data should be kept. All frameworks clearly indicate how credit information is to be made available to financial institutions and even to the public. The regulation and operation of credit information services are typically governed by the central banks.

Regionally, some economies have also allowed non-regulated entities to provide data (e.g. non-bank financial institutions and utilities companies). For instance, the Former Yugoslav Republic of Macedonia has a private credit bureau, while Albania added two non-banking financial institutions and one credit-saving scheme to its credit register in 2013.

Importantly, the credit register legislation in some SEE economies includes provisions that entitle individuals to object to data collection, challenge the data and have sensitive information (e.g. political views, religious beliefs, union membership) protected. For instance, Serbia's Law on Personal Data Protection allows information to be challenged, while the Former Yugoslav Republic of Macedonia entitles individuals to review and correct data.

In most SEE economies, information-sharing mechanisms are also supported by easily and affordably accessed moveable assets registers, with the ownership pledged assets being fully documented. The registers are supplemented by rules stipulating how information should be registered and data be made available online at a low cost. However, the development of registers has been uneven. The Former Yugoslav Republic of Macedonia transitioned from paper-based to electronic submission in 2014. Kosovo's register is, for its part, slightly more advanced, as it is monitored and assessed by the Pledge Sector of the Kosovo Business Registration Agency (KBRA) and its users which leads to readjustments when appropriate.

Cadastre systems are in place and are almost all fully catalogued

The SEE economies often have functioning cadastre systems in which it is compulsory to register property and which banks and credit institutions can access easily. However, with the exception of Kosovo and the Former Yugoslav Republic of Macedonia, real estate property has not been fully inventoried and cadastres will require more work before they are complete.

The Former Yugoslav Republic of Macedonia is reported to have fully catalogued all property, to update it regularly and to have made its cadastre information accessible and affordable. Serbia also has a fully documented cadastre system. It lacks, however a central register of addresses, which considerably reduces the quality of data and information. Montenegro, Bosnia and Herzegovina, and Albania all have functioning cadastre systems with electronic databases. But they either do not contain full property inventories (Albania has catalogued 80%) or face issues ahead of implementation – Bosnia and Herzegovina, for example, has not recorded all property owners and in Montenegro there are concerns over errors in surveys.

Collateral requirements are still high, but governments are making collateral definitions more flexible

The information made available to financial intermediaries ensures that lenders have all the necessary information to assess borrowers' ability to repay. Yet, throughout the region, they still set high collateral requirements. Most SEE economies, though, are in the process of drawing up flexible collateral definitions or flexible provisioning requirements. Additionally, some economies have established collateral registries. However, in the economies where collateral registries do not exist, governments are in the process of drafting legislation to establish and govern them.

In the region, collateral is one of the primary means for SMEs to obtain funding. And the lack of fully developed credit register or cadastre system makes it difficult for borrowers to provide the necessary information to obtain collateral based funding. In the SEE economies, the picture is mixed when it comes to the existence and types of collateral registers which, among other things, contain the collateral levels historically assigned to lenders. For instance, Albania does not have a collateral register, while in Serbia there are multiple registry systems in place and Montenegro has a central collateral registry with unified geographical location and asset classes.

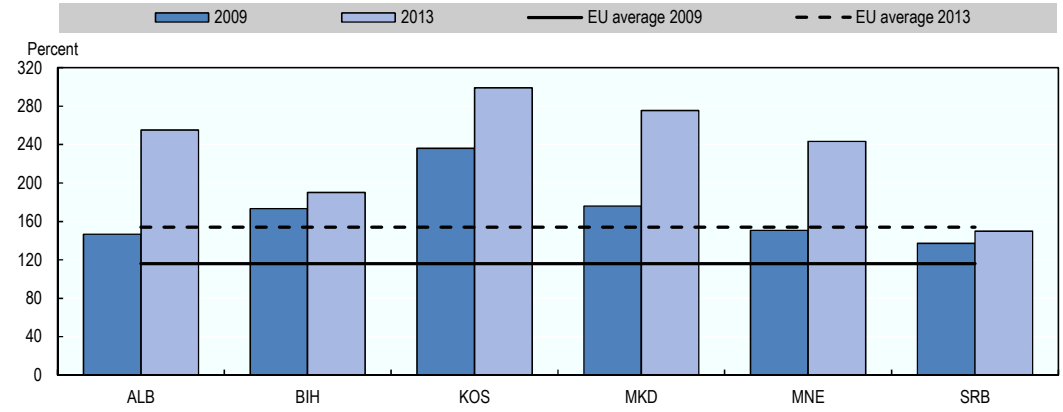
Despite efforts to strengthen and develop the regulatory and institutional framework so that financial institutions enjoy ease of access to information on prospective borrowers, collateral requirements remain high throughout the region (Figure 9.10) – a reflection of the high level of uncertainty and risk that banks associate with borrowers.

Bankruptcy procedures are slow but governments are addressing the issue

Although financial intermediaries can access borrowers' credit and asset information and set collateral terms, they still need guarantees should borrowers default. Appropriately defined insolvency laws and procedures ensure that investor protection. Once again, however, insolvency laws vary as to how far advanced they are. For instance, the Former Yugoslav Republic of Macedonia, Albania and Montenegro have corporate insolvency laws in place, with clear provisions for both the liquidation and reorganisation of assets. On the other hand, Bosnia and Herzegovina has no state level insolvency law, although the entities have theirs', and Kosovo has yet to fully implement its law.

Figure 9.10. **Value of collateral requirement, 2009 and 2013**

Percent of loan amount



Note: Data of Albania for the year 2009 as of 2007.

Source: World Bank (2015a), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

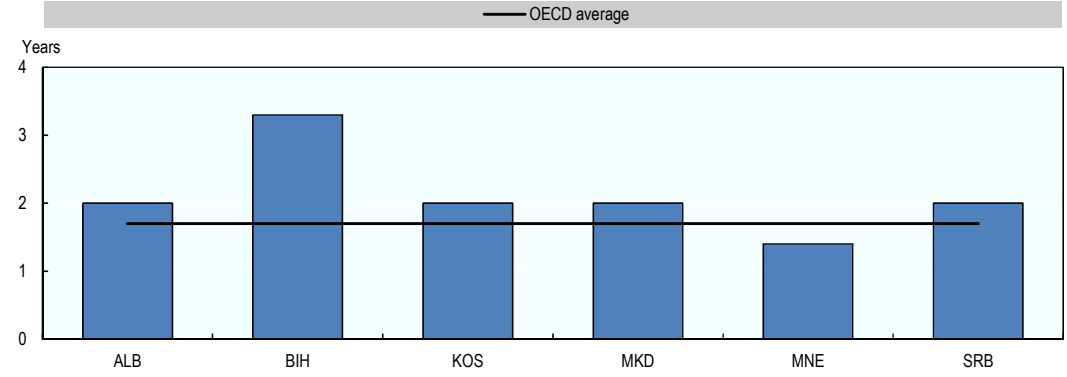
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In most economies, bankruptcy procedures are often considered slow. Serbia has recognised this issue and in July 2014 the government began adopting amendments to the current Law on Bankruptcy, with the explicit aim to shorten procedures and make them more efficient.

Well-defined insolvency laws ensure cases are resolved in a timely manner and that insolvent companies are given the chance to reorganise their current assets. However, according to the World Bank's *Doing Business Report 2015*, the average duration of bankruptcy procedures in South East Europe is 2 years, with the exception of Bosnia and Herzegovina where it is 3.3 years, the highest in the region (Figure 9.11). Some economies are performing rather well, such as The Former Yugoslav Republic of Macedonia and Montenegro, which are at or below the OECD average.

Figure 9.11. **Average duration of bankruptcy proceedings, 2014**

Years



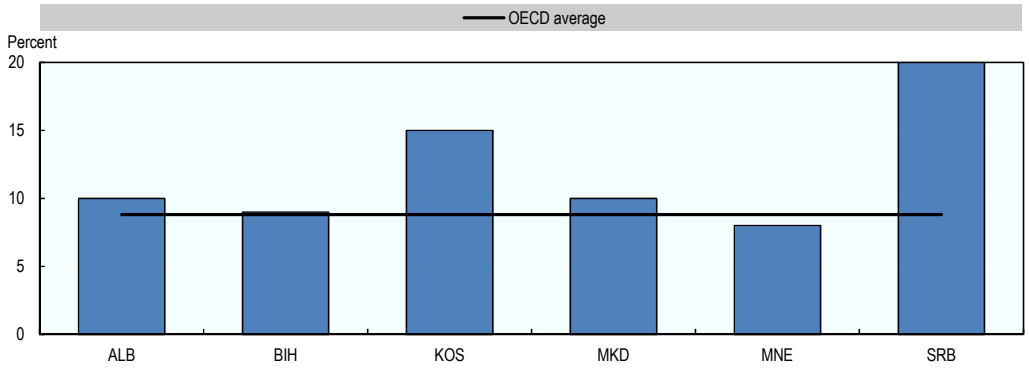
Source: World Bank (2015c), *Doing Business* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933322154

As for the cost of bankruptcy proceedings, as measured by the percentage value of estate, they are in line with the OECD's average of 8.8% (Figure 9.12). In Serbia, however, the cost exceeds 20%.

Figure 9.12. **Average cost of bankruptcy proceedings, 2014**

Percent of estate



Source: World Bank (2015c), *Doing Business* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933322161

The way forward in regulatory and institutional frameworks

As they look ahead, the SEE economies might consider easing high collateral requirements and continuing to draft flexible collateral definitions and provisioning requirements. When possible, they should introduce collateral registry systems and develop frameworks for collecting financial information on borrowers. The governments could also complete any property title and real estate asset cataloguing that is still outstanding and include information on their valuation and property characteristics. Doing so would help banks and other financial intermediaries to better assess lending risks.

All SEE economies can afford to strengthen their insolvency laws by seeing that they are passed by parliament and contain clear legal procedures. It is important that corporate insolvency laws allow firms to liquidate and reorganise their assets, as reorganisation allows them to preserve their innovative, successful branches of business. As for personal insolvency laws, they are underdeveloped region-wide, and policy makers may wish to consider drafting legislation to strengthen them.

Access to Bank Finance Sub-Dimension

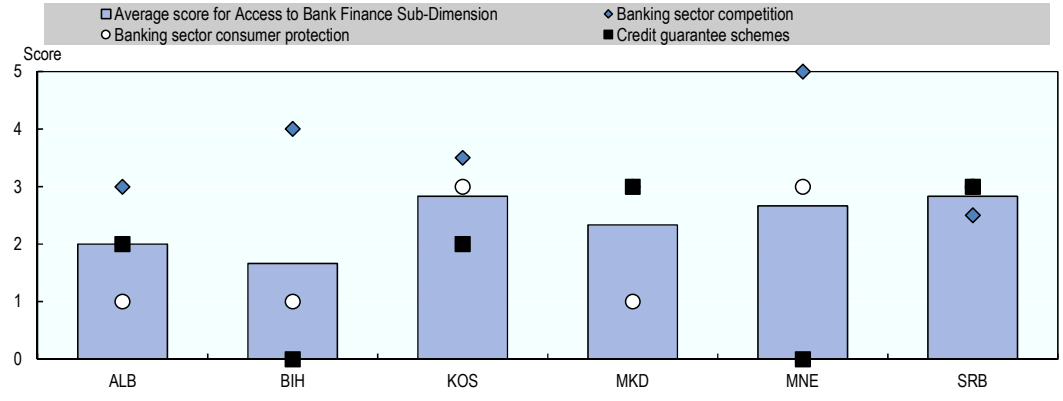
Companies of all sizes from across the region still commonly cite bank finance as one of the chief sources of external finance (EBRD/World Bank, 2015). If banks can effectively live up to their roles as financial intermediaries between owners and users of funds, they can contribute to a more efficient allocation of financial resources. The traditional banking finance sector is considered a prime source of external financing for businesses in South East Europe – particularly as the bond and equity markets are often available only to a few big firms.

This section considers the Access to Bank Finance Sub-Dimension. It measures the extent to which public policies in the different economies facilitate or hamper businesses' access to bank loans across three qualitative indicators.

- **Banking sector competition** facilitates access of would be borrowers to lending services. Competition dynamics in the financial sector, as in other sectors, make for efficient banking, better provision of financial products, greater innovation and lower prices. More competition also enables efficient banks to enter markets and grow, ultimately displacing inefficient ones. The benefits of competition makes it important to evaluate the degree of concentration in the banking sector and to examine what share of total assets the biggest banks control.
- **Consumer protection** should be in place to safeguard borrowers against mistreatment, regardless of whether banks are few or many. The global financial crisis highlighted the need for more effective financial consumer protection, as consumers contend with increasingly complex financial markets. Indeed, the financial markets have been characterised by fast changes in product development, product innovation and technological advances. To protect borrowers against any exploitation, adequate legal safeguards should be in place, backed by agencies that oversee and enforce consumer protection. The media and consumer associations can also play a valuable role in promoting customer protection to the general public in the banking sector.
- **Credit guarantee schemes** safeguard banks themselves against lending to potentially risky borrowers. The objective of credit guarantee schemes is to help small companies who have viable projects and are otherwise denied access to loans because of insufficient collateral or credit history. Typically, a credit guarantee facility offers a bank a guarantee against loan defaults and, in the event of a default, the bank recovers the value of the guarantee.

The SEE economies generally perform better in the Access to Bank Finance Sub-Dimension than others in Access to Finance. Most have moderately well-developed banking sectors with Serbia and Kosovo, for example, scoring an average 2.83, which indicates that policy implementation is in a more advanced stage. However, although almost all the economies have relatively competitive banking sectors, there is a widespread lack of consumer protection.

Figure 9.13. **Access to Bank Finance: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322176

SEE economies have developed frameworks to ensure competitive banking sectors

Table 9.2. **Access to Bank Finance Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Banking sector competition	3.0	4.0	3.5	3.0	5.0	2.5
Banking sector consumer protection	1.0	1.0	3.0	1.0	3.0	3.0
Credit guarantee schemes	2.0	0.0	2.0	3.0	0.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

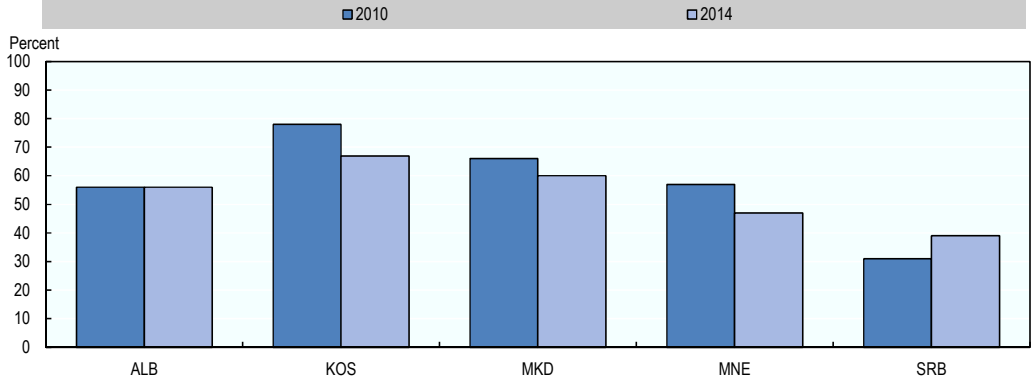
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Different components of the banking sector in South East Europe are at various levels of development. For instance, most economies can be considered to have a highly competitive banking sector, with few limitations on domestic or international operations. By contrast, the development and implementation of credit guarantee schemes is limited, with few schemes in operation and their funding at low levels.

The banking sector in the SEE economies has become increasingly more competitive, with a rising number of foreign and domestic banks penetrating the market. The upshot is a varied provision of services and assets for consumers. The increased competition is reflected in the fact that, across the SEE region, the top three banks' cumulative share of total banking assets has declined (Figure 9.14).

Figure 9.14. **Cumulative market share of top three banks, 2010 and 2014**

Percent of total banking assets



Note: Data for Bosnia and Herzegovina not available.

Source: National Statistics Offices.

StatLink http://dx.doi.org/10.1787/888933322187

Importantly, there are no legal restrictions on the operations of banks, be they foreign or domestic, and state-owned banks are not generally the biggest operators. Foreign-owned banks now dominate the financial sector, accounting for some 60% of activity in the region and up to 80% in Montenegro. Prior to the 2008 financial crisis, the entrance of foreign banks into the region was accompanied by large inflows of foreign capital that helped fuel the credit boom throughout the region.

Generally, economies have drafted and implemented banking laws that do not discriminate between foreign and domestic banks. However, Serbia requires banks to go through screening and approval procedures before it admits them, while banks must be established as a joint stock company in the Former Yugoslav Republic of Macedonia and have a head office there. The region's banking laws apply the same regulatory requirements and prudential supervision policies to all types of banks, regardless of ownership origin. However, many economies in the region have not seen any significant new bank entries in the last two to three years.

The strength of banking consumer protection varies among SEE economies

In some SEE economies consumer protection laws have been introduced to prevent borrowers from being exploited by large financial bodies. However, the strength of those laws varies from one SEE economy to another. Kosovo, Montenegro and Serbia all have legislation that is regionally relatively advanced. Their systems incorporate an agency or ministry that oversees consumer protection in general, not explicitly in banking.

Other consumer protection provisions do, however, indirectly regulate financial activity. Kosovo's Law on Consumer Protection, for example, has clauses that protect financial consumers. As for Montenegro, it is an exception in that its Central Bank has a banking ombudsman which has a defined set of principles for protect banking consumers' rights. Serbia's Central Bank, too, incorporates a special unit, called the Centre for Financial Consumer Protection and Education and Market Supervision, which advises citizens who have grievances and complaints.

Less well-developed banking sector consumer protection arrangements are to be found in Albania, the Former Yugoslav Republic of Macedonia, and Bosnia and Herzegovina. They do not explicitly protect banking consumers, although the Former Yugoslav Republic of Macedonia does provide financial protection for consumer loans and wishes to broaden the scope of that legislative protection to cover all financial service providers and products (loans, deposits, etc.).

As for Bosnia and Herzegovina, the state affords no protection to banking consumers, although indirect protection does exist through the Banking Agency of the Federation of Bosnia and Herzegovina and Republika Srpska. In the absence of state-level safeguards, a consumer protection association is in place. It offers free financial counselling and sometimes helps mediate between citizens and financial institutions.

Credit guarantee schemes are limited in number and scope

Even economies with a highly competitive banking sector and appropriate protection may see a limited flow of investment into the SME sector, widely considered to be high-risk. Credit guarantee schemes facilitate such investment. An effective scheme outlines clear objectives and lending criteria to promote the development of SMEs. In that regard, it is important to note that the strength of credit guarantee schemes depends on the issuer's credit rating. The low credit rating of regional governments often limits credit guarantee schemes.

Albania does have credit guarantee schemes in place, but they are considered very limited, which has prompted Albania to develop a much larger one. The Former Yugoslav Republic of Macedonia's Special Credit Guarantee, operated by the Macedonian Bank for Development Promotion (MBDP), is well developed. It is successfully helping to fund SME development with schemes that cover up to 40% of loans (EIB, 2014). Montenegro

did have a guarantee scheme, too, but it has been ended as a result of a funding cut made by the Montenegro Investment and Development Fund ended it.

The way forward in access to bank finance

As the SEE economies look ahead, they might consider improving their insolvency laws by establishing dispute resolution settlement agencies and ensuring that settlements are timely and affordable. Such a move could be bolstered by the media and consumer associations that play an active role in promoting banking sector consumer protection.

Measures to build more effective credit guarantee schemes differ from economy to economy. Bosnia and Herzegovina and Montenegro, for example, could draw up and initiate credit guarantees, while all the economies would benefit from running outreach programmes to promote such schemes to the appropriate sectors. They would be well served by incorporating clear objectives – which should include financial stability – as well as clearly defined lending criteria.

Box 9.2. **Korean Technology Finance Corporation, an example of best practice**

The government of Korea has established a credit guarantee fund to facilitate investment in SMEs it considers new-technology firms. The fund was founded in 1989 as the Korea Technology Credit Guarantee Fund (KOTEC) before being overhauled and renamed the Korea Technology Finance Corporation (KIBO).

The credit scheme provides 80% of the total guaranteed amount to firms that showcase, use or develop new technological services or products. Such firms are technologically innovative and have good business prospects, but have trouble obtaining the financing to invest and develop. When such firms cannot meet a bank's lending criteria, they can apply to KIBO for a technology guarantee.

The KIBO then investigates and evaluates both the firm's creditworthiness, business potential and the value of its technology. The KIBO discloses its findings to the banks to help them in its deliberations over whether to grant the loan.

KIBO also has a functioning support system in place with a set of mechanisms to help companies that could default and to address other claims. It also helps entrepreneurs seeking to start a high-tech business by evaluating the monetary value of its technologies and the commercial feasibility of a firm.

The KIBO system has facilitated USD 167 billion of credit guarantees.

Source: OECD (2013a), *Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2013-en.

Access to Equity Finance Sub-Dimension

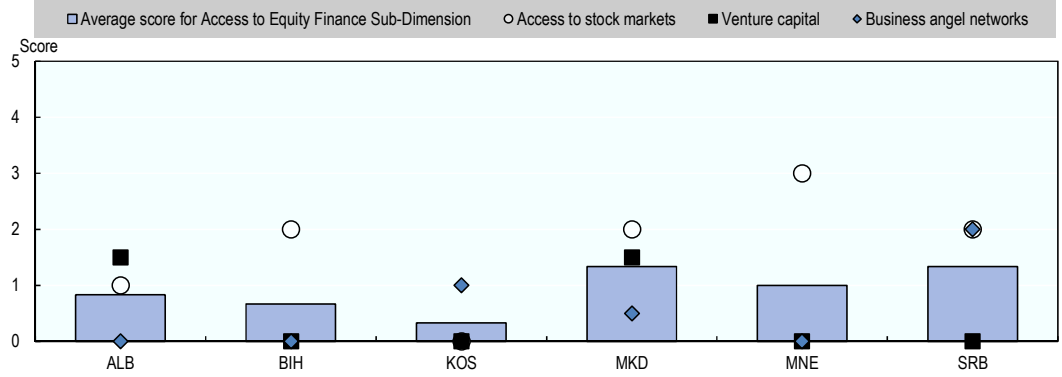
Equity finance is one of the primary business development financing channels. For small, innovative firms, access to bank finance is constrained by uncertain prospects of success, long time horizons, a lack of tangible assets that can be used as collateral and a limited operating history. To grow, they need access to equity finance. Equity finance can also be critical for more mature firms as it enables them to raise capital in the stock markets. In a word, access to equity finance is an important element in competitive environments that support the creation and expansion of businesses.

This section considers the Access to Equity Finance Sub-Dimension. It assesses policies related to three different types of equity financing options – business angel networks, venture capital funds and access to the stock market.

- The **access to stock markets** indicator assesses how liquid the economies' stock markets are, if they have them and – which could benefit SMEs – and the legal framework to allow companies to be listed.
- The **venture capital** indicator ascertains whether the venture capital industry is active and effective and whether legislation exists to regulate it. Legislation should clearly define what constitutes a venture capital investment and should allow pension funds, insurance companies and other financial institutions to invest in venture capital funds.
- The **business angel networks** (BANs) indicator determines whether or not BANs operate in an economy and assesses what conditions and policies are in place to foster their development.

Equity financing is not widely developed in the SEE economies. Few frameworks or legislation are in place to support equity finance instruments and four of the six economies do not have clear legal definitions of venture capital activity. Kosovo has ground to make up. Its average score of 0.3 (Table 9.3) is attributable to limited venture capital activity and the lack of an existing stock market. The two highest-scoring economies with 1.33, the Former Yugoslav Republic of Macedonia and Serbia, have legal frameworks in place but are yet to implement them. However, Serbia still does not legally recognise venture capitalism.

Figure 9.15. **Access to Equity Finance: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322196

Table 9.3. **Access to Equity Finance Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Access to stock markets	1.0	2.0	0.0	2.0	3.0	2.0
Venture capital	1.5	0.0	0.0	1.5	0.0	0.0
Business angels networks	0.0	0.0	1.0	0.5	0.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323390

Business angel activity is very limited in the SEE economies. As for venture capital funding, the economies have not determined appropriate definitions as to what constitutes venture capital activity, which limits legal safeguards for investment and deters investors. There are, however, functioning stock markets with appropriate legislation governing securities trading in Serbia, the Former Yugoslav Republic of Macedonia, Montenegro, and Bosnia and Herzegovina.

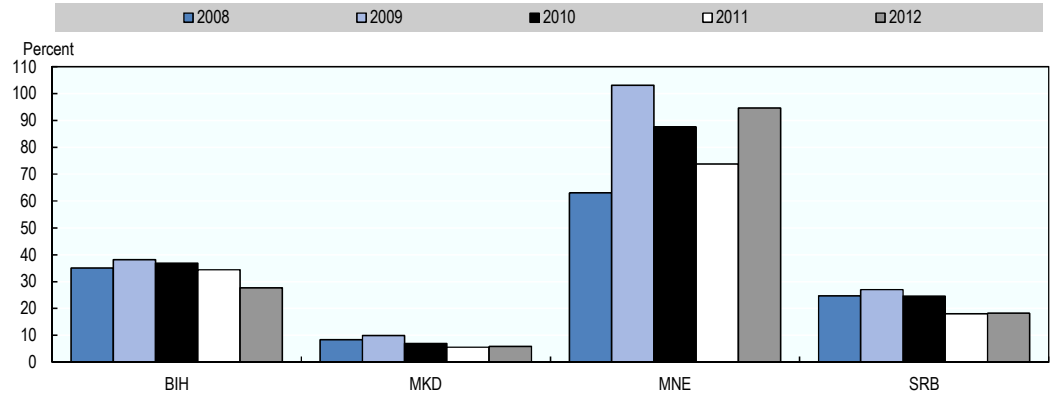
Not all economies have stock markets and those do could clarify their legal frameworks

Equity finance is synonymous with the stock markets in any economy. Cross-country surveys reveal that transparent, liquid capital markets are essential to channelling investment and supporting large and medium-sized companies' efforts to raise capital and reduce reliance on the banking system. Stock markets allow investors to trade their stakes, realise capital gains and redirect their capital into new investments (UNECE, 2009). The importance of well-functioning stock markets calls for an effective legal framework.

The health of equity finance is, to some extent, reflected in the market capitalisation of listed companies as a percentage of GDP, i.e. the share price multiplied by the number of shares outstanding. In the SEE economies, the level of market capitalisation is relatively low (Figure 9.16). Montenegro, though, is a notable case, as market capitalisation there is close to levels in many OECD and EU economies – which suggests a healthy, active stock market where companies can raise equity capital.

Figure 9.16. **Market capitalisation of listed companies**

Percent of GDP



Note: Data for Bosnia and Herzegovina is based on OECD calculations and national stock markets. Data for Albania and Kosovo not available.

Source: Adapted from World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322202

Stock-market activity, or the lack of it, is a measure of how well-developed securities market legislation is. Kosovo, for example, has no existing capital market and no stock exchange operates there. As for Albania, its stock exchange was shut down because it was entirely state-funded and illiquid after not functioning for over a decade. There is still a legal framework in existence, however.

The rest of the economies, however, do have legislation regulating securities trading. Montenegro, Serbia and the Former Yugoslav Republic of Macedonia have established securities and exchange commissions to implement the law, which sets out clear rights and obligations for companies involved in the stock exchange. Bosnia and Herzegovina, for its part, has no state-level stock exchange, but one in each entity (in Sarajevo and in Banja Luka).

Venture capital activity is nascent and still awaiting clear legal definitions

However, there are other ways to obtain equity finance where there is no stock market or when companies have trouble getting listed on the stock exchange. One such mechanism is through venture capital (VC) investment. It is very much oriented towards high-technology companies with high potential and is a significant source of finance as their potential grows and they require larger sources of capital

Venture capital funds play an essential intermediary role: they channel capital from institutional investors to high-potential businesses. They also provide companies with strategic or managerial expertise and network contacts (UNECE, 2009). In many OECD countries, the growth of the venture capital industry has contributed to the increase in private sector innovation (OECD, 1996).

Even in economies where capital markets are underdeveloped, firms are not necessarily able to source equity finance from venture capital.

Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia either have no legislation or are in the early phases of developing a legal framework. In the case of Serbia, no law recognises venture capitalism as an economic activity. The consequent absence of legal protection will continue to hamper venture capitalism activity for the near future. In the Former Yugoslav Republic of Macedonia venture capitalism is regulated in part by the Law of Investment Funds. A few VC funds do exist, although there is concern they operate almost as hedge funds. Overall venture capital activity is at a low-level throughout the region due to little viable opportunity.

Angel investment activity is limited and often with no legal framework governing it

One limitation of venture capital equity financing is that it is geared towards companies with proven business viability. For those seeking early-stage equity finance, business angel networks (BANs) may be a good source of equity capital. Business angels are informal investors who engage in early-stage risk financing and business coaching. Networks of angel investors meet the needs of small high-potential firms during their seed and start-up phases in return for a stake in the company. BANs give prominence to individual investors offering them exposure to a large number of deals and allowing them to diversify their portfolios by taking part in a large number of syndicated deals.

Business angel networks are a recourse only for very few firms seeking early-stage equity financing. Regionally, there is very little angel investing and legislative provisions are underdeveloped. Neither Montenegro nor Albania are home to any angel investor activity, nor do they have a legislative framework to promote it. In Bosnia and Herzegovina, once again, there is no state-wide legislation or activity, though both entities have attempted to introduce it, but are constrained due to financing limitations.

BANs operate in Kosovo and Serbia, however. The Serbian Business Angel Network (SBAN), for example, works in collaboration with the Serbian Investment Promotion Agency, Chamber of Commerce and Innovation Fund towards new development investments. However, although angel investment takes place in Kosovo and Serbia, neither economy has enacted any institutional regulations.

The way forward in equity finance

Venture capital is underdeveloped because legislation does not define it clearly. The SEE economies could consider clearing the way for venture capital by explicitly defining its legal scope. The economies that have defined venture capital activity would benefit from *i)* reviewing the tax treatment of formal equity investment for investors and target companies and *ii)* adopting a facilitating regime for venture capitalists.

The SEE economies could generally improve their securities markets – again by establishing clear legislation that defines securities trading. They could also work to ensure that equity information of companies listed on the stock exchange is publically available.

Alternative Sources of Financing Sub-Dimension

This section looks at the Alternative Sources of Financing Sub-Dimension. It examines forms of business development financing other than the traditional channels and equity financing. The alternatives are, for example, leasing, factoring, microfinance and crowdfunding. They give small firms financing options when they have been denied capital by traditional lenders, or when borrowing requirements are too steep because they have little or no borrowing history or their credit information is costly to access. While the quantity and diversity of financing products ultimately depend on private initiatives driven by supply and demand, clear legal frameworks and active government promotion are important for supporting their development.

This section assesses whether **leasing**, **factoring**, **microfinance** and **crowdfunding** are available in the SEE economies and whether public policies encourage them.

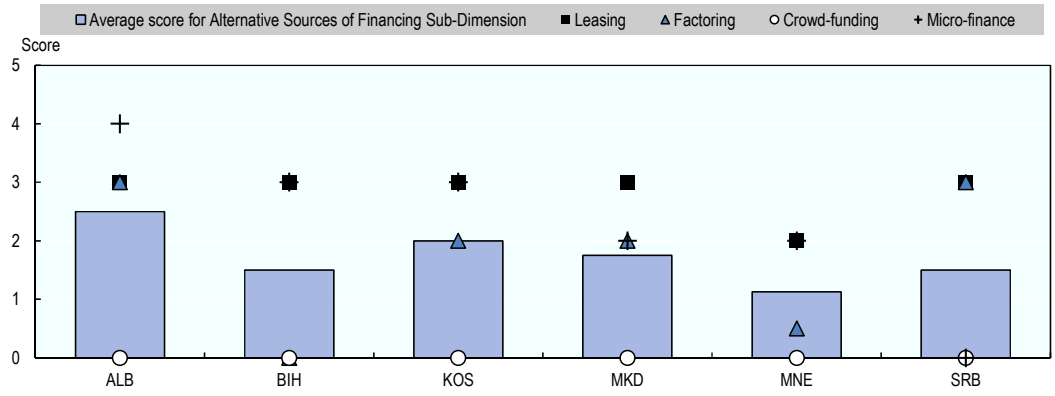
In Alternative Sources of Financing, the economies fare relatively better than in other sub-dimensions of the Access to Finance Dimension (Figure 9.17). Most have developed legal frameworks for leasing and factoring, but have work to do when it comes to developing modern alternative financing sources like crowdfunding.

Although there is a variety of alternative sources of financing, developing individual instruments would ensure that a wide-ranging basket of options is available to firms of all sizes when they consider how to raise capital.

The scores in Table 9.4 suggest that most economies in the region have developed legislative frameworks to govern leasing, which has increased its use as a means of alternative financing. Three or four of the economies have enacted laws governing factoring, but either implementation has not followed or factoring activities are limited. When it comes to microfinance, most economies have drawn up legislation but, like factoring, there is a low level of activity. Crowdfunding, the most recent form of alternative financing, is practically non-existent in the SEE region.

None of the economies can be considered to have a developed a full basket of alternative financing instruments. Nevertheless, Albania, Kosovo and the Former Yugoslav Republic of Macedonia do come close with their moderately well-developed mechanisms for factoring, leasing and micro-financing.

Figure 9.17. **Alternative Sources of Financing: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322212

Table 9.4. **Alternative Sources of Financing Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Leasing	3.0	3.0	3.0	3.0	2.0	3.0
Factoring	3.0	0.0	2.0	2.0	0.5	3.0
Crowd-funding	0.0	0.0	0.0	0.0	0.0	0.0
Micro-finance	4.0	3.0	3.0	2.0	2.0	0.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323408

Leasing is an established practice throughout SEE governed by clearly defined legislation

Leasing is one of the first instruments that policy makers should consider when seeking to ensure that alternative sources of funding are available. Leasing is the renting of an asset for a given period of time as an alternative to outright purchase. It first involves the bank or another lender buying an asset (e.g. machinery), then leasing it to the borrower (the company), who often purchases it when the lease ends.

Leasing is an effective way of expanding access to finance. Collateral is not necessary because ownership remains with the lessor and leasing contracts can be signed without considering credit histories. Governments can play an active part in promoting leasing markets through capacity building and training.

All the SEE economies have financial leasing laws in place, typically overseen and administered by central banks – not, though, in Bosnia and Herzegovina, where there is no state-regulated leasing. However, banks in the two entities do the job.

Serbia has adopted leasing laws in accordance with EU standards, though its prudential regulation requirements are disproportionate to the inherent risk of leasing – leasing companies have to hold reserve funds based on the size of the portfolio, something uncommon in Europe.

There is also some variation among economies as to how leasing activity is taxed. In the Former Yugoslav Republic of Macedonia, for example, value added tax (VAT) legislation considers leasing agreements not as a rental but as a final sale. In Serbia, by contrast, tax policy requires VAT to be paid on the "interest component of leasing payments", which means that leasing is a significant cost disadvantage to bank loans where there is no VAT on interest payments.

In all SEE economies, leasing is primarily the province of the banks, though two non-bank institutions in Kosovo, for example, operate leasing products. However, since the onset of the financial crisis, some economies have experienced a drop in leasing activity.

Factoring activity is limited throughout SEE, with explicit factoring laws seldom in place

Another alternative means of financing is factoring, in which a business (the creditor) sells accounts receivable from customers (the debtor) to a third party (the factor). The creditor sells the receivables at a discount in exchange for immediate payment. Factoring, too, can broaden access to finance since it is based on a business' accounts receivables rather than on its overall creditworthiness.

The SEE economies are at different stages when it comes to factoring legislation. Montenegro has no specific legal framework but, in recognition of the importance of factoring, the government has appointed a working group to draft a law. Again Bosnia and Herzegovina has no state-level legal framework, but the entities' multiple laws can be combined to regulate factoring effectively.

The other economies have not passed laws that explicitly govern factoring, though Serbia and Albania both have legislation that covers the activity and both clearly set out conditions and criteria as to who can provide factoring services and how – it is usually the banks in South East Europe.

Crowdfunding hardly exists in the SEE region and, if it does, is in early stages of development

A more contemporary means of raising funds – away from either the traditional banking system or equity markets – is crowdfunding. It involves raising capital by asking a large number of individuals for small amounts of capital which may take the form of a donation, loan or an equity stake. Typically, fund seekers use crowdfunding platforms or social media. However, issues like investor protection, operational and financial transparency, the security of information and payments, and platform functionality may arise if there is no clear regulatory framework. Regulation is needed to prevent fraud and help would-be funders recognise credible requests.

Crowdfunding has not yet come to the SEE region. The one exception is the Former Yugoslav Republic of Macedonia. The concept was, in fact, non-existent until early 2014, when a crowdfunding online portal was launched. As a result, there is recognition of the need to draft provisions that ensure security of information and privacy of communication and to develop a more sophisticated ICT infrastructure if crowdfunding is to succeed.

Micro-finance activity and governing legislations are varied among SEE economies

An oft-cited means of sourcing financing is micro-finance. It is particularly useful for small business owners with restricted access to more institutionalised sources of finance. It can help them in the initial business idea stage which requires only modest investment. Although small, micro-finance institutions (MFIs) come in a variety of forms. Regulations should be clear, of course, but should also recognise that over-stringent requirements could hamper the development of MFIs.

Apart from favourable regulatory environments, the assessment of micro-finance also considers factors like the types of MFIs operating in the SEE economies, their geographical coverage and the range of available micro-finance products they offer.

Micro-financing legislation and the activity itself are relatively dynamic in the region. Apart from Serbia, the national banks in all SEE economies oversee micro-finance. In Bosnia and Herzegovina, MFIs operating in the different entities cannot co-operate, as they do not have access to a common market or common creditors. The banking agencies in the entities oversee micro-financing.

Micro-financing operations are not always self-sufficient. In Montenegro, nearly 70% of MFI funding comes from donors. In Serbia, too, which does not have a legal framework for micro-finance, donors supply the bulk of funding for its three micro-finance banks.

Only Albania has a well-established regulatory framework for micro-financing. It also boasts a mix of MFIs which cover both urban and rural areas and offer a wide range of products to different types of consumers.

The way forward in alternative sources of finance

As they look ahead, the SEE economies could consider the importance of regulatory frameworks that govern the activities of micro-finance institutions and allow MFIs to operate region-wide. MFIs would also gain from evolving away from state or donor funding towards self-sufficiency. The MFIs that take deposits should be subject to prudential regulation and, when they do not, to record-keeping requirements. Another positive direction for policy makers to take would be to develop links between MFIs, chambers of commerce and commercial banks.

As for factoring policy, the economies' different performances point to different directions for developing the activity. Montenegro, for example, stands to gain from incorporating the selling and assigning of receivables in the legal framework it is drafting. The other economies could, for the most part, consider legally defining factoring services as buy-and-sell transactions. It is equally important that criteria should clearly determine the entities allowed to perform factoring activities.

Another positive move would be to developing a collateral register for the timely collection of information concerning the payment of debt.

Financial Readiness Sub-Dimension

Difficulties in obtaining financing are not only a supply-side problem. They may also be the result of demand-side factors. Venture capitalists, for example, reject large numbers of investment proposals because they are poorly documented and presented.

Mason and Kwok (2010) show that entrepreneurs are ill-informed as to the role of equity finance and misinterpret the high rejection rates of business angels and venture capital funds as meaning that business fails to meet the requirements of investors. The demand-side problem here is one of financial literacy and readiness. Educating and training entrepreneurs in finance can supply critical input that will improve their understanding of and access to finance.

This section considers the Financial Readiness Sub-Dimension. A country's financial readiness can be evaluated by measuring the financial literacy of its people and the programmes deployed to prepare entrepreneurs and business owners for the job of raising investment. Accordingly, the Financial Readiness Sub-Dimension assesses the SEE economies' policies to improve financial literacy and to help businesses be investment-ready.

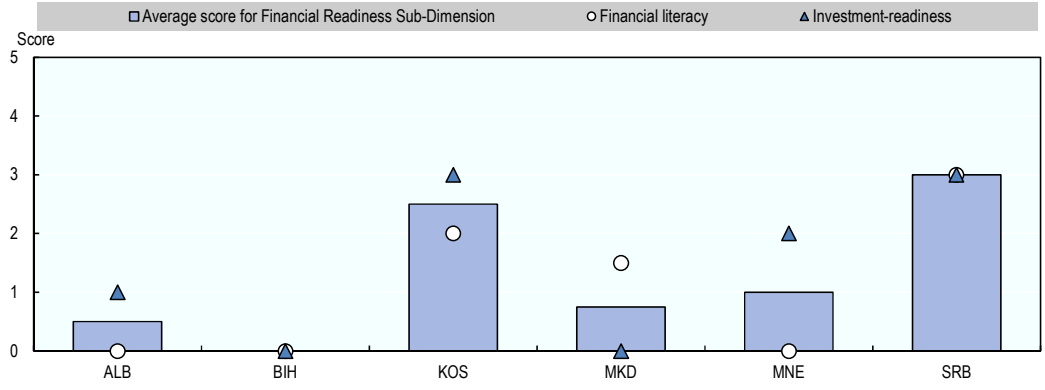
The **financial literacy** indicator considers whether a national strategy is in place, complete with methodology, for assessing financial literacy levels and promoting financial education. It also determines whether the governments run any financial education programmes and whether financial information is widely available to the public.

The **investment readiness** indicator looks at businesses' familiarity with equity finance and their knowledge of how to "sell" their ideas to potential investors. It also assesses to what extent the SEE governments put in place public programmes to improve and support investment readiness. The effectiveness of supply-side and other forms of intervention (e.g. business angel networks) depend in part on the investment readiness of the businesses that investment readiness programmes target.

There are wide differences in the scores of the SEE economies in the Financial Readiness Sub-Dimension as a whole and in its constituent indicators, investment readiness and financial literacy.

Financial literacy education is the process by which financial consumers and investors improve their understanding of financial concepts and, through information, training and advice, better understand financial risks and opportunities. The importance of financial literacy has grown in recent years as financial markets have become more sophisticated and new products continuously emerge.

Figure 9.18. **Financial Readiness: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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As noted above, the SEE economies fare very differently in assessments of their financial readiness policies. Serbia and Kosovo have both introduced financial literacy and investment-readiness programmes, while policy in Bosnia and Herzegovina appears not yet to have addressed financial readiness.

Table 9.5. **Financial Readiness Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Financial literacy	0.0	0.0	2.0	2.0	0.0	3.0
Investment-readiness	1.0	0.0	3.0	0.0	2.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The economies that do run financial literacy programmes also have frameworks for evaluating their existing financial literacy levels. And they are contemplating, or are in the early stages of, executing policies to promote financial education programmes. Here again there is variation between the different economies.

Serbia, for instance, has a national financial education strategy headed by the national bank. Its programmes primarily target schoolchildren in primary and secondary schools who receive a grounding in the financial system. The Former Yugoslav Republic of Macedonia and Kosovo are also both seeking to promote financial knowledge to the general public, financial consumers and young people.

The other economies do not have national strategies in place. However, in Bosnia and Herzegovina, a USAID-backed financial literacy and training programme targets specific groups. As for Montenegro and Albania, although they do not run national financial literacy programmes, they sporadically undertake education outreach efforts.

For entrepreneurs and firms seeking to benefit from the financial market, financial literacy lays the foundations of understanding a country's financial system. However, for those seeking to raise new capital investment, understanding how to make the most of a system to that end – being investment ready – is what matters.

Investment readiness policies are at different stages of development in the SEE economies. For instance, Serbia and Kosovo have both recognised the importance of investment readiness and have instituted programmes to that effect. Serbia is running an investment-readiness programme between 2014 and 2020 as part of the Integrated Innovation Support Programme, funded by the EU's Pre-Accession Fund. Kosovo, for its part, operates a voucher scheme for companies to utilise for training purposes, while the government has developed a programme specifically for female and young entrepreneurs. As for the Albanian government, it is in the early stages of developing a donor-funded investment-readiness programme.

Neither Bosnia and Herzegovina nor the Former Yugoslav Republic of Macedonia have national strategies in place. However, in the Former Yugoslav Republic of Macedonia an investment readiness scheme is under development. Its objective is to train entrepreneurs to be better prepared for applying for and using financial support from the planned Export Development and Investment Fund (EDIF).

The way forward in financial readiness

As they look ahead, SEE economies could consider intensifying their work to assess the level of financial literacy in the population and develop national financial literacy programmes based on those levels. They would also benefit from designing a methodology for assessing the existing educational programmes.

A positive move on the part of the economies that do not run investment readiness would be to start developing them. And, if programmes are already in place, they should contain components that support investment readiness, e.g. training in business plan development and presentation.

Box 9.3. **Financial education in the United Kingdom, an example of best practice**

The government of the United Kingdom was one of the first to develop and roll out a strategy for improving the financial literacy of its population. The Financial Services Authority (FSA) led the initial part of the strategy, "Financial Capability in the UK: Delivering Change" from 2006 to 2011. In April 2011, the Money Advice Service, provided by the Consumer Financial Education Body (which took over from the FSA in 2010), continued educating people in financial education.

In 2006, as part of "Financial Capability in the UK: Delivering Change", a country-wide baseline survey took place to determine the financial capability of the adult population. (The survey has since been emulated by dozens of countries both within and outside the OECD wishing to assess people's financial capability and develop financial literacy strategies). As a result of the survey's findings, the FSA rolled out a programme to deliver financial education courses, workshops, seminar and online tools that targeted schools, the workplace, young adults and new parents. The programme was considered successful, surpassing its stated target and reaching 10 million people.

Building on the early success of the strategy and the initial baseline survey, the UK government commissioned an independent review, the Thoresen Review of Generic Financial Advice. It identified financial vulnerabilities in the population and recommended a multi-channel provision (online, telephone, in person, etc.) of generic advice on money to improve people's financial capability. Thoresen's recommendations led to the establishment of the Money Advice Service as the multi-channel information provider in 2011.

The results of the original FSA strategy suggested that financial literacy programmes should be based on the consumer's needs and developed through a process of testing, evaluation and refinement. The FSA also specified that interventions are most successful when people are targeted at key stages in their life – e.g. when starting a family, on being made redundant, on retirement, etc.

Source: OECD (2013b), *Advancing National Strategies for Financial Education*, www.oecd.org/finance/financial-education/G20_OECD_NSFinancialEducation.pdf.

Conclusions

Recent policy reforms in the SEE economies have facilitated access to finance and underpinning institutional and regulatory frameworks have been put into place. Insolvency frameworks, too, have been improved, while reforms to banking finance frameworks have opened up competition between banks and ensured that there is an adequate range of financial products available to clients.

While the basic conditions for facilitating firms' access to finance have been established, there is still considerable room for improvement in most economies. Credit and collateral information systems require upgrading and updating, while further development of venture capital systems would yield new financing opportunities for innovative, high-growth enterprises. The deployment of investment readiness programmes would be a welcome move, as would greater financial consumer protection.

SEE governments could consider these recommendations as they pursue their efforts to build safe, inclusive and effective financial systems.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same guideline. A score of 1 denotes a draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 10.

Tax policy in South East Europe

Effective tax policy aims to strike a balance between the tax burden on enterprises and individuals, while still allowing the government to raise the revenue required to deliver public services and finance public policy objectives. Three sub-dimensions make up the overall Tax Policy Dimension. The Corporate Tax Policy Sub-Dimension analyses to what extent tax legislation fosters an environment conducive to business and effective tax revenue collection, in the form of tax incentives, transfer pricing rules, tax treaties and regional co-operation. The Tax Administration Sub-Dimension investigates the functions of tax administrators and their ability to ensure tax compliance. The Tax Analysis Sub-Dimension evaluates the ability of tax authorities to collect tax statistics and analyse tax policy effectiveness and their impact on government budgets.

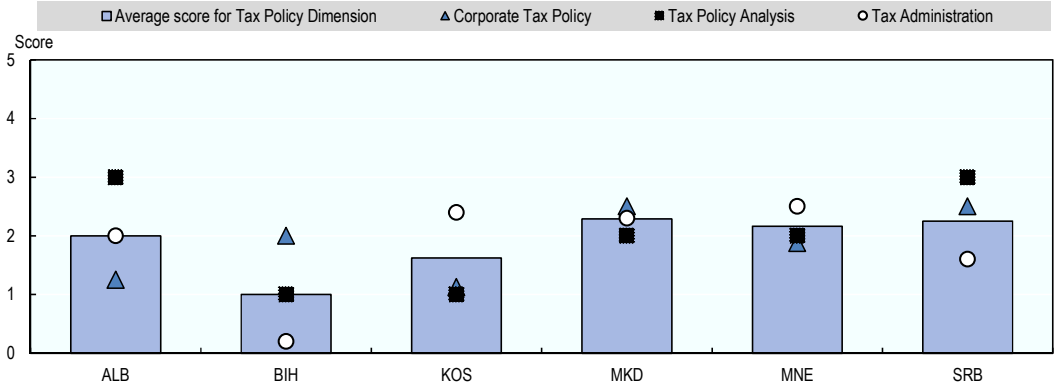
Main findings

Well-functioning tax systems are an essential component of a competitive fiscal environment that fosters investment, risk taking and entrepreneurship. Effective tax policy also helps strike a balance between the tax burden on enterprises and individuals while raising the revenue required to deliver public services and finance public policy objectives.

Over the years, tax revenues have steadily risen throughout South East Europe (SEE), with only a small portion of the increase attributable to improved labour participation, since employment levels have generally stagnated in the region. Payment procedures and the filing of tax returns have grown steadily less complex and costly, thus improving compliance among the general public and business throughout the region. The SEE economies have also begun to build the institutional capacities and policies that support a competitive, vibrant private sector, while ensuring the collection of taxes to fund government operations. However, a number of challenges remain, such as the need for continued modernisation of tax systems and better defined tax incentives.

The degree of development of tax systems varies from one SEE economy to another. Most, however, have legislative and institutional frameworks in place and are implementing them – again to varying degrees.

Figure 10.1. **Tax Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322238

Different factors shape tax policy performance in South East Europe. For example, Bosnia and Herzegovina's low average performance is due, in part, to the fact that each entity – rather than the state – administers its own tax policy. Both Serbia and Albania can, to a certain extent, attribute their higher-than-average performances to their relatively more developed tax policy analysis practices, which include the collection of tax statistics and efforts to improve their analytical capacities. Most of the SEE economies have performed well in corporate tax policy because they have signed a number of tax agreements to avert double taxation between firms and have drawn up clearer transfer pricing rules.

Achievements

The SEE economies have seen improvements in the foundations of their tax policy.

SEE economies have signed and ratified tax treaties with each other and with EU countries to help eliminate issues of double taxation.

SEE economies are streamlining and modernising filing and payment procedures. Most economies have introduced electronic procedures for certain types of taxes, which has reduced the time associated with filing tax returns and payments.

SEE economies have introduced transfer pricing rules in order to ensure that the price and other conditions of transactions between associated enterprises are consistent with those that would occur between unrelated enterprises.

SEE economies have initiated efforts to build tax analysis capacities. They include the development of legislation and institutional capacities required for the regular collection of tax statistics and data in most SEE economies.

Challenges

Despite progress, SEE economies have room to improve their tax policy development and implementation.

Tax incentives are not fully aligned with EU acquis as defined by the EU Code of Conduct for Business Taxation. Moreover, clear sunset clauses are still to be introduced as a signal to firms that tax incentives are temporary and are designed to facilitate monitoring and evaluation and to curb abuse.

Taxpayer services are not fully developed. Tax authorities in the region are not always staffed by personnel with the necessary skills and knowledge to effectively answer taxpayers' enquiries. Modern tax administration organisational systems and tools (e.g. web-based information and auditing systems) would allow staff to carry out their tasks more effectively.

Tax policy analysis is at an early stage of development. Although the collection and communication of tax statistics have improved, modelling and forecasting methods are required for meaningful tax policy analysis. Tax expenditure reporting is also limited in most SEE economies

Modern tax return filing and payment procedures are not uniformly implemented. Progress in developing electronic systems for tax collection is uneven between the economies and their coverage could be widened.

Tax authorities often have limited autonomy over their operations. Limited measures are being taken to give tax authorities the power to manage their own budget, determine their own organisational structure and manage their human resources (recruitment, dismissal, wages). Further efforts are also required to change the professional environment and culture of tax officials and to strengthen tax administration.

Recommendations

Steps to address identified challenges can strengthen tax policy in the region to help reach government objectives and create a stable investment environment.

Review tax incentives to ensure compliance with the EU acquis. Relatively straightforward measures could be taken to ensure that all tax incentives and corporate tax exemptions are in line with the EU Code of Conduct for Business Taxation.

Further develop taxpayer services throughout the region. SEE economies could ensure that information on how to file and pay taxes is made available online or through telephone and in-person enquires. Further efforts to modernise tax filing systems could focus on electronic filing and payment procedures for most types of taxes in order to support increasing levels of taxpayer self-service. In this regard, it is essential to ensure that systems and procedures are well designed and compliance issues addressed from the outset. The SEE economies could also consider intensifying their efforts to respond to appeals and requests for information in a timely and efficient manner.

Increase staff capability. It is important that the SEE tax authorities possess the necessary knowledge and skills to effectively perform their duties. Staff competence, integrity and performance are of critical importance. Staff are the single largest component of tax administration costs and are widely seen as the single most important asset in good tax administration. However, as tax authorities move towards modernisation of services, fewer staff will be needed.

Increase the capacity of SEE tax authorities to analyse tax policy analysis more effectively and explore ways in which the tax authorities can better allocate resources to train and hire staff. The result would be the capacity to undertake more robust tax policy analysis – namely modelling and forecasting tax revenues – and tax expenditure reporting.

Improve tax filing and payment procedures. Work done in the last few years has helped ease the burden of filing tax returns and paying taxes. Filing tax returns should be kept simple and e-filing used for as many taxes as possible.

Consider increasing the autonomy of tax authorities. Autonomy will allow tax administrators to perform in an efficient and effective manner. A suitable level of autonomy would be the power to design and implement their operational policy, independently manage their budget, recruit and develop staff (which would include setting pay levels), interpret tax laws and exercise enforcement.

Improve the implementation of the transfer pricing regime by stating the acceptable transfer pricing methods and documentation obligations in the transfer pricing guidelines. In order to eliminate double taxation and to prevent base erosion and profit shifting by multinational enterprises through transfer pricing, the SEE economies could consider aligning their transfer pricing rules with the OECD Transfer Pricing Guidelines (OECD, 2010a).

Overview

To ensure that the state functions effectively, governments need to mobilise domestic resources. Sound tax systems and policies are central to achieving public policy objectives and a favourable investment environment (OECD, 2015). They enable governments to deliver public services, meet social needs, like education, health and social security, and build and maintain infrastructure. The underlying design of a tax system influences economic decisions concerning domestic and international investment, output, labour supply and demand, and savings rates. Moreover, the level of taxation and the design and administration of tax policy directly affect business costs and returns on investment. Tax reform thus plays an important role in building competitive fiscal

environments that promote investment, risk taking and entrepreneurship and optimise tax revenue by encouraging compliance and collection and deterring evasion (OECD, 2015).

An essential component of a competitive fiscal environment is efficient tax administration. It facilitates compliance by making tax procedures as easy and seamless as possible and minimises government costs. Tax administration reform generally aims to modernise management and operational structures, and expand and enhance taxpayer services.

The Tax Policy Dimension is linked to other policy areas examined in this report, in particular:

- **Chapter 1. Investment policy and promotion** and foreign direct investment are facilitated by a sound tax environment including tax systems with the right institutional and legislative frameworks to avert double taxation. SEE economies could co-operate on harmonising tax policies to prevent a taxation-related "race to the bottom", which would be detrimental to national tax bases and the ability to fund long-term investment.
- **Chapter 11. Competition policy** is strengthened by transparent tax policies that help prevent the tax evasion and avoidance that harms market competition and the efficient allocation of resources in the economy. Large companies operating across borders are better positioned to engage in aggressive tax practices and ultimately gain an unfair competitive advantage over domestic competitors. Hence the need for strong regional and international co-operation in curbing such harmful practices (OECD, 2014a)
- **Chapter 8. Environmental policy** can be supported by tax-related incentives to help reduce environmental footprints. Environmental tax policy and carbon taxation in particular are becoming important aspects of policy design in a number of countries.
- **Chapter 4. Research, development and innovation** are facilitated by predictable tax rates and credible policy commitments as they create environments conducive to innovation. Moreover, tax incentives for R&D activities on the cost or income side show that economies wish to encourage R&D. Environmental taxes (such as levies on emissions) may also steer firms towards innovation in order to reduce both pollution and the tax burden.

Box 10.1. **Tax Policy Dimension in the SEE 2020 Strategy**

Elements of tax policy are found in the Sustainable Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Sustainable Growth Pillar is to boost growth and jobs by supporting a strong, diversified and competitive economic base, while becoming better connected, more sustainable and more resource-efficient. The Competitiveness Dimension in the Sustainable Growth Pillar outlines how SME development can be supported through greater access to finance, peer reviews of SME development policy and an improved general business environment. It specifically addresses the need for closer co-operation between economies to harmonise tax policy and eliminate double taxation.

The official SEE 2020 Strategy Co-ordinator for the Tax Policy Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and enhance regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Tax Policy Dimension assessment framework

This chapter assesses the Tax Policy Dimension of the SEE 2020 Strategy's Sustainable Growth Pillar. It gauges the SEE economies' efforts to develop tax policies that foster investment and competitiveness and build the institutional capacity for effective tax administration.

The chapter is selective in scope. It does not attempt a comprehensive evaluation of tax systems or rates. It confines itself to three aspects – or sub-dimensions – of tax policy and uses qualitative and quantitative indicators to assess the SEE economies' performance. The three sub-dimensions are:

- Corporate Tax Policy

  Does tax legislation in the SEE economies foster an environment conducive to business and effective tax revenue collection? How does it affect investment and competitiveness levels?

- Tax Administration

  What are the functions of tax administrators? How effectively are they able to ensure tax compliance?

- Tax Policy Analysis

  Do the tax authorities have the capacity to collect tax statistics and analyse such facets of tax policy as changes in rates and the effect on budgets?

Figure 10.2 shows how the sub-dimensions and their constituent indicators make up the Tax Policy Dimension assessment framework.

Figure 10.2. **Tax Policy Dimension assessment framework**

Tax Policy Dimension		
SEE 2020 headline target • Increase overall employment rate **Outcome indicators** • Share of firms identifying tax as a constraint • Number of annual tax payments by firms • Time to comply with tax laws • Total tax revenue		
Sub-Dimension 1 Corporate Tax Policy	**Sub-Dimension 2** Tax Administration	**Sub-Dimension 3** Tax Policy Analysis
Qualitative indicators 1. Tax incentives 2. Transfer pricing rules 3. Tax treaties 4. Regional co-operation	**Qualitative indicators** 5. Functions and organisation 6. Compliance assessment and risk management 7. Independence and transparency 8. Tax filing and payment procedures 9. Taxpayer services	**Qualitative indicators** 10. Tax statistics 11. Modelling and forecasting 12. Tax expenditure reporting
Quantitative indicators	**Quantitative indicators** 1. Per capita annual expenditure on tax administration 2. Number of staff employed in tax administration	**Quantitative indicators**

Each sub-dimension is assessed through quantitative data and qualitative information, which the Regional Cooperation Council (RCC) collected with the support of the OECD.

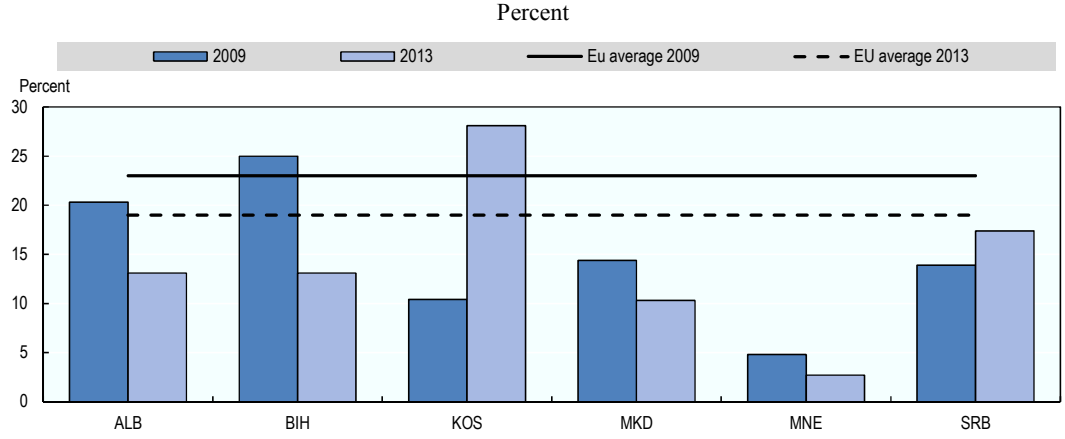
Quantitative indicators are drawn from national or international statistics, while qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Tax policy performance in SEE economies

The administration of tax laws should encourage and facilitate enterprise growth potential and investment levels. According to the 2013 World Bank Enterprise Survey, most South East European entrepreneurs have seen improvements in tax administration. The filing of tax returns and payment procedures have been modernised and simplified and will ultimately ease constraints on enterprise growth.

Two notable exceptions are Kosovo and Serbia, where businesses continue to report difficulties in dealing with the tax authorities due, in part, to low or no progress in reducing the number of tax payments and the length of time it takes to pay them (Figures 10.4 and 10.5). By contrast, thanks to significant efforts to reduce the tax administration burden, firms in Montenegro and the Former Yugoslav Republic do not claim that it is a constraint on business. As for Bosnia and Herzegovina, persistent difficulties there are attributable to the fact that tax collection is performed at the entity level, which negatively affects enterprises operating across the entities and filing multiple returns.

Figure 10.3. **Firms identifying tax administration as a major constraint, 2009 and 2013**



Note: Data of Albania for the year 2009 as of 2007.

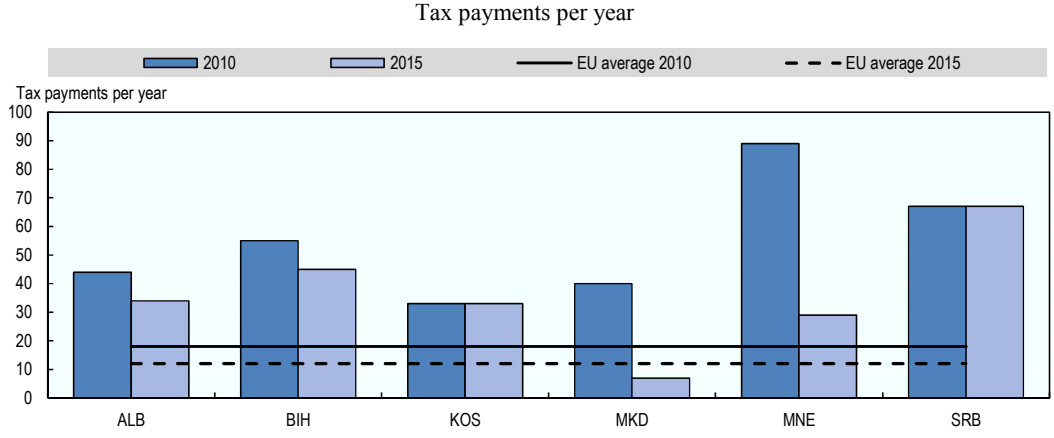
Source: World Bank (2015a), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

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Nevertheless, there are clear indications throughout the region that the tax procedure burden on firms has eased. For instance, the World Bank's *Doing Business Report 2016* shows the number of taxes that companies pay has fallen in most of the region's economies (Figure 10.4), except in Kosovo and Serbia, where there has been no change. The Former Yugoslav Republic of Macedonia and Montenegro, in particular, have seen substantial drops over the last five years. Overall, however, the number of taxes that businesses have to pay is well above the EU average, save in the Former Yugoslav Republic of Macedonia.

Another trend is the decline in the number of hours that firms are required to spend complying with tax laws (Figure 10.5), although the drop is not as pronounced as in the EU (Bank, 2014). And, apart from Kosovo and the Former Yugoslav Republic of Macedonia, the SEE economies still take considerably more time to comply than in the European Union. In Bosnia and Herzegovina, Albania, and Montenegro, they take nearly twice as long.

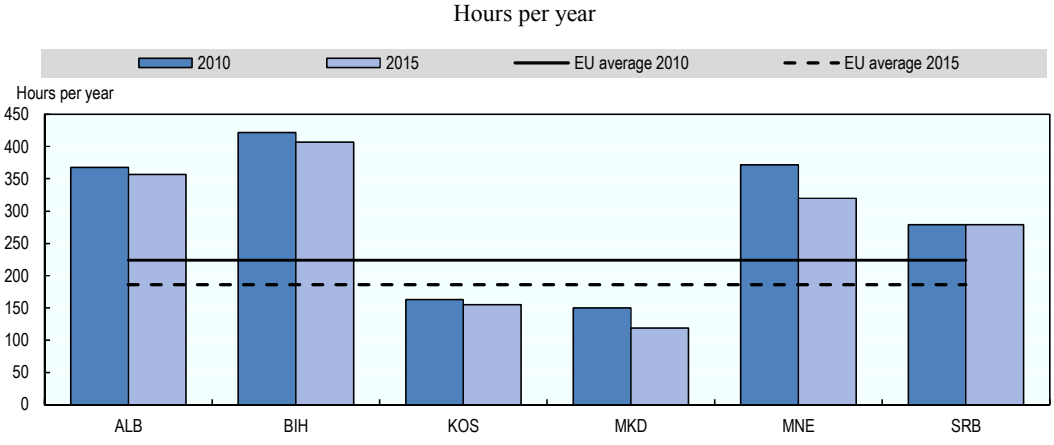
Figure 10.4. **Number of tax payments firms have to make, 2010 and 2015**



Source: World Bank (2015b), *Doing Business* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933322257

Figure 10.5. **Time to comply with tax laws, 2010 and 2015**



Source: World Bank (2015b), *Doing Business* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933322260

Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro saw an average 21% increase in tax revenue between 2010 and 2014.[2] The rise was, in part, the result of modernised systems for filing tax returns that cut paperwork and the introduction of electronic e-filing and e-payment.

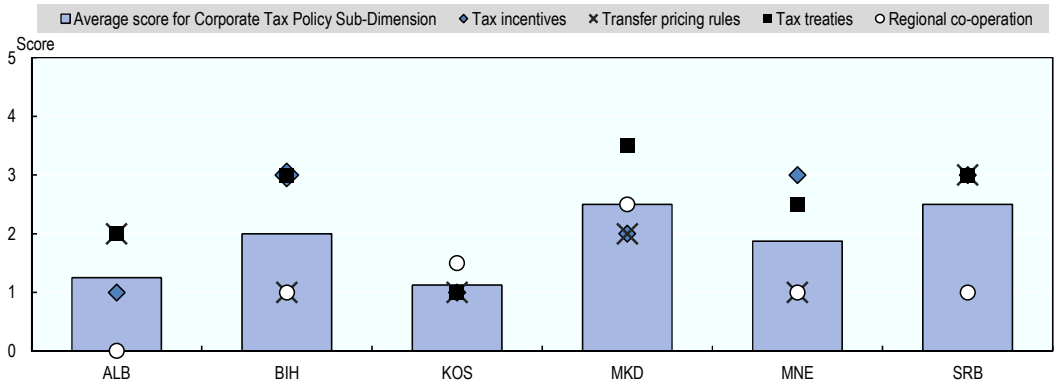
Corporate Tax Policy Sub-Dimension

Taxing corporate profits directly affects companies' after-tax profitability. In addition to high tax rates, unclear legislation and rules deter business and investment by raising project costs and uncertainty over net profitability. The overall performances of the SEE economies in the Corporate Tax Policy Sub-Dimension are obtained by assessing how they fare against four qualitative indicators.

- **Tax incentives** are a policy instrument that is widely used to attract larger flows of foreign investment. Incentives should have clear policy goals, revenue targets, transparent eligibility criteria and implementation rules, and they should include "sunset clauses" which state the date after which they expire. The method by which an economy attracts FDI is complex and springs, first and foremost, from the need to foster a competitive investment climate, which includes building a competitive tax environment that is transparent, certain and fair. Tax incentives should be used to attract investment flows from abroad when there is a positive benefit, such as knowledge spillover. EU accession countries, candidate countries and potential candidate countries are expected to follow the EU Code of Conduct for Business Taxation. It defines the tax legislation *acquis* and seeks to eliminate tax incentives which could cause harmful tax competition within the EU.
- **Transfer pricing rules** ensure that multinational enterprises do not have opportunities to engage in base erosion and profit shifting. The rules guarantee that transactions between one part of a multinational group and another part of the same group are conducted in accordance with the arm's length principle. The arm's length principle requires that transactions between related enterprises ("transfer pricing") should be priced in the same manner as between unrelated enterprises in the same or similar circumstances.
- **Tax treaties** attract investors because they provide certainty in the taxation of cross-border trade and activities and eliminate double taxation. Policy makers from the region could review the scope and content of tax treaties and endeavour to adopt the tax treaty provisions based on the OECD's income and capital model treaty (OECD, 2012) or the UN's double taxation model agreement (UN, 2011). Such a course of action would address the most common problems in the field of double taxation in accordance with tax treaty policies adopted by other countries.
- **Regional co-operation** on tax policy would help the SEE economies harmonise their current frameworks and practices and maximise tax revenues – without running the risk of a race to the bottom (i.e. lure foreign investors with the lowest tax rates).

SEE economies are at different stages of development in their corporate tax policies (Figure 10.6). The more advanced – the Former Yugoslav Republic of Macedonia and Serbia – have legislative frameworks in place and are starting to execute them. The less developed economies, Albania and Kosovo, are drafting their tax policy frameworks.

Figure 10.6. **Corporate Tax Policy: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322275

Further efforts are required to improve the legal and regulatory frameworks for tax incentives and transfer pricing

The tax incentive frameworks of the SEE economies vary, as Table 10.1 shows. Bosnia and Herzegovina, Montenegro and Serbia have better developed tax incentive policies than their peers in the region, with clear provisions that include eligibility criteria. Within Bosnia and Herzegovina, tax benefits vary from one administrative entity (the Federation of Bosnia and Herzegovina and Republika Srpska) to another. But all have sunset clauses and are harmonised with EU standards in the Code of Conduct and Business Taxation.

Table 10.1. **Corporate Tax Policy Sub-Dimension: Tax incentives indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax incentives	1.0	3.0	1.0	2.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323427

Tax exemptions and incentives in the Former Yugoslav Republic of Macedonia and Montenegro, target economic sectors. In the Former Yugoslav Republic of Macedonia, they are designed for companies that have operated in technological and industrial development zones for 10 years and for trade businesses that meet certain eligibility criteria. Kosovo, by contrast, is still drafting tax incentives and should clearly define guidelines for implementation.

Improve transfer pricing methodologies and transfer pricing documentation obligations

To prevent unfair practices and curb tax avoidance, SEE economies have adopted transfer pricing rules. However, legal provisions often fail to clearly define transfer pricing methods, as in the Former Yugoslav Republic of Macedonia, for example, and Bosnia and Herzegovina, and Montenegro, where the arm's length principle is only

partially observed. In Montenegro, the Ministry of Finance is introducing secondary legislation to further develop the regulatory framework for transfer pricing rules. In Kosovo, however, rules are clearly spelled out and in line with OECD guidelines (OECD, 2010a). However, there is no administrative institution that regulates transfer pricing rules and efforts to establish one have made little progress since 2013.

Table 10.2. **Corporate Tax Policy Sub-Dimension: Transfer pricing indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Transfer pricing rules	2.0	1.0	1.0	2.0	1.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323436

Align tax treaties more closely with international guidelines and strengthen regional tax policy co-operation

Regional co-operation is relatively underdeveloped in the region, with very few meetings on harmonising tax policy taking place between economies (Table 10.3). The Former Yugoslav Republic of Macedonia and Serbia have some of the best developed legislative frameworks governing tax treaties.

Table 10.3. **Corporate Tax Policy Sub-Dimension: Cross-border taxation legislation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax treaties	2.0	3.0	1.0	3.5	2.5	3.0
Regional co-operation	0.0	1.0	1.5	2.5	1.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323449

Most of the economies are signatories to multiple tax treaties – a Yugoslavian legacy. However, Kosovo (which has a score of 1) is an exception to that rule, as it is party to only 11 double taxation treaties, although it is signing and bringing into force three more. The other economies have all signed and executed over 40 treaties each, with Serbia having as many as 55 to its name. Most tax treaties seek to follow international guidelines, such as the OECD and UN model tax conventions (OECD, 2012; UN, 2011), which include provisions for assistance in tax collection, dispute resolution (the mutual agreement procedure) and the exchange of information between the competent national authorities.

Although there are variations in the SEE economies' performance against the regional co-operation indicator, most score relatively low because they have made only limited efforts that have been limited chiefly ad hoc.

The way forward in corporate tax policy

As there are considerable variations between the SEE economies in tax incentives, they could go about making them more effective in different ways. Albania and Kosovo, for example, could endeavour to develop corporate tax incentives and/or align them with

clear policy goals. And they could build their capacity to administer tax incentives and better define implementation instructions. All the economies stand to gain from aligning tax incentives more closely with the EU *acquis*, namely the EU standards on the Code of Conduct for Business Taxation. And they could all also work to set up independent bodies to review the effectiveness of tax incentives and adjust policies according to the bodies' recommendations.

Most SEE economies would, in the future, benefit from further work to improve their respective transfer pricing regulatory frameworks so that they clearly set out the transfer pricing methods that can be used, for example, and the documents that are required. At the same time, they should move to ensure that regulatory frameworks are in line with the OECD transfer pricing guidelines. The SEE economies could also conclude bilateral or multilateral advance pricing agreements with their tax treaty partners in order to provide taxpayers with greater upfront certainty on the prices for their related party transactions.

As they move forward, it is recommended that the SEE economies keep up their efforts to negotiate and sign additional tax treaties, especially with their major trade and investment partners. Agreements should comply with international guidelines, such as the OECD's income and capital model treaty (OECD, 2012) or the UN's double taxation model agreement (UN, 2011). Treaties should contain provisions for assistance in tax collection and dispute resolution (the mutual agreement procedure) as well as provisions for international standards of transparency and exchange of information for tax purposes. The intensification of co-operation efforts will help the SEE economies to reap the full benefits of harmonisation and maximise tax revenue.

Tax Administration Sub-Dimension

Sound tax policies and legislation are not enough to guarantee that tax systems are competitive. Governments must implement tax frameworks consistently and transparently through efficient tax administration that maximises compliance and revenue collection. From a business perspective, efficient tax administration also limits the costs of taxpayer compliance.

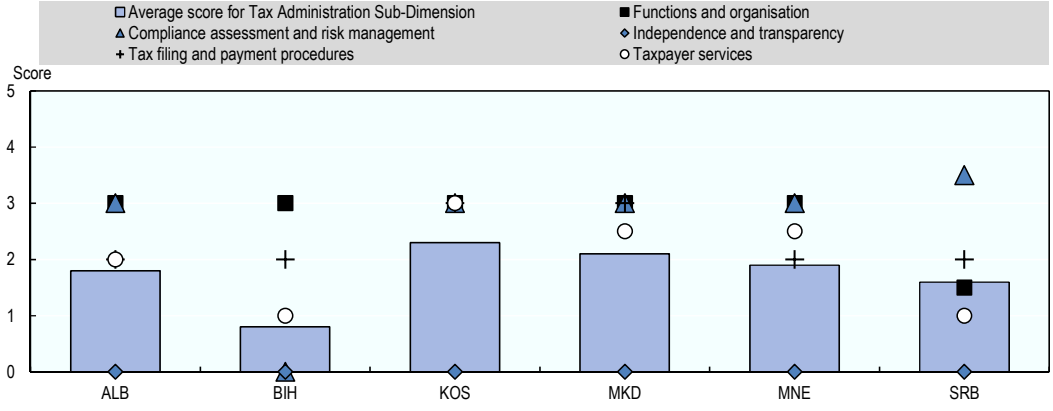
Tax compliance refers to the key obligations of taxpayers under the tax system: registration for tax purposes, filing tax returns, correcting and reporting tax liabilities, and paying taxes on time. Tax administration facilitates compliance by good design, effective procedures and services and monitoring compliance behaviour. Well-developed tax audit capabilities are an important element in helping tax authorities manage risks and collect total tax due. How the SEE economies perform in the Tax Administration Sub-Dimension as a whole is gauged by how they fare against five qualitative indicators.

- A prerequisite for efficient, effective tax administration requires strategic systems design, supported by internal **functions and organisational** capabilities. A key factor in this respect is a single tax authority which covers all taxes and performs all core tax administration functions.
- To effectively monitor **compliance assessment and risk management**, tax administration should incorporate a system for referring the riskiest declarations for audit and assigning them, in order of risk, to the available resources. Audit results should also be regularly reported and assessed to inform and help improve the tax authority's overall risk management model. When it comes to compliance, procedural justice is an important issue, as people's perceptions of fair and unfair taxation shape their willingness to comply with tax rules and regulations.

- Only tax authorities characterised by **independence and transparency** provide the necessary safeguards when collecting tax obligation from taxpayers and will be perceived as legitimate. Corrupt tax collectors deter people from paying their taxes formally, prompting them to opt for bribery or join the informal economy. Similarly, transparency prevents pressure from politicians who renege on established tax laws or use their powers of taxation to discriminate against their rivals. Transparent, independent tax administration enables government to demonstrate to taxpayers its credibility and the integrity of its tax procedures and to reassure the private sector that it will not abuse the power to tax.
- Companies' tax-paying duties are not limited to **tax filing and payment procedures**, but also to register, provide documentation and report – all of which can come at a considerable cost, especially to SMEs. Streamlining compliance procedures helps reduce those costs. The tax filing and payment procedures indicator assesses the smoothness of taxpaying formalities and whether efforts have been made to streamline them through the use of simplified or pre-filled tax returns, clear and user-friendly methods for calculating tax due, and the provision of e-filing and e-payment.
- **Taxpayer services** in the form of tax authorities' support to corporate taxpayers to access the requisite information facilitate the ability of corporate taxpayers to file tax returns correctly. Hence the importance of evaluating the types of taxpayer services offered by the tax authorities. They typically include taxpayer information and assistance, responding to in-person and telephone inquiries, the handling of appeals, and the availability of online filing and payment systems. Good services help maximise voluntary compliance by providing the advice and support that businesses need to meet their tax obligations.

Four SEE economies score a 2 or higher, which denotes a moderately well-developed tax administration environment. Bosnia and Herzegovina stands as a regional outlier (Figure 10.7). It has a less developed tax administrative regime, having no single state-level definitions of tax administrative functions and organisations, tax filing and payment procedures, or risk management techniques. However, it is important to note that those elements do exist at the sub-national entity level in Bosnia and Herzegovina.

Figure 10.7. **Tax Administration: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Tax authorities' functions are well defined, though compliance and risk management units require building

As Table 10.4 shows, all the SEE economies have built frameworks that outline the functions and structure of their tax authorities.

Table 10.4. **Tax Administration Sub-Dimension: Administrative organisation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Functions and organisation	3.0	3.0	3.0	3.0	3.0	1.5
Compliance assessment and risk management	3.0	0.0	3.0	3.0	3.0	3.5
Independence and transparency	0.0	0.0	0.0	0.0	0.0	0.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro have a central tax authority that audits and collects taxes. Montenegro's tax system is structured by function (registration, declarations, audit, appeals, refunds, etc.), while Kosovo's is organised by functions and taxpayer group (e.g. large corporate taxpayers, SMEs, individuals). In Bosnia and Herzegovina, there is no overarching authority, with each entity administering taxation by function and taxpayer group.

Compliance assessment and risk management are well developed throughout the region, save in Bosnia and Herzegovina. The tax authorities in the other economies have set up audit divisions and large-taxpayer units. Legal frameworks to ensure procedural fairness in tax compliance rulings are also in place.

In Bosnia and Herzegovina, there is no tax audit division at the entity-level. In the absence of systematic procedures, risk assessment is random. The other five economies have instituted units to assess taxpayer compliance (including large taxpayers) and risk management. In the Former Yugoslav Republic of Macedonia, the General Tax Inspectorate operates an IT-based forensics laboratory for more efficient risk assessment. Montenegro, by contrast, seeks to identify different segments of the taxpayer population, including those prone to avoidance.

Tax authorities are seldom independent of the ministries of finance, which hold direct powers of taxation. The authorities in the SEE economies have been building their capacity to levy tax, which rose from EUR 7.3 per capita in 2010 to EUR 8.3 in 2014, – a gauge of the growing importance of tax administrators and the growing expenditure on administration. The increased spending is a sign that governments are investing in building up the tax authorities' capacity to carry out their duties and provide services that support compliance.

Tax authorities modernise filing and payment systems and services to ensure compliance

Economies from the region have started streamlining and modernising procedures by introducing e-filing and e-payment (Table 10.5). Yet procedures are still considered too complex and time-consuming.

Table 10.5. **Tax Administration Sub-Dimension: Taxpayer compliance indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax filing and payment procedures	2.0	2.0	3.0	3.0	2.0	2.0
Taxpayer services	2.0	1.0	3.0	2.5	2.5	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323466

Albania, Kosovo, the Former Yugoslav Republic of Macedonia and Serbia have all introduced mechanisms for electronically filing and paying certain taxes. Montenegro, too, has introduced electronic tax submission, though it appears to apply only to commercial entities for business-related taxes for the time being. Montenegro has additionally attempted to facilitate company registration in regional offices rather than only in the capital city of Podgorica.

Serbia, for its part, is introducing the electronic submission of income tax and social security contributions and is training taxpayers on how to use the service. As for Bosnia and Herzegovina, although it has sought to simplify the filing of returns and tax refunds, the government has yet to introduce electronic submission. The entities' tax agencies are fully capable of rolling out the e-filing of returns and are already using databases and web applications, though only for a few types of taxes. Albania and the Former Yugoslav Republic of Macedonia have made it compulsory to e-file returns on certain taxes – e.g. VAT, corporate income tax, personal income tax, and social and health insurance.

As regards taxpayers' access to information on compliance, the SEE experience varies. Most of the economies run websites that offer comprehensive taxpayer information, which typically includes instructions, legislation and legal decisions. In Serbia and Bosnia and Herzegovina, by contrast, there are worries over the quality of in-person and phone support, which raises wider concerns about the skills of tax officials and the need for proper training. In Montenegro, taxpayer services include educational units that advise citizens on tax compliance, while the only economies to have established a tax ombudsman's office are Albania and Kosovo.

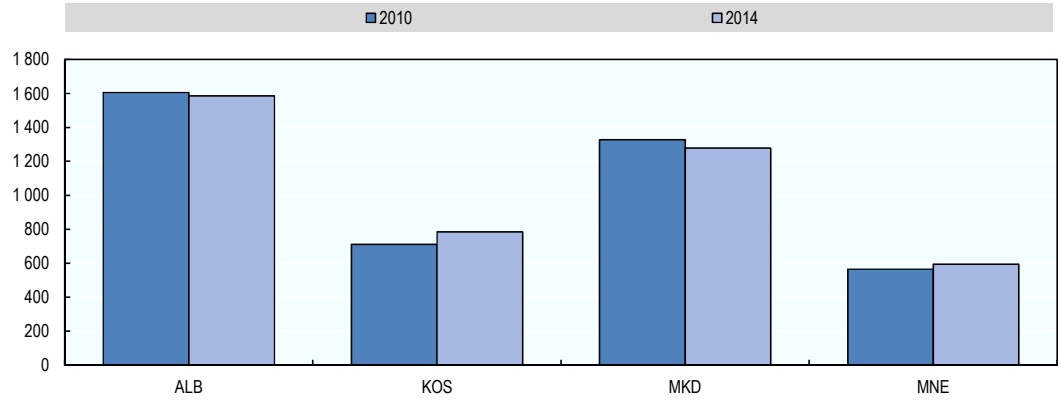
Tax administrations need to further build the capacity of tax authorities and upgrade the skills of staff, to provide better services to taxpayers. Kosovo and Montenegro have seen slight staff increases since 2010 and Albania and the Former Yugoslav Republic of Macedonia slight declines (Figure 10.8). Regular reviews of human resource management policies, staff numbers and skills levels are important to ensure that tax authorities are in a position to deliver on their mandates.

The way forward in corporate tax policy

As they look to the future, it is recommended that the SEE economies consider establishing legal frameworks to ensure procedural fairness in tax compliance rulings. The economies that have no audit unit in place to assess compliance and risk management would benefit from setting one up.

The SEE economies have room to further improve the autonomy of their tax authorities, which often is not a policy priority. The feasibility of providing increased autonomy to the tax authority from the Ministry of Finance deserves serious consideration, as do the legal provisions, statutory rules, organisational structure and operational policy freedom it would have.

Figure 10.8. **Number of staff employed in tax administration, 2010 and 2014**



Note: Data for Bosnia and Herzegovina and Serbia not available.

Source: National statistical sources.

StatLink http://dx.doi.org/10.1787/888933322293

As the SEE economies look ahead, they could continue to simplify tax return forms and payment procedures and make e-returns available for as many taxes as possible. To that end, it is important that taxpayers have all the information they need to utilise electronic filing and payment methods.

SEE economies would benefit from introducing legal provisions to ensure procedural fairness and equity in tax compliance rulings. Another positive move for economies that have no audit units in place for assessing compliance and risk management would be to introduce and develop them.

Tax Policy Analysis Sub-Dimension

Tax policy analysis aims to understand how different taxes contribute to total tax revenue (the tax mix), to analyse the economic effects and policy trade-offs of different taxes and incentives, and to estimate how tax revenues are likely to change when rates, or other parameters, change. Sound tax policy analysis that communicates its findings properly can reduce uncertainty over tax reforms and garner political support. It also helps to identify "winners" and "losers" of reforms. The statistical and analytical tools which economies use to assess their tax policies play an important part in informing and strengthening tax policy. The overall performances of the SEE economies in the Tax Policy Analysis Sub-Dimension are obtained by assessing how they fare against three indicators.

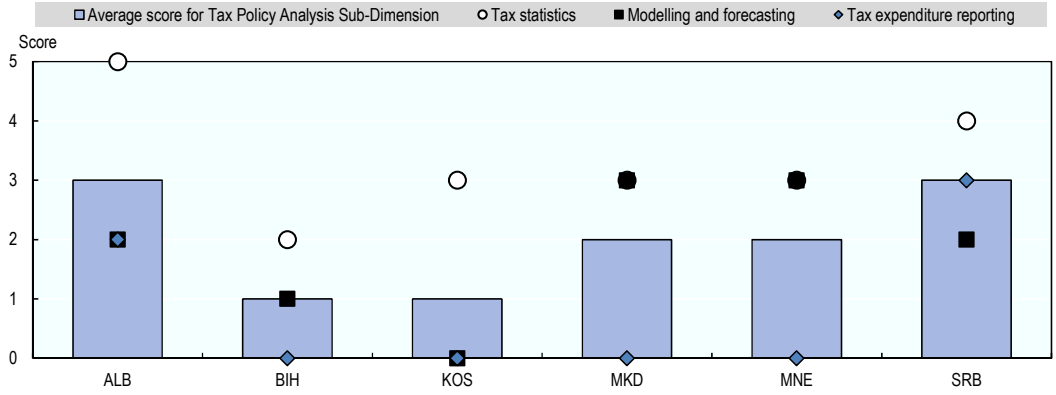
- The regular collection of **tax statistics** is critical to informed policy making. The tax statistics indicator assesses whether tax collection agencies routinely collect statistics on corporate taxation and whether the data are made publicly available and easily accessible. It also examines whether tax statistics are systematically fed into the policy-making process.
- **Modelling and forecasting** tools enable policy makers to estimate future tax revenues. They also need to identify the taxpayer groups who will be positively or adversely affected by a proposed reform and so decide whether it is desirable. To

that end micro-simulation models, which rely on taxpayer-level micro-data, are widely used.

- **Tax expenditure reporting** records what is, in effect, tax relief for certain activities or groups of taxpayers. Because it is public spending, though, it needs to be offset by higher taxes in another policy field. Tax expenditure therefore needs to be measured, reported and factored into national budgets.

There are considerable differences between the tax analysis capacities of the SEE economies (Figure 10.9). Albania and Serbia, for example, boast advanced policies. As for the Former Yugoslav Republic of Macedonia and Montenegro, they are now starting to implement tax analysis, while Bosnia and Herzegovina and Kosovo are still in the early stages of building their analytical capacities.

Figure 10.9. **Tax Policy Analysis: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322306

SEE economies' tax agencies regularly collect tax statistics to help inform policy making

Most SEE economies have drafted the necessary legislation and built the institutional capacity to collect tax statistics (Figure 10.9).

Table 10.6. **Tax Policy Analysis Sub-Dimension: Tax statistics indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax statistics	5.0	2.0	3.0	3.0	3.0	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323472

The foundation of an economy's ability to carry out formal tax analysis is the regular collection of reliable tax statistics. The tax authorities in the region routinely collect statistics on corporate taxation and the data are publicly available and accessible. In Montenegro, the tax administration runs six statistical surveys on tax data collection. Albania, too, has a good statistics gathering capacity, with systematic co-operation

between the general Directorate of Taxation and the Ministry of Finance on Tax Statistics. The Bosnia and Herzegovina Entity Tax Administration and Indirect Taxation Authority regularly collects statistics although it makes only some of them publicly available.

Despite strong statistics bases, the way they are used for effective tax analysis varies

Modelling and forecasting capacities vary, with the Former Yugoslav Republic of Macedonia and Montenegro having the strongest. In tax expenditure reporting, only Albania and Serbia have basic capacities in this area (Table 10.7).

Table 10.7. **Tax Policy Analysis Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Modelling and forecasting	2.0	1.0	0.0	3.0	3.0	2.0
Tax expenditure reporting	2.0	0.0	0.0	0.0	0.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323487

SEE economies make use of aggregate tax revenue forecasting models for a few selected taxes. Kosovo, however, is currently working with the IMF on revenue forecasting and there is no indication that the Ministry of Finance has used modelling for any taxes. Bosnia and Herzegovina has a slightly better developed system, with aggregated tax revenue forecast models for indirect taxes only. Efforts are currently being made to further develop Bosnia and Herzegovina's modelling and forecasting capabilities. The Former Yugoslav Republic of Macedonia and Montenegro use tax revenue forecasting models for their main taxes and micro-simulation models (on an ad hoc basis in Montenegro) to assess the impact of taxation measures.

Tax expenditure reporting is an advanced analysis-based tax statistical method for which most of economies in the region lack capacity. Serbia and Albania, however, have designed tax expenditure reporting mechanisms and are now applying them. Serbia reports routinely and incorporates its reports in its annual budget. Serbia also participates in the Road to Europe – Programme of Accounting Reform and Institutional Strengthening (REPARIS). REPARIS helps countries to adapt laws and regulations that govern financial reporting and to develop the related institutions in line with EU requirements. Albania, for its part, performs tax expenditure reporting sporadically, usually when the fiscal package has been revised and new tax relief measures are introduced.

The way forward in tax analysis

As the SEE economies move forward, they would benefit from a number of measures to further develop their modelling and forecasting capacities. Kosovo's Ministry of Finance might well consider starting to apply aggregate tax revenue forecasting models. Bosnia and Herzegovina, too, could expand tax revenue forecasting to all main types of taxes. Indeed, it would be beneficial for all the SEE economies to use micro-simulation models for analysing the revenue impact of alternative tax regimes and carry out disaggregated analyses of their current tax regimes.

It is recommended that the SEE economies further build their tax authorities' capacity to report tax expenditure. Albania could try reporting tax expenditure on a routine basis and incorporating it into the budget. Serbia could begin monitoring its tax authority's tax expenditure reporting to evaluate its effectiveness.

Box 10.2. **Best practices for tax analysis and expenditure reporting**

With their numerous methodologies, tax analysis and tax expenditure reporting are highly complex. However, there is no single ideal methodology or system. Tax analysis often has to be country-specific, taking into account both the types of taxes which are administered and the capacity of the tax authority to carry out the analysis.

The report, entitled *Tax Expenditures in OECD countries,* published by the OECD (2010b) offers a series of cases studies of methods of tax analysis and expenditure reporting in different developed economies.

Examples include a number of OECD economies that carry out tax expenditure reporting for all or most of their taxes. The report describes the methodologies each economy uses. For example, the Japanese benchmark system of analysis offers a general, broader analysis of tax measures than other OECD countries. The report also provides information on how frequently countries publish their reports and how they incorporate tax expenditure reporting into their budget process.

Policy makers in South East Europe can utilise the case studies to examine methodologies and choose the one that best suits their environment.

Source: OECD (2010b), *Tax Expenditures in OECD Countries*, http://dx.doi.org/10.1787/9789264076907-en.

Conclusions

To conclude, SEE economies have made progress in reducing the complexity and costs of filing and paying taxes, introduced transfer pricing rules, and built initial tax analysis capacities. Furthermore, tax treaties have been signed and ratified throughout the region which has helped address issues of double taxation between SEE economies and with EU member states. These achievements have contributed to improving tax payment compliance and increasing tax revenues in the region.

Despite these achievements, SEE economies still face a number of challenges. They include the need to fully align tax incentives with the EU *acquis*, to further develop taxpayer services, to enhance the scope and quality of the resources of the relevant government bodies and to enhance tax filing and payment procedures, especially through e-filing. Governments should also consider working towards increasing the independence of the tax authorities and defining more clearly the implementation procedures of transfer pricing regulations.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).
2. Montenegro data are based on 2013 figures; information from Bosnia and Herzegovina and Serbia have not been made available.

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Chapter 11.

Competition policy in South East Europe

Competition policy supports competitive economic environments that allow new firms to challenge incumbents, efficient ones to grow and inefficient ones to exit, and give all incentive to improve the quality of their products. In the Competition Policy Dimension, four policy areas broadly measure the scope and strength of competition policy regimes. The Scope of Action Policy Area assesses to what degree the competition authority is invested by law with the power to investigate and sanction anti-competitive practices. The Anti-Competitive Behaviour Policy Area describes the development of policy to prevent and prosecute exclusionary vertical and horizontal agreements and anti-competitive mergers. The Probity of Investigation Policy Area examines the independence and accountability of institutions which enforce competition law and how fair their procedures are. The Advocacy Policy Area looks at further action to promote a competitive environment.

Main findings

A competitive economic environment that allows new firms to challenge incumbents, efficient firms to grow and inefficient ones to exit, and incentivises all firms to improve the quality of their products helps boost economic growth and increase living standards. It also stimulates competitiveness by giving businesses incentive to lower their costs and reduce their prices, to better respond to customers' needs and to be more innovative. And it motivates them to supply internationally competitive products and services and to upgrade in global value chains.

The economies of South East Europe (SEE) appear to have most of the basic building blocks of a functional competition policy regime, though some gaps persist and enforcement records appear limited.

Achievements

The SEE economies have advanced in creating a competitive economic environment.

The SEE economies have put in place a number of policies that prohibit anti-competitive behaviour. Indeed, all six have introduced policies that enable the competition authorities to investigate and impose, or ask the courts to impose, sanctions on firms that exhibit anti-competitive behaviour.

Competition authorities are formally independent and governments have not formulated binding directions on competition enforcement. That being said, the authorities already have most of the tools and powers that allow them to enforce competition law effectively.

Challenges

Despite the established legal foundations of competition policy in the region, challenges remain in systematic implementation.

The enforcement record of competition law remains limited. As the enforcement track record is one of the most important indicators of an effective competition regime, strengthening it emerges as a priority for the competition authorities.

Guidance for stakeholders in the competition authorities' enforcement practices is scarce. 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, SEE competition authorities have published few or, in some cases, no guidelines to that effect.

Recommendations

SEE economies can take further steps towards addressing the identified challenges to strengthen competition in the economic environment.

Develop guidelines on enforcement practices. As the SEE economies gain more experience in enforcing their competition laws, the competition authorities could consider developing enforcement practice guidelines to better inform and guide the business sector and civil society. As a starting point, the SEE economies could envisage adopting existing EU guidelines, given the significant overlap between the rules in the competition laws of the six SEE economies and those included in the EU *acquis*.

Expand the use of market studies in co-operation with government bodies. Market studies by competition authorities can be an effective tool for identifying unnecessary obstacles to competition in public policies and, through their recommendations, can suggest effective ways to address them. However, such recommendations are not usually binding on government bodies in SEE economies. Governments might therefore consider committing to responding to recommendations within a set time period.

Reinforce intra-regional co-operation on competition policy. The six SEE economies assessed in this report, together with Croatia and Bulgaria, are members of the Sofia Competition Forum, which meets twice a year to share experiences across the region. However, co-operation could be further extended at an operational level, namely through joint market studies, joint training and staff secondments and exchanges.

Overview

There is extensive empirical evidence that industries which have to rise to greater competition experience faster productivity growth. In that regard, seminal research (Nickell, 1996) finds that there is a statistically significant association between strong competition and fast productivity growth. Further evidence of the link appears in numerous other studies that analyse industry- and firm-level data in sectors and countries (see OECD [2014] for an overview). The main reason behind the link seems to be that competition leads to an improvement in allocative efficiency by allowing more efficient firms to enter and gain market share at the expense of less efficient ones.

Competition can also improve businesses' productive efficiency, as firms that have to compete seem better managed. Bloom and van Reenen (2007) have demonstrated that differences in productivity between countries depend on differences in management quality and that those with low productivity growth often have a long "tail" of very badly managed firms at the bottom of the distribution. Competition helps eliminate the tail, either because firms exit the market or because it has disciplining effects on managers (Bloom and van Reenen, 2007).

A competitive business environment thus stimulates the competitiveness of a country as it gives companies incentive to lower their costs and reduce their prices, better respond to customers' needs, become more innovative, and supply products and services that are internationally competitive.

Creating and maintaining a competitive environment requires a sound, well-structured competition law which prevents firms, whether individually or jointly, from engaging in conduct that distorts or curbs competition and deters them from anti-competitive mergers. Good competition law also ensures that public policies, laws and regulations do not create unnecessary obstacles to competition.

A good competition law is not sufficient by itself, as it can be effective only if it is properly enforced. Hence the need for an adequately resourced and skilled competition authority which fulfils its mandate free from any political interference. Such an authority should 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 a more competitive environment. At the same time, the competition authority should ensure fair, transparent application of the law by guaranteeing the right to fair process, the clarity of rules, consistency and predictability in

their enforcement, and certainty as to the length of the enforcement procedures (OECD, 2015).

The Competition Policy Dimension is linked to other policy areas examined in this report, particularly:

- **Chapter 4. Research, development and innovation** is facilitated by competitive environments. Yet the relationship is not simple and the empirical evidence shows that moderately competitive markets innovate the most, with both monopoly and highly competitive markets showing 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).

Box 11.1. **Competition Policy Dimension in the SEE 2020 Strategy**

The Competition Dimension is a part of the Sustainable Growth Pillar in the South East Europe 2020 Strategy (SEE 2020). The central objective of the Sustainable Growth Pillar is to boost growth and jobs by supporting a strong, diversified and competitive economic base, while helping it become better connected, more sustainable and more resource-efficient. By creating a competitive economic environment, competition policies can contribute to the SEE 2020 Strategy's headline targets of an increase in net enterprise creation (new businesses per year) from 30 107 to 33 760 and a rise in the value of the region's goods and services exports from EUR 1 780 per capita to EUR 4 250.

The official SEE 2020 Strategy Co-ordinator for the Competition Policy Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and enhance regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Methodological approach

The analytical framework applied to the six SEE economies in this chapter draws on a questionnaire developed by the OECD. It does not seek to create a complete and detailed account of competition policy regimes, but rather to broadly measure their scope and strength. The questionnaire includes four policy areas for which there is broad OECD-wide consensus as to their importance for the foundations of a competition policy regime. It has a much stronger focus on the *de jure* characteristics of a regime than on its *de facto* enforcement and implementation.

Each of the 67 questions addresses a foundational competition policy criterion. These criteria are grouped into sub-dimensions of policy areas of competition policy. The policy areas are:

- Scope of Action

  Is the competition authority invested by law with the power to investigate and sanction anti-competitive practices? To investigate, remedy, or block anti-competitive mergers?

- Anti-Competitive Behaviour Policy

  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?

- Probity of Investigation

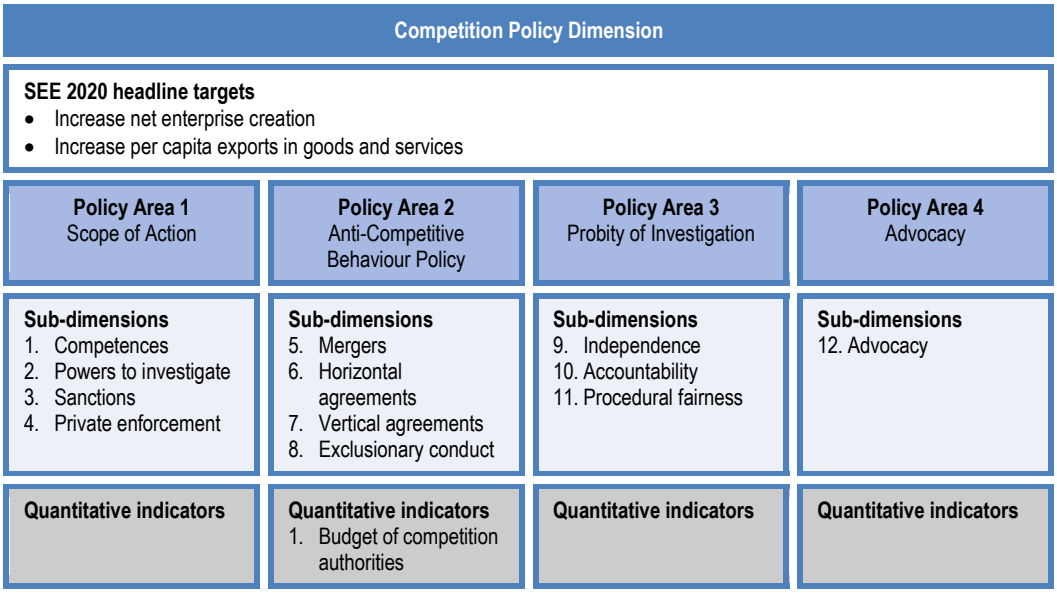
  How independent and accountable are institutions which enforce competition law? How transparent are they? How fair are their procedures?

- Advocacy

  What activities other than standard enforcement of competition law are taken to further promote a competitive environment? Are market studies and reviews of new laws and regulations for any distortionary impact on competition conducted?

Figure 11.1 depicts how the four policy areas constitute the overall dimension and how, in turn, sub-dimensions constitute the policy areas.

Figure 11.1. **Competition Policy Dimension assessment framework**

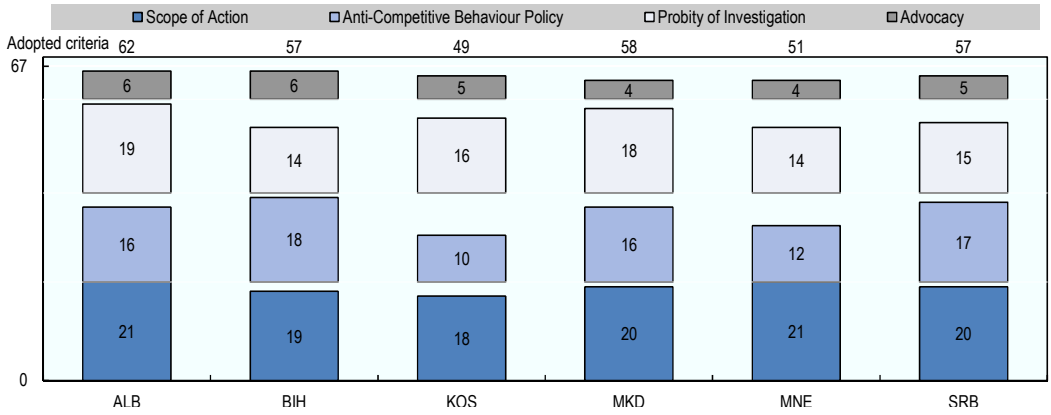


Quantitative data on competition authorities' human and financial resources and their level of activity complement the data collected in the questionnaire. The assessment also drew on OECD competition experts familiar with the SEE economies and a 2013 report that took a comparative look at competition regimes in the Balkan region (Sofia Competition Forum, 2014).

Competition policy performance in the SEE economies

The six SEE economies appear to have most of the basic building blocks for a functional competition policy regime, though some gaps persist (Figure 11.2). They could, for example, seek to make greater use of their competition law enforcement powers to further strengthen their overall enforcement records.

Figure 11.2. **Competition Policy: Number of adopted criteria**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The competition authorities should have enforcement powers, tools and guidelines

When it comes to powers and tools, a few improvements could be made to ensure that the competition authorities in the six economies have all those that are most important for enforcing competition law effectively and for protecting and fostering competition. In the Former Yugoslav Republic of Macedonia, for example, the competition authority could be given the power to advocate competition at central and regional government levels. In Kosovo and Montenegro, they could be empowered to advocate competition at regional government level.

Improvements could also be made with respect to the approaches adopted by the competition authorities in the assessment of anti-competitive behaviour. The Montenegrin competition authority, for example, could conduct an economic analysis of the competitive effects of mergers and horizontal agreements when investigating them. In Kosovo, it could analyse the competitive effects of horizontal and vertical agreements when it looks into them.

The weak points that the assessment identifies in the competition authorities' approaches are based only on answers to the OECD questionnaire, which does not examine approaches in depth, but merely 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 UNCTAD, could afford such insights.

The assessment also finds that that stakeholders could do with more guidance on enforcement practices, as competition authorities have published few or no guidelines on how they apply competition law provisions. A good intermediary step – until such time as the SEE economies gain enough experience in enforcing competition law to develop national guidelines themselves – is 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.

Levels of enforcement activity could be taken further across the region, particularly in Kosovo. Only Bosnia and Herzegovina and Serbia have blocked or remedied more than a single anti-competitive merger in the last five years. As for sanctions taken against

cartels, neither Bosnia and Herzegovina nor Kosovo have imposed one in the last five years. Region wide, the competition authorities have not made full use of unannounced inspections in the premises of investigated firms. Such little activity is attributable to a number of factors.

Why there is low or no competition law enforcement and what can be done

Enforcement activity is possible only if an authority has in place a functioning structure that allows it to investigate and sanction or remedy anti-competitive behaviour and mergers. That requirement holds true of all the SEE economies. Kosovo, in particular, could take steps to appoint and support an operational council – the council being the authority's statutory decision-making body. Without it a competition regime cannot function. It is important that any changes or new appointments to the council happen seamlessly to avoid unnecessary disruptions to enforcement activity.

Inexperience in enforcement could be offset by sharing good practices

Low levels of enforcement may also originate from competition authorities' still limited experience. They all came into being in the mid-2000s (even though a few were already operating to some extent within ministries). As a result, staff are relatively new and need time and training to acquire the appropriate skills and expertise to deal with competition issues.

The SEE economies are relatively close geographically, in levels of economic and social development and, to some extent, in economic weight and language. There is thus a platform on which the competition authorities to exchange knowledge and experience and which could contribute to strengthening their enforcement capacity. Through such a platform authorities might be able to benefit from each other's experience in investigations and advocacy interventions and even built a joint approach. Alternatively, individual agencies could develop practices from what they learn from their peers.

The pooling of experience could provide the competition authorities with the critical mass that they are still building. One effective initiative to that end could be a formal arrangement between all the region's competition authorities which would involve the regular sharing of experience at all levels of staff (economists, lawyers, case managers, heads of division, etc.). The OECD could play a part in co-ordinating such action.

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 experience. However, the Forum's members could extend co-operation to a more operational level in order to carry out joint projects – such as policy papers or market studies – and widen experience-sharing to authorities' operational staff. This could be done either within the Sofia Competition Forum or through a separate initiative.

A blueprint for such an initiative could be the collaboration between Nordic competition authorities (Box 11.2). In the medium to long term, it could also serve as a template for co-ordinating parallel proceedings and exchanging confidential, case-related information – on condition that the requisite legal framework is in place.

The OECD-GVH Regional Centre for Competition in Budapest offers regular training and organises seminars for Eastern and South East European competition agencies, favouring exchanges of experience and sharing of good practices (OECD-GVH Regional Centre for Competition, n.d.). Such events could be a highly effective way for the six competition authorities to ensure regular training for their staff. Indeed, they are already regular participants at events and would benefit from actively continuing.

Box 11.2. **Nordic competition authorities co-operation, an example of good practice**

The Nordic competition agencies – from Sweden, Denmark, Finland, Iceland, Greenland, the Faroe Islands and Norway – co-operate closely and meet on a regular basis every year. Important components of collaboration are the sector inquiries and joint reports on competition issues of common interest. The agencies have jointly produced a number of reports on competition in sectors ranging from telecommunications, energy, banking and the food market. The first report issued by the Nordic competition authority was published in 1998.

Source: EC (2010), *The Nordic competition authorities: Joint report on the financial crisis – regional cooperation works: The Nordic experience*, www.ec.europa.eu/competition/ecn/brief/01_2010/nordic.pdf.

Under-resourced competition agencies have to cope with high caseloads

Another cause of the low level of enforcement in the region could be the number of cases the authorities have to address relative to the resources at their disposal. The six SEE economies' competition agencies are bound by the principle of legality and consequently have to deal with each complaint that is brought to their notice. Clearly the caseload generated is considerable.

To address the issue, governments could allow competition authorities some discretion as to the cases they choose to open and investigate so that they are able to focus their resources on those most likely to yield the greatest benefits. However setting priorities, especially when authorities are new and still have to build a reputation for independence, may lead to a presumption of favouritism. The difficulties of prioritisation casts the spotlight on another possible option – that of increasing the authorities' resources so that they have the means to cope effectively with their workloads.

Market studies are a non-distorting form of advocacy that can strengthen enforcement

Competition advocacy plays a prominent role in the enforcement of competition law, since pro-active advocacy can ensure the design of new public policies and regulations with no unnecessary distortions to the workings of competition. One form of advocacy is the market study.

Market studies by competition authorities are a highly effective way of advocating competition and identifying distortions, while their recommendations can suggest good ways of removing barriers. Although such recommendations are not usually binding, governments that do not seriously consider them lose an opportunity to enhance competition and improve market efficiency.

SEE governments could consider committing to respond within no more than six weeks to the market study recommendations that competition authorities submit to them. A government would thus always respond publicly, stating whether and when it intends to adopt the recommendation and, if it does not, supply a clear explanation of why it has rejected the recommendation.

SEE economies could make greater active use of the guidance and training materials that have been developed by a number of organisations – e.g. the International Competition Network (ICN), the United Nations Conference for Trade and Development (UNCTAD) and the OECD. The OECD (2009) has actually developed a set of bid-rigging guidelines that suggest ways to spot and prevent bid rigging in public

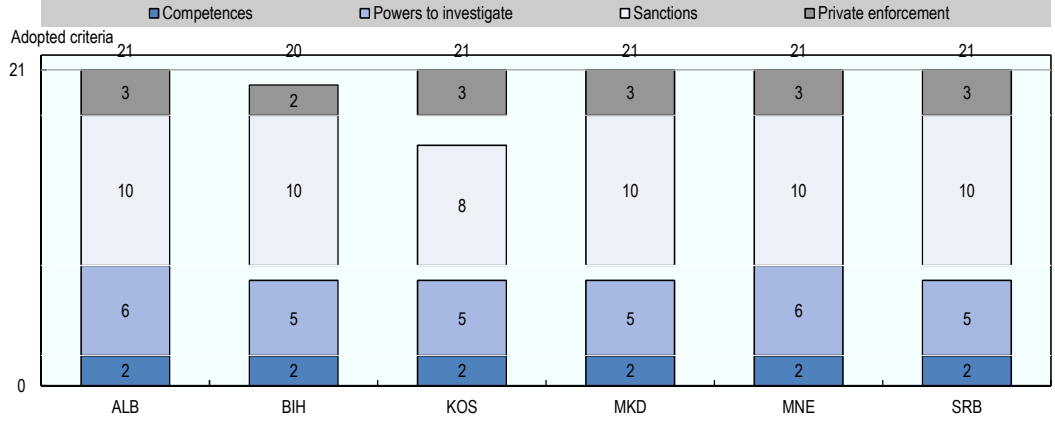
procurement. Competition authorities can play a key role as multipliers of bid-fixing knowledge in their countries, passing it on to public procurement officials and, reciprocally, obtaining valuable information on potential cartels. The OECD (2011) has also developed a toolkit for assessing competition. It furnishes detailed guidance on how to evaluate the impact on competition of laws and regulations and can be used by agencies in their advocacy work.

Scope of Action Policy Area

The section looks at the Scope of Action Policy Area (Figure 11.3). It assesses the scope of the SEE competition regimes' powers to uncover, remedy, deter and penalise anti-competitive behaviour and mergers. To that end it uses four sub-dimensions:

- The **powers to investigate** and the **sanctions** sub-dimensions 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 **competences** sub-dimension relates to public and foreign firms' exemptions from competition law.
- 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 11.3. **Scope of Action: Number of adopted criteria**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All SEE economies can compel firms and third parties to provide information for the purposes of investigating possible antitrust infringements and mergers. They can also conduct unannounced inspections in firms' premises. Although such powers are robust and can be valuable, however, only the competition authorities in Albania, Montenegro and Serbia have made use of them in the last five years. While it is possible that no such interventions have been necessary, the apparent reluctance may also be due to a lack of sufficiently experienced staff or, indeed, of staff at all. Unannounced inspections are resource-intensive because impromptu searches generate large volumes of data that then

have to be analysed. An additional risk is that of causing legal disputes with the firms under investigation, which might attract political attention.

In all SEE economies, apart from Bosnia and Herzegovina and Kosovo, the competition authorities can settle voluntarily with the parties under investigation for an alleged antitrust infringement and thus close the investigation. It is a way of finding quick, acceptable solutions and avoiding long drawn-out cases. Clear guidance on the kind of case for which settlement arrangements are best suited helps make them effective and efficiency-enhancing. Lack of guidance, by contrast, may result in the misuse of out-of-court settlements and possibly endanger due process and transparency.

All competition authorities can impose a sanction on a firm that hinders an investigation on an alleged antitrust infringement and all, except Kosovo's authority, have done so in the last five years.

None of the six economies exempts state-controlled or foreign companies from the ambit of competition law, which also applies to firms operating outside an economy if its dealings directly affect competition or consumers in that domestic market.

Individuals, firms and groups of consumers in all SEE economies can bring legal action against firms that have committed an antitrust infringement and seek redress for any harm they have incurred as a consequence. There is little point in seeking private redress, however, if plaintiffs cannot rely on strong enough public enforcement. Generally, decisions by antitrust authorities are considered to have strong indicative, if not probative, value when private parties pursue their damage.

Anti-Competitive Behaviour Policy Area

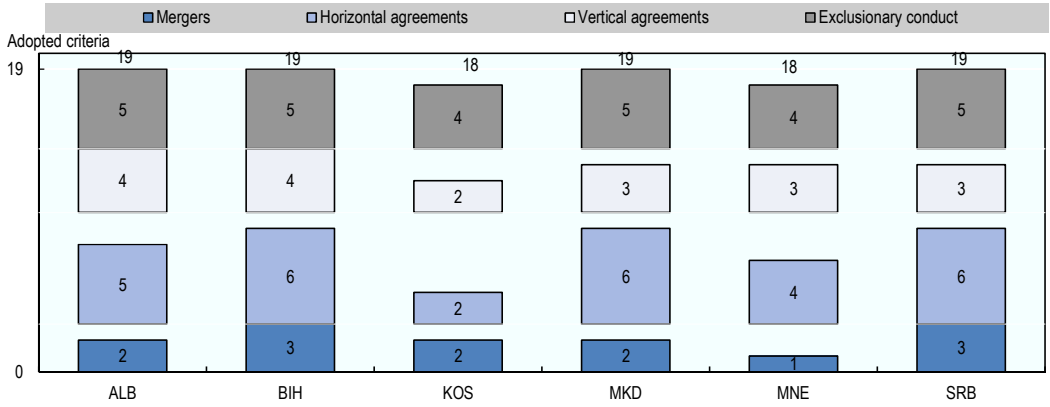
An effective competition law and policy regime is one where anti-competitive behaviours and mergers are punished, remedied or blocked. An effective regime also requires that, during the investigation of an alleged antitrust infringement or of anti-competitive merger, investigators assess the economic impact of each case and take into account any potential efficiency gains.

In order to effectively prosecute competition law violations, the competition authority needs not only formal powers to investigate, impose a sanction or remedy, it should also be adequately resourced and skilled to enforce competition. The Anti-Competitive Behaviour Policy Area gauges those powers and resources. It uses four sub-dimensions – **mergers**, **horizontal agreements**, **vertical agreements** and **exclusionary conducts** (Figure 11.4). They assess whether the anti-competitive behaviour is prohibited, what tools and practices the authorities have at their disposal when investigating allegedly anti-competitive behaviour, and what their enforcement track record is.

When it comes to the number of practices for countering anti-competitive conduct that the economies have adopted, the picture across South East Europe is one of contrast. Bosnia and Herzegovina and Serbia meet most of the 19 criteria, while Kosovo and Montenegro implement approximately 60% and are looking to make up ground on the other SEE economies.

All six SEE jurisdictions prohibit exclusionary conduct by dominant firms and all carry out economic analysis to determine whether it is likely to jeopardise competition or produce efficiency gains. In the last five years, all the jurisdictions except Kosovo have imposed a sanction on at least one firm for exclusionary conduct.

Figure 11.4. **Policy on Anti-competitive behaviour: Number of adopted criteria**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Anti-competitive agreements and mergers are prohibited but seldom prosecuted

All six SEE economies also 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 and Bosnia and Herzegovina have imposed sanctions on companies for vertical agreements.

Although anti-competitive horizontal agreements – which include cartel deals – are prohibited in all SEE jurisdictions, Bosnia and Herzegovina has not prosecuted any cartels in the last five years and only one anti-competitive horizontal agreement. Kosovo has levied no penalties on cartels, either. That two economies' should have taken such little action is all the more remarkable as horizontal restraints and cartels tend to be quite frequent in most jurisdictions and are relatively simple to analyse and prosecute.

All jurisdictions have leniency programmes for cartel participants in place – schemes which offer partial or full immunity from sanctions to firms that unveil the existence or provide evidence in support of a cartel investigation, whether or not the firm is the first applicant and degree of immunity accorded to them. In Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia 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 the instrument may be attributable to limited levels of enforcement. Leniency programmes are attractive to cartels only if detection is likely and fines high enough to pose a threat to their anti-competitive agreements.

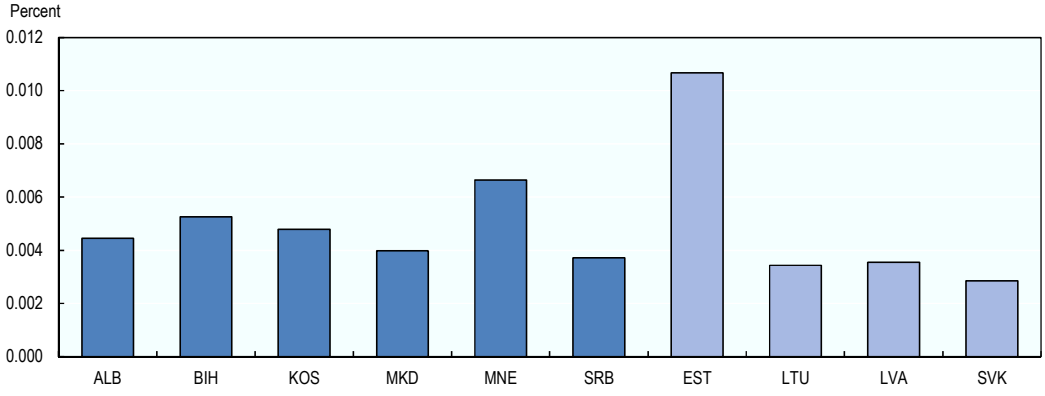
All competition authorities can investigate mergers and all analyse them to consider any efficiency gains that they may generate. However, only Bosnia and Herzegovina and Serbia have blocked or otherwise remedied a merger in the last five years. Yet mergers are frequent in any economy with at least a moderate level of development, so it is noteworthy that no mergers in the other four economies have prompted concerns over competition. One possible solution may be to strengthen economic analyses to improve the assessment of anti-competitive mergers.

Resources are inadequate to the task of enforcement and may explain the lack of sanctions

If the SEE region's economies are to enforce competition law effectively, their competition authorities need resources adequate to the task. The size of the budgets in the six competition authorities appears to be in line with those of its peers in the OECD area with similar levels of GDP (Figure 11.5). However, in absolute terms, staff numbers are often very low, which may make enforcement difficult.

Figure 11.5. **Budget of competition authorities, 2013**

Percent of GDP



Source: Antimonopoly Office of the Slovak Republic (2014), *2013 Annual report*, www.antimon.gov.sk/data/att/1404.pdf; Competition Council of the Republic of Lithuania (2014), *Annual report 2013*, http://kt.gov.lt/en/annual/2013_eng.pdf; Estonian Competition Authority (2014), *Annual report 2013*, www.konkurentsiamet.ee/public/Aastaraamat/Annual__Report_2013.pdf; Latvian Competition Council (2014), *Annual report 2013*, www.kp.gov.lv/documents/f997f704f466d45b4cca1ff80afc09463b2bd885; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933322342

In general, the information collected shows that low enforcement rates are a common feature of policy in the six SEE economies. Indeed, answers to the questionnaire reveal that some economies deploy no enforcement measures in certain important areas of competition. As enforcement records are one of the most important indicators of effective competition law in recent regimes and contribute 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.

Probity of Investigation Policy Area

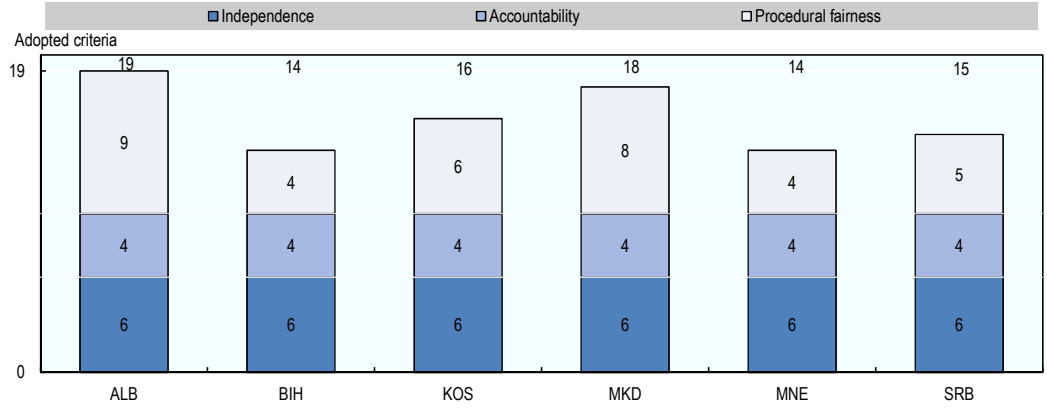
Probity of investigation plays an essential role in fair and effective law enforcement. It requires the competition authorities to be free from political influence – as does effective advocacy.

Companies must be safe in the knowledge that their practices are in conformity with the applicable laws in the economies where they operate. They must also be able to correctly understand legal procedures and the statutory authority (or other body) which oversees them. And, should they have to mount a defence in court, they need to be informed properly and in good time of the allegations against them.

The Probity of Investigation Policy Area gauges how fair competition law enforcement is and how independent and accountable the competition authorities are. To that end, it uses three sub-dimensions (Figure 11.6):

- The **independence** sub-dimension assesses whether the authorities that enforce competition law are independent of government interference in investigations or decisions in antitrust infringements and mergers.
- The **procedural fairness** sub-dimension assesses whether companies under investigation are entitled to be heard and to receive information on the procedures.
- The **accountability** sub-dimension assesses whether the activities and decisions of the competition authority are transparent and whether the authority may be required to account for them in court.

Figure 11.6. **Probity of Investigation: Number of adopted criteria**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322352

Competition authorities are formally independent and ensure due process, but could give companies better legal guidance

Albania and the Former Yugoslav Republic of Macedonia meet almost all of the criteria in the probity of investigation policy area. Bosnia and Herzegovina and Montenegro, however, are currently seeking to catch up with the SEE average.

Competition authorities in all SEE economies are formally independent and, in the last five years, governments have given no binding directions as to whether they should open investigations or impose sanctions. Nor have they overturned any decision by the competition authorities in that time.

All SEE competition authorities regularly publish reports on their activities and all decisions that ascertain infringements of antitrust legislation.

To ensure due process, the competition authorities provide the parties under investigation for an antitrust infringement or a merger an opportunity to consult them about the significant legal, factual or procedural issues during the course of an investigation.

When it comes to giving businesses general guidance, the competition authorities in Albania, the Former Yugoslav Republic of Macedonia and, to a certain extent, Serbia have published guidelines on how they assess different types of competition infringements and how they calculate monetary sanctions for antitrust infringements. Guidelines are important for the effective enforcement of competition law as they help deter anti-competitive practices and mergers by clarifying the law and informing firms and their legal advisors of the risks and consequences of taking them. The absence of enforcement guidelines could be the result of insufficient enforcement practice, since guidelines are the fruit of experience, best national practices and case law.

Advocacy Policy Area

Competition may be inhibited by public policies, laws and regulations that create barriers to entry or distort the incentives faced by firms. Some distortions are unnecessary and can be eliminated without affecting the policy objectives the government is trying to achieve. The mandate of a competition authority should therefore extend beyond merely enforcing competition law and address the additional obstacles to competition. It should also join in the formulation of public policies to prevent them from adversely affecting competitive market structures, business conduct and economic performance. Accordingly, it should be able to advocate competition and contribute to the discussion of public policies by assessing them against barriers to competition and flagging potential threats for competition.

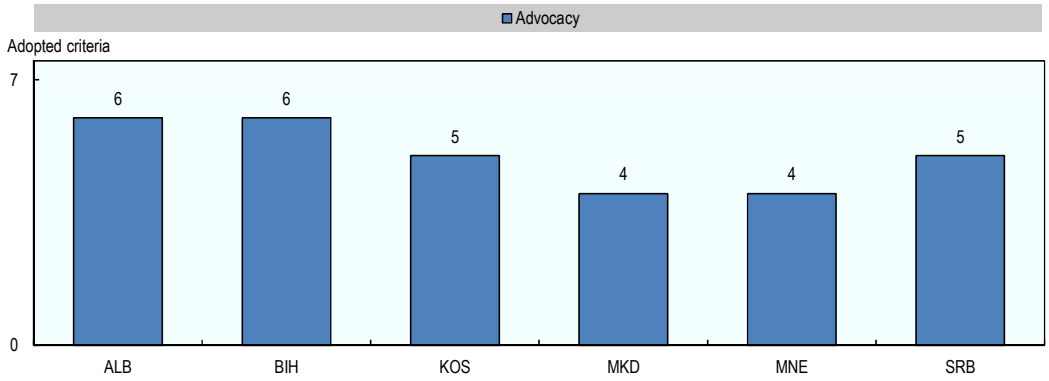
This section looks at the Advocacy Policy Area. It considers the capacity of the competition authority to advocate a more competitive environment at different government levels. Such advocacy can involve reviewing new and existing regulations to identify any unnecessary distortions to competition and performing market studies that may lead to policy recommendations on how to foster competition and make the regulatory environment more pro-competition.

The competition authorities in all SEE economies advocate competition at the central government level and three also do so at local government level. In all six economies, they scrutinise new public policies that may affect competition, although they have insufficient resources to carry out thorough, effective assessments.

Market studies are another instrument through which competition authorities can advocate competition (Figure 11.7). 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.

In all SEE economies the competition authorities may conduct market studies and all have done so in the last five years. If a market study includes a recommendation to the government on how to address an obstacle or restriction to competition caused by public policy, none of the six governments is required to publicly respond to it. However in Montenegro and Serbia the governments usually do.

Figure 11.7. **Advocacy: Number of adopted criteria**



Source: OECD assessment conducted in the SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Conclusions

Overall, SEE economies appear to have laid most of the basic building blocks for a functional competition policy regime. All the economies have in place policies for prohibiting anti-competitive behaviour and reviewing 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 and all SEE economies have room for further improvement in that regard. Accordingly, the competition authorities could consider intensifying enforcement activity as a matter of priority and governments should enable them to do so by providing adequate resources. 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.

Addressing those challenges could improve the business environment in SEE economies and ultimately lead to increases in new businesses and exports.

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Chapter 12.

Employment policy in South East Europe

Employment policy seeks to provide a framework of institutions, laws and practices that improve labour market functions, inclusiveness, and the ability to address post-crisis and demographic challenges. This chapter on the Employment Policy Dimension considers three sub-dimensions in its assessment of employment performance and policy development. The Labour Mobility Sub-Dimension examines to what extent economies regulate the labour and occupational mobility of workers. The Labour Market Governance Sub-Dimension analyses the capacity of public employment services, strategies to facilitate employment among young people and vulnerable groups, and policies that address informal employment. It also describes employment protection legislation analysed with OECD indicators and methodology. The Social Economy Sub-Dimension describes the development of government action to promote the social economy and an environment conducive to social enterprises.

Main findings

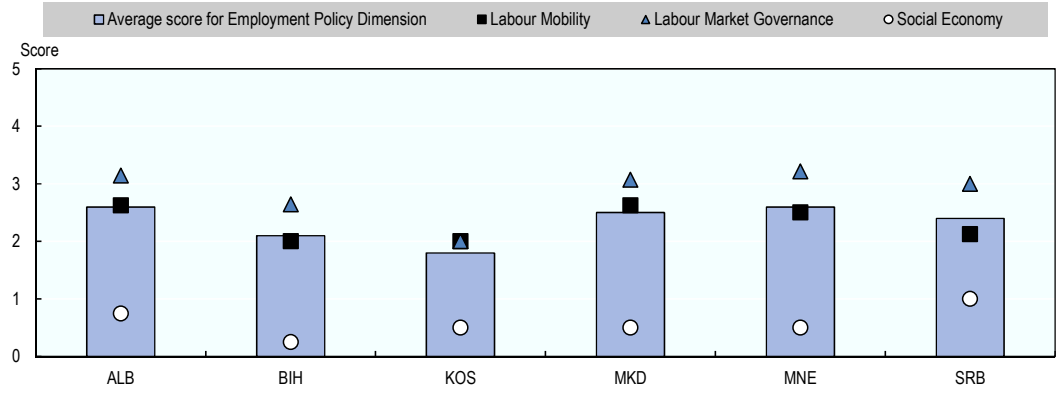
Creating more and better-quality jobs is a major challenge for governments seeking to raise living standards, boost productivity and growth, and foster more inclusive, cohesive societies. Growth-enhancing policies have an important role to play in increasing productive, remunerative employment. However, growth in itself is not sufficient. It requires labour market policies that improve employment opportunities and yield better, more equitable outcomes for the working-age population, which includes vulnerable groups. Employment policy can provide a framework of institutions, laws and practices that improve the functioning of labour markets, make them more inclusive, and support their ability to address the post-crisis and demographic challenges.

A number of labour market conditions and trends are common to the economies of South East Europe (SEE) whose employment performance is considerably below that of EU countries. One of the most prominent is low employment: 37% of the working-age population was employed in 2013, compared to 64% in the EU member states. The region is also affected by youth and long-term unemployment rates that are among the highest in Europe. A further challenge is informal employment which has harmful consequences for workers.

Most of the economies in SEE have taken steps to improve their employment policy frameworks. They generally do well when it comes to labour market governance, but could do more to ease labour mobility and integrate foreign workers. As for policy to promote the social economy, it is still nascent.

The SEE economies' average score in the Employment Policy Dimension is 2.4 out of 5 which means that policy frameworks and strategies have been adopted, although further support is needed to implement them. Four of the economies – Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia – score at least 2.5 (the median score), thanks to their relatively more advanced (albeit incomplete) strategy implementation. Bosnia and Herzegovina, with a score of 2.2, could take implementation much further, while Kosovo is in the final stages of adopting its policy frameworks.

Figure 12.1. **Employment Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have made progress in developing employment policy.

SEE economies have made efforts to design comprehensive employment strategies developed through consultative processes to address their specific challenges.

All SEE economies are attempting to address structural unemployment, particularly youth unemployment, in their strategies and are making headway in implementing them.

Challenges

Despite recent improvements, SEE economies still face significant obstacles to reaching high-levels of quality employment.

Structural unemployment is a serious issue and has been rising in recent years. Very high rates of youth and long-term unemployment are of particular concern across the region.

Public employment services (PES) lack the capacity and infrastructure to provide quality support. Staff workloads are very high (up to 600 jobseekers for a single PES officer) and seriously constrain effective employment policies.

Informal employment is high. Although estimates put informal employment as high as 30% of total employment in some economies, measures to gradually coax informal workers into formality are often not in place.

Social economy initiatives are nascent. Very little legislation relating to the social economy, e.g. social businesses, has been in adopted. The lack of data further hampers analysis and progress in policy.

Recommendations

The following steps and measures are recommended for SEE economies to facilitate more job creation and high-quality employment.

Further promote active labour market policies such as youth employment schemes, self-employment programmes and additional training opportunities for the long-term unemployed. Active labour market policies would, ideally, be part of a broader, evidence-based employment policy which is monitored regularly.

Increase the capacity of public employment services (PES). The quality of the services delivered by the PES needs to be improved. Co-operation between the various public sector actors could be further facilitated.

Align labour statistics with Eurostat norms. The scope of labour force surveys could be widened to collect information on migration flows, with particular attention paid to migrants' demographic and socio-economic characteristics. Another focal point could be skills gaps and mismatches in the economy. The SEE economies would benefit from closer regional co-operation between their national statistics offices to facilitate peer learning on data collection norms and standards.

Improve detection and enforcement measures in addressing informal employment. Policy makers could consider developing analytical tools to detect informal employment and implementing effective enforcement measures as part of efforts to curb the informal sector.

Develop a legislative framework for social businesses. Most economies do not have a legislative basis for their social economy initiatives, even though they recognise the potential of social enterprises for creating jobs.

Overview

Employment policy relates to government activities, laws and practices intended to promote full and productive employment. The SEE economies' weak labour markets are a serious source of social concern as they undermine medium- and long-term economic growth. Low rates of employment mean forgone production, while the unemployed risk losing their skills and struggling to find work in the future. Very low youth employment rates impede the building of human capital and increase young people's dependency on support systems, so diminishing the economies' long-term growth potential. Finally, 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.

Employment policy is linked to other policy areas addressed in this *Competitiveness Outlook 2016*:

- **Chapter 3. Education and competences** largely determines 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).
- **Chapter 2. Trade policy and facilitation**, through economic diversification and global value chain development, pose challenges which necessitate adaptability in the labour force (ibid.). An adaptable labour force is thus key to creating a favourable environment in which both domestic and foreign enterprises grow through new investment and respond quickly to changing circumstances.

  Furthermore, the cross-border labour mobility of workers can help match skills with jobs more closely, transfer knowledge and technology, increase economic productivity and create jobs (ILO/OECD/World Bank, 2015). Encouraging and enabling mobility will make small SEE economies more competitive.
- **Chapter 1. Investment policy and promotion** addresses key factors to facilitating investment, including employment policy. Research finds that more stringent employment protection legislation may deter foreign direct investment (FDI) (Benassy-Quéré, Coupet and Mayer, 2007; Dewit, Görg and Montagna, 2009; Gross and Ryan, 2008) and that relaxing labour regulations may increase it.
- **Chapter 13. Health policy** directly affects the labour force and the business environment. Investing in people's health as human capital helps improve the general health of the population and strengthens employability, thus making active employment policies more effective, helping to secure adequate livelihoods and boosting growth (EC, 2013a).

Box 12.1. **Employment Policy Dimension in the SEE 2020 Strategy**

The Employment Dimension is a part of the Inclusive Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). A central objective of the Inclusive Growth Pillar is to improve employment through the development of skills, the creation of jobs and the increase of labour market participation that includes vulnerable groups and minorities. Employment policy also means fighting poverty, modernising labour markets and strengthening education and training systems.

The Inclusive Growth Pillar's headline target is an increase in the overall region-wide employment rate from 39.5% to 44.4% by 2020. That target is based on the broadest possible definition of employment pursuant to the International Labour Organisation (ILO) definition, which includes people aged 15 and over. The SEE 2020 Employment Dimension comprises three objectives: promote labour mobility, enhance labour market governance and stimulate social economy initiatives.

The official SEE 2020 Strategy Co-ordinator for the Employment Policy Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and improve regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Employment Policy Dimension assessment framework

This chapter proposes an analysis of employment policies in South East Europe. It does not seek to be exhaustive, however. It confines itself to three broad sub-dimensions based on the objectives set out in the Inclusive Growth Pillar of the SEE 2020 Strategy. The sub-dimensions are:

- Labour Mobility

  Do the SEE economies regulate the labour and occupational mobility of foreign workers, and to what extent? Are policy makers easing labour market restrictions on foreign workers? What measures are in place to address the skills gap in the workforce?

- Labour Market Governance

  Do policies seek to improve the capacity of the public employment services? Have there been efforts to ease employment protection legislation? Are there measures in place to reduce youth unemployment and bring vulnerable groups into the labour market? Do policies address informal employment and how far advanced are they?

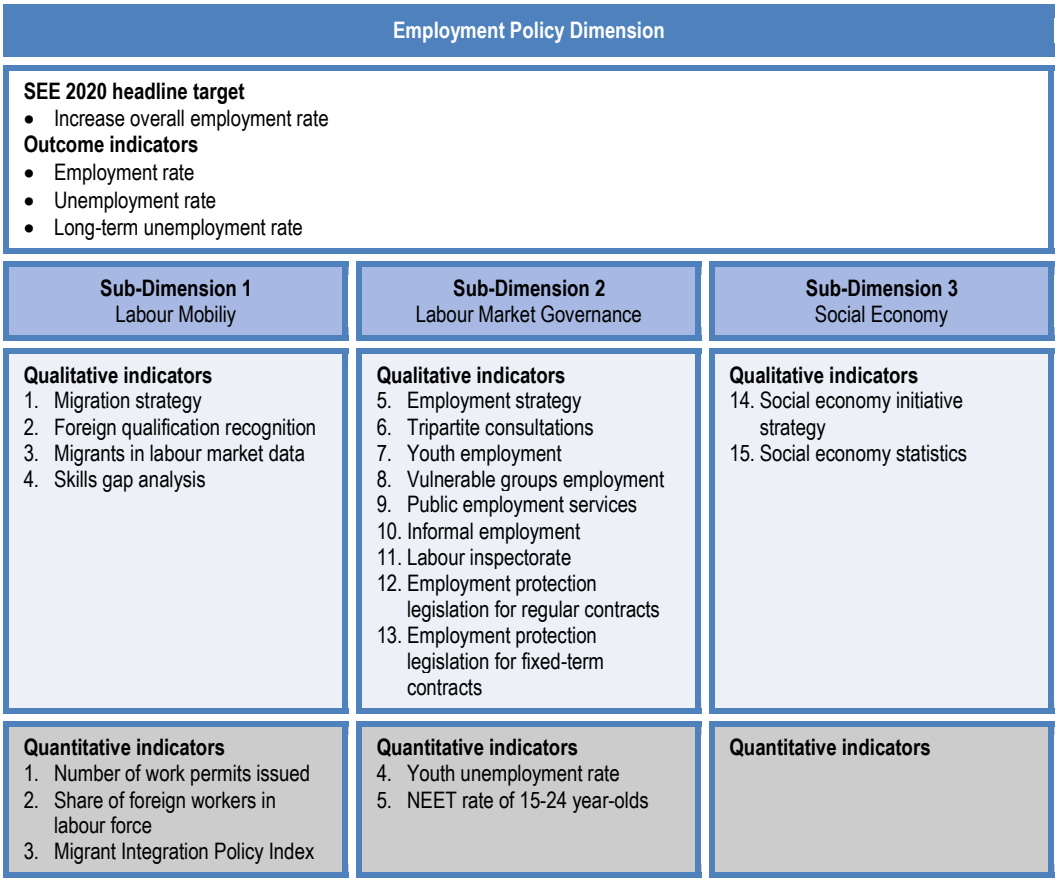
- Social Economy

  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 12.2 shows how the sub-dimensions and their constituent indicators make up the Employment Policy Dimension assessment framework.

Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional Cooperation Council (RCC) collected qualitative and quantitative data.

Figure 12.2. **Employment Policy Dimension assessment framework**



Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Labour market performance in SEE economies

Labour markets in South East Europe are characterised by high levels of structural unemployment (Figure 12.4). It not only undermines medium- and long-term economic growth, it is also a serious social concern in the region.

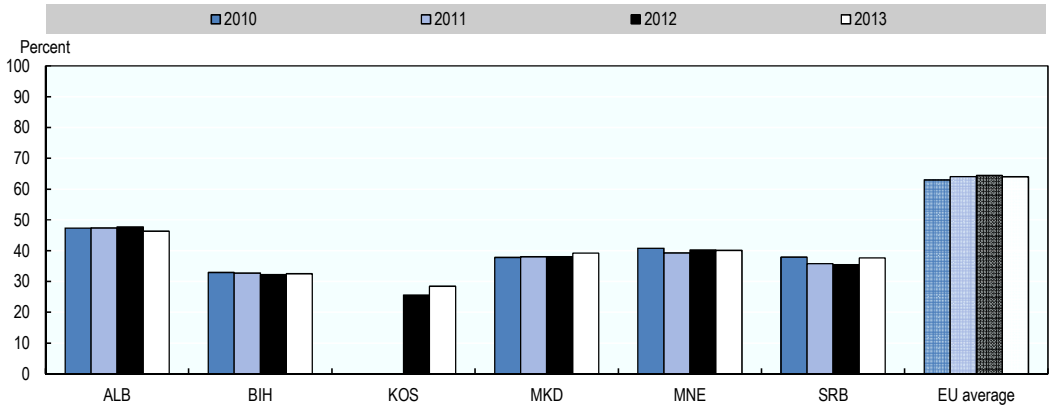
Employment rates are generally low in the SEE economies (Figure 12.3). They are relatively higher in Albania and particularly low in Kosovo and Bosnia and Herzegovina. Rates in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia lay within a similar range of between 35% and 40% in 2013.

Employment fell in four of the economies between 2010 and 2013, albeit at varying rates – from a 1 percentage point drop in Albania to one of 0.2 points in Serbia. The Former Yugoslav Republic of Macedonia, by contrast, experienced a rise over the same period, as did Kosovo between 2012 and 2013.

The unemployment rate is the proportion of the labour force that does not have a job and is actively looking for work (Figure 12.4). It is much higher in the SEE region than in EU countries – 24% on average compared with 10% in 2014.

Figure 12.3. **Employment rate of 15 year-olds and over**

Percent



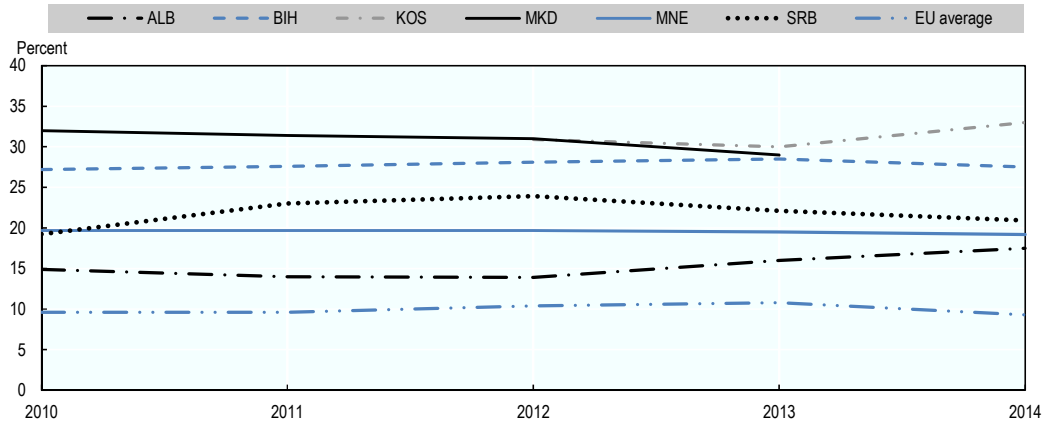
Note: Data not available for Kosovo for the years 2010 and 2011.

Source: EC (2015a), *Employment and unemployment* (Labour force survey, Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm; Kosovo Agency of Statistics (2015), *Labour Market* (database), https://ask.rks-gov.net/ENG/labour-market/tables.

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Figure 12.4. **Unemployment rates of 15 year-olds and over**

Percent



Note: Data not available for Kosovo for the years 2010 and 2011 and for the Former Yugoslav Republic of Macedonia for 2014.

Source: EC (2015a), *Employment and unemployment* (Labour force survey, Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm; Kosovo Agency of Statistics (2015), *Labour Market* (database), https://ask.rks-gov.net/ENG/labour-market/tables.

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Particularly high unemployment rates are to be observed in the Former Yugoslav Republic of Macedonia and Bosnia and Herzegovina, with a slight fall in the former and rise in the latter between 2013 and 2014. Kosovo's rates are both high and rising – to

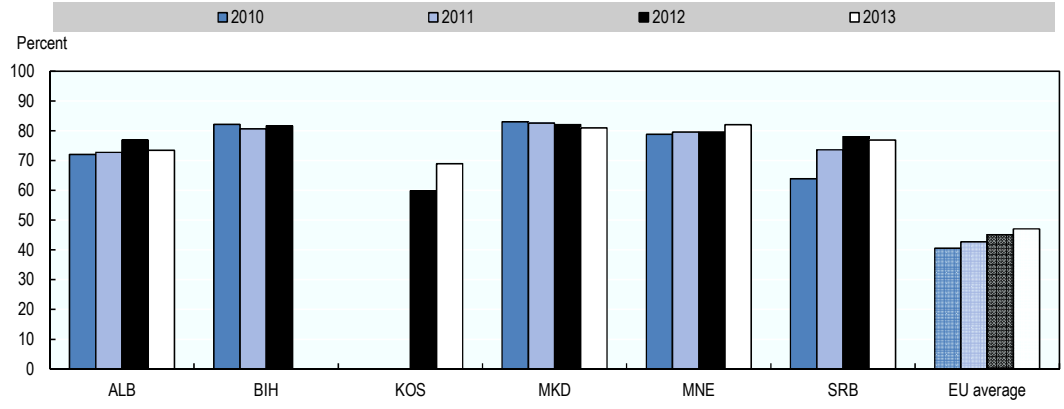
33% in 2014. Albania, Montenegro and Serbia all show lower unemployment, although Albania saw a 2.6 percentage point increase between 2010 and 2014.

Unemployment tends to have more severe effects the longer it lasts (OECD, 2013a). Short spells of joblessness can normally be managed through unemployment compensation, savings and, perhaps, assistance from family members. When it lasts, though, it can cause substantial financial hardship, especially when unemployment benefits either do not exist or have been exhausted (Figure 12.5).

Long-term unemployment is a serious issue in South East Europe. Compared to the EU average long-term unemployment rate of 43.9%, 80% of all unemployed have been out of a job for 12 months or longer in the SEE economies. The sole exception is Kosovo where the long-term unemployment rate declined to 56% in 2013.

Figure 12.5. **Long-term unemployment rate (12 months +)**

Percent of all unemployed



Note: Data not available for Bosnia and Herzegovina for the year 2013 and for Kosovo for the years 2010 and 2011.

Source: EC (2015a), *Employment and unemployment* (*Labour force survey*, Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm; Kosovo Agency of Statistics (2015), *Labour Market* (database), https://ask.rks-gov.net/ENG/labour-market/tables.

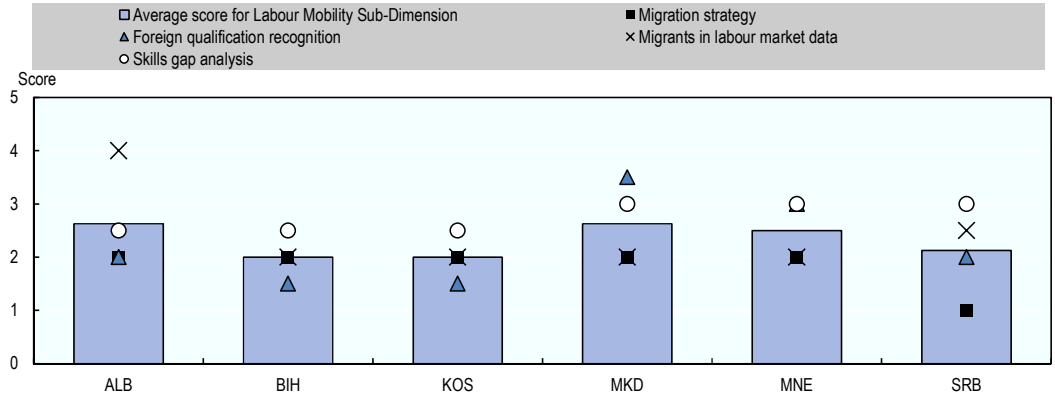
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Long-term unemployment can lead to loss of skills, self-confidence and motivation, and translate into acute social and health problems that sap people's ability to work and look for a job (OECD, 2014). Indeed, without additional, well-targeted support there is a substantial risk that the long-term unemployed exit the labour market altogether. For example, Krueger, Cramer and Cho (2014) show that, in the United States, workers who had been unemployed for six months or more were twice as likely to have left the labour force than to have found work 15 months later.

Labour Mobility Sub-Dimension

This section looks at the Labour Mobility Sub-Dimension (Figure 12.6). It examines to what extent SEE policy makers regulate the labour and occupational mobility of migrants and seek to ease labour market restrictions on foreigners. It also analyses governments' efforts to address skills gaps in the workforce and to gather data to that end.

Figure 12.6. **Labour Mobility: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The average labour mobility score of 2.3 indicates that, although the SEE economies have adopted the requisite instruments and frameworks, they have not yet fully implemented them. While Albania,the Former Yugoslav Republic of Macedonia and Montenegro have average scores of above 2.5, the other economies score below average.

A relatively strong performance is to be observed in the analysis of skills gaps, where the average score is 2.6. The indicator where there is the most room for improvement is the strategic approach to regulating labour migration, where the average score is 1.8 (Table 12.1).

Labour mobility needs to be further facilitated

Geographical labour mobility can act as an economic adjustment and growth mechanism. Indeed, mobility, whether domestic or cross-border, can bring gains, such as the movement of workers from regions with an over-supply of labour to ones that are under-supplied. It can also drive a more efficient allocation of labour to jobs and regions where it is (presumably) more productive and can generate more income. Voluntary occupational mobility in particular may enhance workers' employability, income and career prospects. As for greater labour mobility, it makes firms more flexible, adaptable and competitive, as they reduce their costs and increase their productivity (ILO, 2009).

The **migration strategy** indicator assesses to what degree migration policy is strategic. The **foreign qualification recognition** indicator assesses provision, if any, for recognising foreign credentials. More specifically, it gauges whether there is a co-ordinated, holistic government approach to labour migration, how widely it has been implemented and how well all stakeholders are included in the process.

Finally, the **migrants in labour market data** indicator measures governments' efforts to produce such labour market information, particularly the socio-economic characteristics of migrants. A well-designed, transparent labour market information system is crucial for analysing labour mobility.

Table 12.1. **Labour Migration Sub-Dimension: Labour migration indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Migration strategy	2.0	2.0	2.0	2.0	2.0	1.0
Foreign qualification recognition	2.0	1.5	1.5	3.5	3.0	2.0
Migrants in labour market data	4.0	2.0	2.0	2.0	2.0	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323499

With the exception of Serbia, which is still formulating its migration policy, all economies have approved strategy documents on their policies:

- the National Strategy on Migration and Action Plan – Albania
- the Strategy on Migration and Asylum – Bosnia and Herzegovina
- National Strategy and Action Plan on Migration – Kosovo
- the Resolution on Migration Policy – the Former Yugoslav Republic of Macedonia
- the Strategy for Integrated Migration Management – Montenegro.

Although the strategies are in place, the economies have been slow to implement them.

An important aspect of labour mobility is the speedy recognition of foreign qualifications. In Albania, recognition procedures are still lengthy. It is currently trying to introduce an on-line application which is not yet in place, while new complementary procedures (e.g. the professional card) require further capacity building. As for Bosnia and Herzegovina, its complex institutional structure scatters responsibilities across different bodies and authorities (cantons, entities and the state), which further hampers matters. Mutual recognition agreements governing foreign qualifications are a state-level competence, while adoption and implementation is the responsibility of each entity, both of which have different internal legislation.

Kosovo, for its part, has not yet ratified the Lisbon Recognition Convention on the recognition of higher education qualifications, while in the Former Yugoslav Republic of Macedonia the recognition of academic qualifications is an ongoing process. It has bilateral agreements with several of its regional neighbours (Albania, Bulgaria, Kosovo and Serbia) and recognises professional qualifications in accordance with the EU *acquis communautaire*. It needs a new law, however, when it comes to the freedom to provide services.

Montenegro has partially aligned its regulations on labour mobility with the EU *acquis*. It plans to adapt the legislation in order to enable EU citizens and their family members free access to the labour market in Montenegro, in order to fully comply with the principle of free movement of workers. The Law on Foreigners came into force in April 2015. In Serbia, legislation on the mutual recognition of professional qualifications has not yet been formally adopted. It is due to be towards the end of 2015.

Statistical data on labour migration can help the integration of foreign workers

The collection of labour migration statistics is most advanced in Albania, which has gathered them quarterly as part of a special module in the Labour Force Survey since 1 January 2014. The data collected relate to internal and return migration and emigration. They include facts and figures on socio-economic characteristics, year of migration, and reasons for immigrating and emigrating.

Although the other economies do collect some data on migration and mobility, they do not do so systematically. National statistics agencies should harmonise regional labour market data and all economies should increase their efforts to align their indicators with Eurostat methodologies.

An indicator that quantifies (inward) labour mobility is the number of work permits an economy issues. Montenegro issues by far the most, Croatia has cut back significantly due to its prolonged recession, and the Former Yugoslav Republic of Macedonia has steadily issued more and more. As for Bosnia and Herzegovina and Serbia the total number of work permits they issue is slightly lower, albeit with some increase between 2010 and 2013.

Another important quantitative indicator is the share of foreign workers as a percentage of the labour force or employed population. Generally, though, the proportions of foreign workers in individual SEE economies are very low – only 0.4% of total employment in Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia and 0.1% in Serbia. Montenegro, where foreign workers accounted for almost 8% of the workforce in 2013, is an exception

How well are foreign workers integrated in the SEE economies? The Migrant Integration Policy Index (MIPEX), which recently added Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia to its database, measures migration policy against seven metrics:

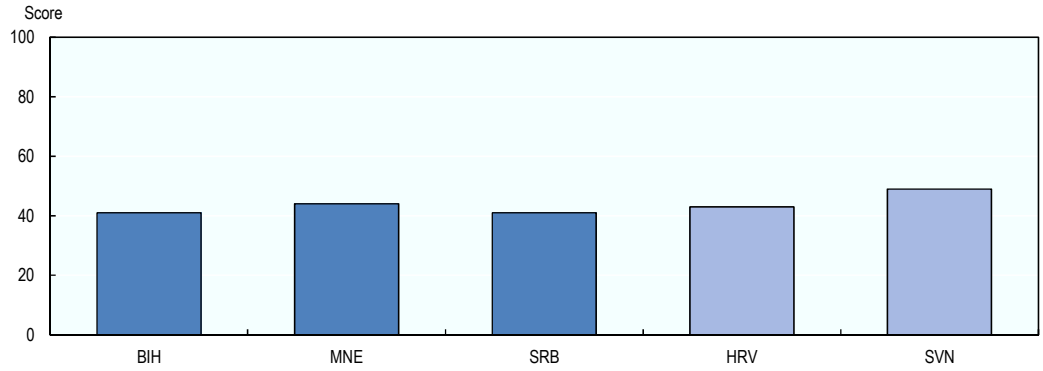
1. labour mobility
2. family reunion
3. education
4. political participation
5. long-term residence
6. access to nationality
7. anti-discrimination.

It ranks countries on a scale of 0 to 100, where 100% is the top score (Figure 12.7). A score of 50% means, therefore, that policies create as many obstacles as opportunities for immigrants seeking to become equal members of society (Migration Integration Policy Index, 2015).

With an overall MIPEX score of somewhat above 40, SEE economies are hardly even halfway favourable to integration. The SEE economies are all below Slovenia's rating, even though policies in the Montenegro are slightly more inclusive than those of its regional peers.

Figure 12.7. **Migrant Integration Policy Index (MIPEX), 2014**

MIPEX indicator score



Note: A score of 100 refers to the best possible score and 0 to the worst. For further information on the methodology of the Migration Integration Policy Index please consult: http://mipex.eu/methodology. Data for Albania, Kosovo and the Former Yugoslav Republic of Macedonia not available.

Source: Migration Integration Policy Index (2015), *Migration Integration Policy Index* (webpage), www.mipex.eu.

StatLink http://dx.doi.org/10.1787/888933322426

Evidence and analysis of skills gaps and labour market flows could be improved

Skills gap analysis is a method of identifying and assessing gaps and mismatches between the skills people have and those needed in the workplace. On a broader level, it can also contribute to more effective investment in human capital by individuals, governments and businesses. The **skills gap analysis** qualitative indicator measures to what extent an economy conducts skills gaps analysis.

Table 12.2. **Labour Migration Sub-Dimension: Skills gap analysis indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Skills gap analysis	2.5	2.5	2.5	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323501

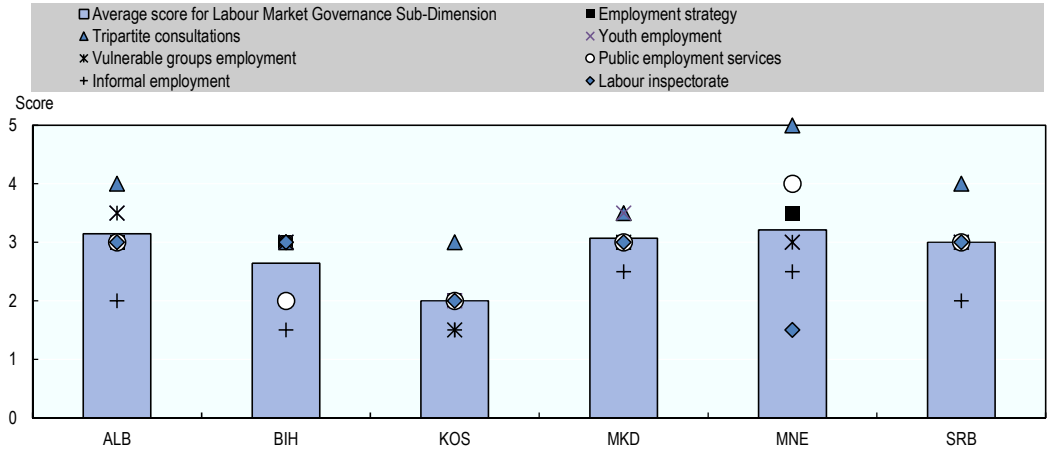
All the SEE economies conduct some form of skills gap analysis. In most of them, it is usually the public employment service that researches employers' needs (mainly in the form of business surveys) to assess occupation levels, special knowledge and know-how, etc. In Montenegro, the Former Yugoslav Republic of Macedonia and Serbia such analyses are not exclusively donor-funded and often target strategic economic sectors and/or particular groups.

The 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. In the long run, it might be useful to use such findings to improve education systems so that students are equipped to enter the workplace. That would require close co-operation between education policy makers, public employment services and labour market policy makers.

Labour Market Governance Sub-Dimension

This section looks at the Labour Market Governance Sub-Dimension (Figure 12.8). It examines qualitative indicators of strategic approaches to employment, programmes to reduce youth unemployment, measures to bring vulnerable individuals into the workplace and policy on informal employment. It further addresses the capacity of the public employment services and discusses employment protection legislation.

Figure 12.8. **Labour Market Governance: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322439

The SEE economies' average scores in labour market governance indicate that they have adopted strategies to improve it. However, some economies have gone further in implementing those strategies than others and monitoring schemes are not in place. Four economies score above 3, while Bosnia and Herzegovina's average score is 2.7 and Kosovo's is 2.2.

Efforts have been made to establish strategic frameworks for employment policy

Two qualitative indicators assess the employment policy framework (Table 12.3). The **employment strategy** indicator considers whether a comprehensive strategic approach to employment is in place, while the **tripartite consultations** indicator gauges government commitment to engage with the social partners in tripartite approaches such as a council.

Table 12.3. **Labour Market Governance Sub-Dimension: Strategic approach and tripartite consultations indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Employment strategy	3.0	3.0	2.0	3.0	3.5	3.0
Tripartite consultations	4.0	3.0	3.0	3.5	5.0	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323514

Tripartite councils provide a national forum where the social partners – employers, trade unions and the government – express their views on employment-related issues. But their prime purpose is to connect the government's policy agenda with the economic actors on the ground (employers and workers) and thus facilitate participatory policy-making processes.

All SEE economies 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, all are implementing measures, particularly to fight youth unemployment. The next step is to monitor implementation against the implementation plan's goal so that, if necessary, corrective action many be taken. Currently, only Montenegro's Employment and Human Resource Development Strategy includes some form of monitoring.

Tripartite councils exist in all economies. In Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo the council is consulted on draft legislation, although only in a limited number of labour-related policy fields. In Albania and Serbia, adequate representativeness criteria enable the social partners to participate in tripartite consultations. The council meets on a regular basis and is systematically consulted on labour-related legislation. It covers a wide range of issues such as social security, healthcare, pensions, wages, prices, taxes and industrial relations.

The Montenegrin Tripartite Council is an example of good practice in the region – it scored a 5 in the tripartite consultations indicator. The council has local branches and it is reported that the relationship between the parties is one of mutual trust. The council and its local chapters are involved in the drafting of employment-related laws and national strategies. They make recommendations on extensions of collective agreements or give opinions on policy initiatives and action plans.

Youth unemployment in SEE needs to be further addressed

The first experience of employment has a profound influence on later working life. Getting off to a good start helps young people take their place in the labour market and lays the foundations of a good career. By contrast, it can be hard to make up for a first-time failure (OECD, 2014). Reducing youth unemployment is thus crucial in the SEE economies (Figure 12.9).

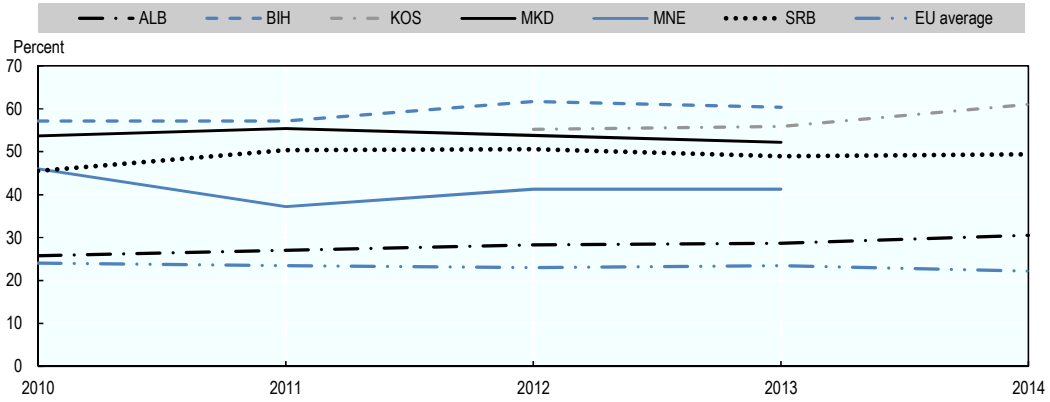
The youth unemployment rate is the proportion of 15-24 year olds in the workforce who do not have a job and are available and actively looking for work. By that definition, unemployment among the young in the SEE economies is significantly higher than in the total population. Weak job creation in the region leads to difficult school-to-work transitions and most young people enter the labour market only after an initial spell of unemployment. The result is youth unemployment rates of 52.2% in the Former Yugoslav Republic of Macedonia, 48.9% in Serbia and 60.4% in Bosnia and Herzegovina, compared to 23.5% in the EU. The only exception is Albania where the figure was only slightly higher than in the EU countries at 28.7% in 2013.

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. With the exception of Montenegro, the rate of young people not in employment, education or training (NEET) in the SEE economies is almost double the EU average (Figure 12.10). Young NEETs are considered "at risk", being jobless, inactive and with no access to learning. Most economies train much attention on youth unemployment although "unemployment"

underestimates how vulnerable young people can be. Broadening the perspective from unemployed youth to young people not in employment, education or training affords a better insight into the challenges they face. Furthermore, it informs the development of policies that contribute to a better future for them and their countries.

Figure 12.9. **Youth unemployment rate**

Percent



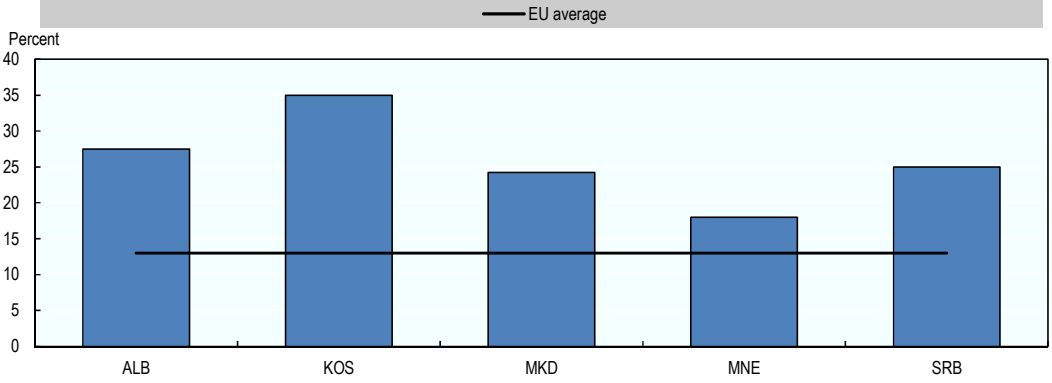
Note: Data for Bosnia and Herzegovina not available for the year 2014. Data for Kosovo not available for the years 2010 and 2011. Data for the Former Yugoslav Republic of Macedonia and Montenegro not available for the year 2014.

Source: EC (2015a), *Employment and unemployment* (Labour force survey, Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; ILO (2015), *Key Indicators of the Labour Market* (database), www.ilo.org/empelm/what/WCMS_114240/lang--en/index.htm; Kosovo Agency of Statistics (2015), *Labour Market* (database), https://ask.rks-gov.net/ENG/labour-market/tables.

StatLink http://dx.doi.org/10.1787/888933322444

Figure 12.10. **NEET rate of 15-24 year-olds, 2013**

Percent



Note: Data for Bosnia and Herzegovina not available.

Source: EC (2015b), *Education and Training* (Eurostat database), http://ec.europa.eu/eurostat/web/education-and-training/data/database; Ministries of Labour of Albania, Kosovo, Montenegro, and Serbia.

StatLink http://dx.doi.org/10.1787/888933322451

Participation in employment, education or training is critical if young people are to establish themselves in the labour market and achieve self-sufficiency. With the exception of Montenegro, the proportion of young people not in employment, education or training (NEET) in the SEE economies is almost double the EU average in.

NEETs are considered "at risk" as they are jobless and inactive and have little access to learning opportunities. Most economies focus on unemployment among the young, which underestimates the full extent of their vulnerability. Expanding the focus to NEETs could afford clearer insight into the challenges that young people face and inform policies that contribute to a better future for them and society.

Inclusive, sustainable growth requires policies that improve employment opportunities and outcomes for the working-age population, particularly those groups that risk long-term exclusion and vulnerability. Two qualitative indicators examine the effectiveness and scope of programmes that target **youth employment** and **vulnerable groups employment** in South East Europe. They measure whether programmes are co-ordinated and to what extent they are implemented and monitored.

Table 12.4. **Labour Market Governance Sub-Dimension: Disadvantaged groups indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Youth employment	3.5	3.0	2.0	3.5	3.0	3.0
Vulnerable groups employment	3.5	3.0	1.5	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323529

All national employment strategies in the region emphasise the issue of rising youth unemployment, a social concern which could become even greater in the future. All the SEE economies implement measures to reduce youth unemployment. The only exception is Kosovo where programmes are implemented by donors in an uncoordinated manner – a worrying situation as Kosovo's youth unemployment rate is among the highest in the region.

Youth employment programmes include professional training in Montenegro, compensation for employers who hire young people in Albania and Bosnia and Herzegovina (at entity level), and "first-chance programmes' in Serbia. Similar programmes in Albania and the Former Yugoslav Republic of Macedonia incorporate a monitoring component.

All SEE economies also take measures to promote employment opportunities for vulnerable groups, such as women, the elderly and minorities. (Again, the exception is Kosovo, where programmes are uncoordinated and donor-run.) Measures include schemes for the Roma minority and the disabled and, in some economies, women. Albania's programmes have built in monitoring.

Capacity in public employment services needs to be increased for effective employment policy

The Labour Market Governance Sub-Dimension contains a qualitative indicator that assesses the efficiency and effectiveness of the **public employment services** in SEE. To be specific, it assesses their operational structure and capacity. National employment agencies cater primarily to officially registered jobseekers and people who, though

currently employed, are at risk of involuntary job loss due to their employers' economic difficulties – a situation that is particularly relevant in the current period of recovery from the economic crisis.

Table 12.5. **Labour Market Governance Sub-Dimension: Public employment services indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Public employment services	3.0	2.0	2.0	3.0	4.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323539

Public employment services exist in all economies. In Bosnia and Herzegovina and Kosovo, employment agencies have a formal mandate to implement active labour market policies. In Albania, the Former Yugoslav Republic and Serbia the duties of PES staff are well defined – in other words, their job is to assist people in finding work and they receive regular training to that end. In Montenegro, an independent assessment body monitored the work of the PES against stated policy objectives, which were then readjusted on the basis of findings. Albania and Bosnia and Herzegovina urgently need to increase capacity and make sure that PES staff perform tasks that go beyond merely registering unemployed clients. Albania, Montenegro and Serbia also need to train staff regularly and consider having their employment agencies assessed by an independent auditor in order to improve efficiency and effectiveness.

Studies have shown that employment agency staff in SEE economies spend most of their time registering clients and providing basic information (Tomev and Meinardus, 2012). Their workload is extremely high, which seriously inhibits the effectiveness of employment policies. The staff-to-client ratio in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Kosovo is over 1/600 (i.e. 1 staff member for 600 jobseekers), which is very high by international standards (Tomev and Meinardus, 2012). Montenegro has the lowest ratio with 1/84.

Informal employment calls for action to deter, detect and sanction

Another important issue for labour market governance is employment in the informal sector – i.e. all jobs in informal sector enterprises and anyone who, during a given reference period, was employed in at least one informal enterprise.

> As argued by La Porta and Shleifer (2014), informality is ultimately the result of both demand (i.e. high demand for basic products supplied by informal firms) and supply factors (i.e. poor skills). Many (possibly most) informal firms are fundamentally different from formal ones and they would be unable to compete in the formal economy, even if the costs of formalisation were low. This is why forcing these firms to enter the formal economy may simply drive them out of business. (OECD, 2015)

The OECD recommends three key measures to promote formalisation. Policy makers need to prioritise and tailor them to their specific context before implementing them. Additionally, they should give special attention to any potentially negative effects, such as increased workforce casualisation – the shift from mostly permanent to contract and casual positions (ibid.).

> First, firms and workers need to clearly recognise the benefits of formalisation. Governments should improve the quality of the public services they deliver and strengthen the link between contributions and benefits in social protection schemes. Better public services will increase people's trust in their governments and strengthen their motivation to join the formal sector. The introduction of individual unemployment saving accounts is a good example of how the costs of formalisation can be clearly linked to its benefits, providing incentives to workers to join the formal sector.
>
> […]
>
> Second, the costs of formality should be lowered for employers and the self-employed. Simplified tax and administrative systems, streamlined registration processes and a reduction in red tape are crucial steps in the right direction.
>
> […]
>
> Third, enforcement methods should be improved. Enforcement agencies, such as labour inspectorates, should be given sufficient resources to carry out their work effectively. (ibid.)

The most recent World Bank Enterprise Survey reports that one of the most prominent obstacles to doing business is the informal sector, especially in Kosovo where 58.9% of firms identify the practices of informal competitors as a serious constraint. Drawing on household surveys, the ILO estimates that in the Former Yugoslav Republic of Macedonia and Serbia between 6% and 12% of the workforce is employed in the informal sector.

Two qualitative indicators assess the informal sector policy. One examines the effectiveness and scope of programmes to reduce **informal employment**, while the second assesses the capacity of **labour inspectorates** in the SEE region (Table 12.6). They suggest that, given the large estimated share of informal employment and its negative effects on formal business, SEE economies do not sufficiently address informal employment.

Table 12.6. **Labour Market Governance Sub-Dimension: Informal employment indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Informal employment	2.0	1.5	1.5	2.5	2.5	2.0
Labour inspectorate	3.0	3.0	2.0	3.0	1.5	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323546

In Bosnia and Herzegovina, Republika Srpska runs a number of programmes with strengthened labour inspectorates to curb informal employment, while the Federation of Bosnia and Herzegovina lacks a coherent approach – as does Kosovo. As for Albania and Serbia, they address informal employment through their SME policies, but do not fully implement measures.

The large numbers of people employed in the informal sector compel the SEE economies to take urgent action. They should start by understanding the costs and benefits of informal employment. Where people have chosen to leave the formal sector, they need incentive to return.

Governments could propose incentives like indexing benefits to social contribution levels or simplifying administrative procedures for businesses and workers. Enforcement measures should also be strengthened. However, not all informal workers opt out of the formal economy voluntarily. Some have no choice. It is important that policies address their needs using an adapted approach (OECD, 2009).

Build the capacity of labour inspectorates

Another line of action is to strengthen labour inspectorates. A well-functioning labour inspectorate is required to effectively ensure compliance with the law. It is an essential part of labour regulation. Labour inspection is certainly as complex an activity as labour standards are broad, often incorporated in legal instruments and raising numerous issues. Inspection is also labour intensive and, without being costly, does need resources and well-trained inspectors to function optimally.

Labour inspectorates exist in all SEE economies. Their tasks include providing education and information on the requirements of legislation, preventing violations of labour standards by offering advice and sanctioning offences. Montenegro scores lowest because it has no specialised labour courts and inspections chiefly target a selected set of businesses. All the SEE economies, with the exception of Kosovo, operate labour inspection databases and have workplaces inspected regularly. Labour legislation, offences and penalties are clearly defined and have been made easily accessible to employers.

The SEE governments should ensure that labour inspectors are independently monitored and that inspectorates should adjust their practices according to findings. Inspectorates should be adequately staffed, too, to meet the ILO recommendations on labour inspections in transition countries – 1 inspection for every 2 000 employees. Inspectors' wages have been brought into line with those possessing similar qualifications in other sectors, though appeal procedures still need to be streamlined.

Box 12.2. **Incentives to employ and register the unemployed in the fight against informal employment: good practice from Croatia**

In Croatia, employers are awarded grants to employ people from groups threatened by unemployment and at risk of slipping into undeclared work. Grants, for example, enable employers to give young people without relevant experience or education a chance to gain work experience or relevant training, so improving their employability.

Boosting employment is a key goal of the Croatian government. Data from Eurostat show that, in 2011, the youth unemployment rate in Croatia was 35.8%, one of the highest in Europe. In the third quarter of 2011, the long-term unemployed in the country accounted for more than half of unemployed young people. The consequences are low productivity levels, poverty and social exclusion (Bejaković, 2010). Young people with no work experience or relevant education have particularly low levels of employability and highly exposed to unemployment (Bejaković, 2010). For those reasons, the government has created incentives to employ young people and other at-risk groups.

The overriding objective of the incentive scheme is to increase employment in certain social groups. However, it also indirectly facilitates the legalisation of people of working in the informal sector.

Box 12.2. **Incentives to employ and register the unemployed in the fight against informal employment: good practice from Croatia** (*continued*)

Incentives are designed to employ and register the over 50s, the young with no work experience, the long-term unemployed and people with disabilities. Hiring people from those groups earns employers grants which they can use to strengthen their business. Incentives are also available for the unemployed who wish to be self-employed. Grants in the craft industry are worth EUR 2 500, while for merchants they are EUR 3 250. The hospitality and trade industries are excluded, however, because both are already well developed in Croatia.

In the period from 1 January to 31 March 2009, the incentive scheme supported the employment of 1 003 young people with no work experience, 460 of whom were women (Bejaković, 2010).

The contractual duration of employment is 12 months, so it is unknown whether employers retain the employees they hire under the scheme. However, in Croatia, young people participate in many other active labour market measures such as upskilling, requalification, education and public works, so becoming more employable (Bejaković, 2010). In 2009, a total of 3 025 people took part in training schemes (Bejaković, 2010).

The incentive scheme is obviously transferable between demographic groups. However, the fact that a number of other countries have adopted such policies suggests that it has much wider transferability potential.

Source: Bejaković (2010), *Croatia, EEO Review: Youth Employment Measures*, www.ec.europa.eu/social/BlobServlet?docId=12330&langId=en.

Employment protection legislation

Employment protection legislation (EPL) is designed to increase job security by providing workers with safeguards against risks like the loss of earnings and the obsolescence of their job-specific skills and experience (Box 12.3). However, EPL can sometimes constrain firms so much that it discourages job creation and the reallocation of resources. Striking the right balance between employee protection and the efficient allocation of labour is a priority for policy makers. EPL is a valuable policy instrument in that respect. From both a research and policy perspective, it is important to accurately measure EPL in order to determine its labour market impacts, identify best practices and assess the progress of reform (OECD, 2013a). Two indicators, **EPL for regular contracts** and **EPL for fixed-term contracts** look at the latest EPL estimates for SEE economies.

Table 12.7. **Labour Market Governance Sub-Dimension: Employment Protection Legislation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB	HRV
Employment protection legislation for regular contracts	2.5	2.6	2.0	2.3	2.9	2.2	2.3
Employment protection legislation for fixed-term contracts	3.3	2.3	0.3	3.3	2.0	3.5	2.9

Note: OECD analysis based on methodology from the Directorate for Employment, Labour and Social Affairs and 21 items reported in the database.

Source: OECD (2015c), *OECD Indicators of Employment Protection* (database), www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm.

StatLink http://dx.doi.org/10.1787/888933323554

On average, workers on permanent contracts enjoy greater protection against individual and collective dismissals in Albania, Bosnia and Herzegovina and Montenegro than in OECD countries. In the Former Yugoslav Republic of Macedonia and Croatia, EPL affords much the same safeguards as in the OECD area. When it comes to 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.

Box 12.3. **OECD indicators of the strictness of employment protection legislation**

The OECD employment protection legislation indicators quantify employer costs and procedures of individual or collective dismissals or hiring workers on fixed-term or temporary-work-agency contracts in force on 1 January of each year. By contrast, the indicators may not always capture how effectively legislation protects workers. Care should therefore be taken when using the indicators for purposes other than measuring legislation-induced costs for employers making staff changes. The indicators' focus on costs to the employer reflects the dominant approach taken in the empirical and theoretical literature that examines the labour market impact of employment protection.

Two summary indicators of EPL are key to policy analysis. One concerns regulations governing individual and collective dismissals of workers with regular, open-ended contracts (EPRC) and the other the regulation of temporary contracts (EPT). The two indicators are made up of four sub-indicators quantifying different aspects of employment protection which are, in turn, broken down into 21 components. The 4 sub-indicators are:

- Regulation of individual dismissal of workers with regular contracts (EPR)

  Incorporates three aspects of dismissal protection: the procedure-related inconvenience to employers of starting a dismissal process (e.g. notification and consultation requirements), periods of notice and severance pay which typically vary by employee tenure, and the difficulty of dismissal in some circumstances and the consequences for the employer if a dismissal is found to be unfair (such as compensation and reinstatement).

- Additional restrictions on collective dismissals (EPC)

  Includes only additional costs which go beyond those applicable for individual dismissals. It does not reflect the overall strictness of regulations governing collective dismissals, which is the sum of the costs of individual dismissals and any additional cost of collective dismissals.

- Regulation of standard fixed-term contracts (EPFTC)

  Quantifies the regulations that govern the hiring of workers on fixed-term contracts. It concerns the types of work for which EPFTC contracts are allowed, their renewal and cumulative duration.

- Regulation of temporary work agency employment (EPTWA)

  Quantifies the regulations governing "temp" agency employment, the types of jobs for which EPTWA contracts are allowed, and the renewal and cumulative duration of assignments at the user firm. This measure also includes some of the regulations governing the establishment and operation of temporary work agencies. Accordingly, it covers the requirement that agency workers should enjoy the same pay and/or working conditions as equivalent workers in the user firm, which may make it more costly to use temp agency workers than to hire workers on other types of contracts.

Source: OECD (2013a), *OECD Employment Outlook 2013*, http://dx.doi.org/10.1787/empl_outlook-2013-en.

Social Economy Sub-Dimension

The definition of the concept of "social economy" varies between, and even within, countries. The OECD suggests that "what is critical about the idea of the social economy is that it seeks to capture both the social element as well as the economic element, inherent in those organisations which inhabit the space between the market and the state" (Noya and Clarence, 2007). A more specific definition is required, however, for the purposes of collecting data.

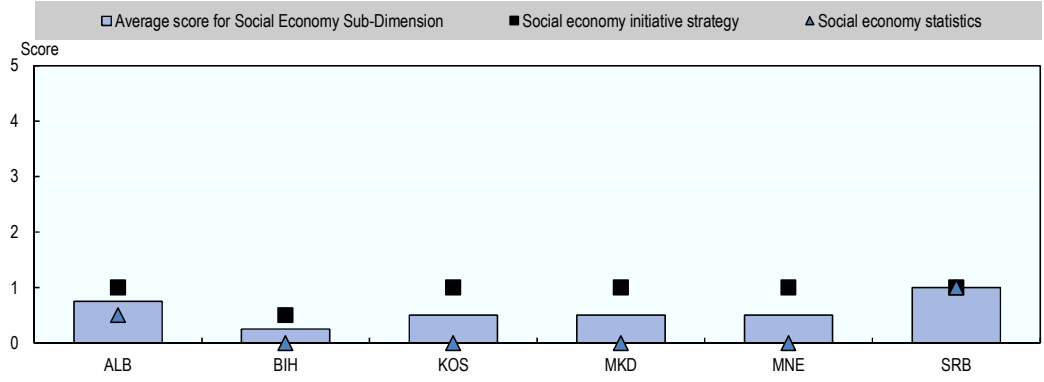
The European Union acknowledges the role of the social economy in addressing unemployment in a sustainable manner and fostering social inclusion. Recent data show that it engages 6.5% of the total working population in the EU and that employment rates in the sector have been steadily rising (EC, 2013b).

The social economy could contribute significantly to greater employment and better provision of social and health services in South East Europe. It also has the potential to generate social innovation in many different sectors. For the time being, however, the social economy is in the very earliest stages of its development (Figure 12.8). The Social Economy Sub-Dimension assesses policy measures, if any, to promote the social economy.

SEE efforts to support social enterprises are still nascent

The SEE economies' average score in the Social Economy Sub-Dimension is 0.6, which suggests that policy to promote the social economy is still at a very basic level.

Figure 12.11. **Social Economy: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322460

The region addresses the social economy, which chiefly comprises social businesses, through social policy and in strategies to promote entrepreneurship and the business development of SMEs. However, such measures are individual and not part of any strategic approach specifically to promote the social economy. The SEE economies have drawn up no legislative framework for social businesses and conduct little formal data collection.

The **social economy initiative strategy** indicator assesses strategic approaches and efforts to support social economy initiatives (SEI). The **social economy statistics** indicator measures baseline statistics collection, an important requirement for institutional

support. More specifically, the indicator assesses the legislative basis for systematic data collection, allocated funds, collection mechanisms, and the distribution and publication of data.

Table 12.8. **Social Economy Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Social economy initiative strategy	1.0	0.5	1.0	1.0	1.0	1.0
Social economy statistics	0.5	0.0	0.0	0.0	0.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323566

With the exception of Serbia, and to some extent Albania, where sporadic statistics on the development of the social economy are made available from a variety of uncoordinated public sources, there are no baseline statistics on the social economy. Nor do there seem to be any plans to collect them in the future. Yet comprehensive, accurate, regularly updated statistics ensure that policy making is evidence-driven and would help to develop the social economy to its full potential. The kind of data that should be collected would include, for example the sector's contribution to employment, the number of businesses, exports and gross value added.

As for strategic approaches to promoting social economy initiatives, the indicator reveals that there are none. All SEE economies need to develop the legal, regulatory and financial framework required to foster the growth of social businesses and entrepreneurship. Such frameworks of support measures should be tailored to the individual needs of each economy. They should also, however:

- Introduce the 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.
- Include tax exemptions or privileges and subsidies.
- Set out stable, predictable funding mechanisms ideally modelled on a grant scheme.

Conclusions

The SEE economies generally show progress in action to improve their employment policy. Most of them have made efforts to design comprehensive employment strategies that address structural unemployment, particularly youth unemployment. They have also taken steps to make their labour markets more flexible.

Despite their achievements, however, the SEE economies share certain weaknesses and their performance falls short of the EU's. They still face a number of challenges. Structural unemployment, especially high youth and long-term unemployment, is a serious issue across the region and has risen in recent years. Public employment services lack the capacity and infrastructure to provide quality support. Staff have to cope with very high workloads, which inhibits effective employment policies and their implementation.

Informal employment is very widespread across the region and few measures to gradually shift informal firms and workers into the formal sector are in place. The lack of reliable labour market statistics is an additional challenge for policy makers.

Rising to those challenges would increase living standards in the region, boost productivity and growth, and foster more inclusive, cohesive societies.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 13.

Health policy in South East Europe

Health policy aims to improve the state of physical, mental and social well-being of a person. Four sub-dimensions analyse the Health Policy Dimension. The Universal Health Coverage Sub-Dimension examines whether universal, high-quality health systems have been adopted and the extent to which they address services at all levels of care and health in low-income and vulnerable groups. The Health Governance and Resources Sub-Dimension assesses intergovernmental mechanisms for co-ordinated policy action and health intelligence systems. The Health Promotion and Disease Prevention Sub-Dimension evaluates health literacy and empowerment initiatives and instruments for curbing tobacco and alcohol consumption. The Regional Co-operation Sub-Dimension describes cross-border harmonisation activities.

Main findings

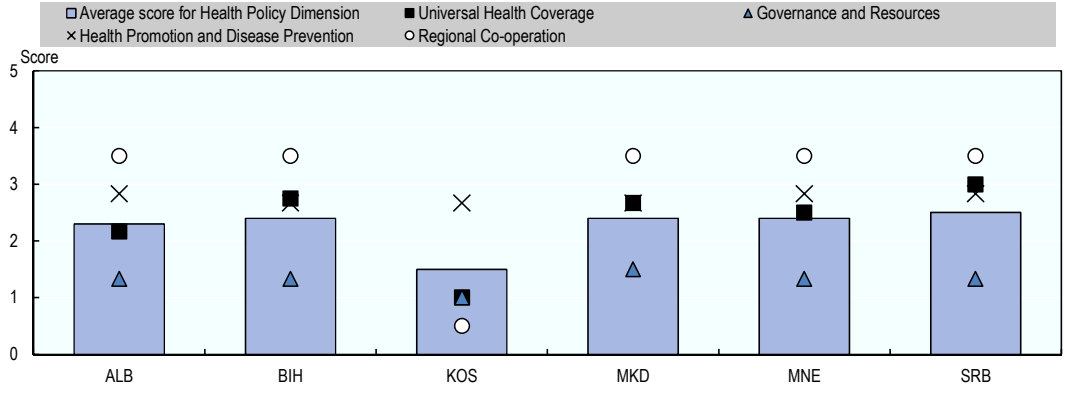
Good health is a state of physical, mental and social well-being. It increases people's opportunities to participate in fair, secure employment and lifelong learning. And it strengthens their social and economic protection. It also gives them the chance to play a fuller part in the civil and cultural life. Such rights and opportunities underpin and extend the dividends that flow from better health, including greater labour productivity, demographic change and higher educational attainment. Conversely, poor health undermines growth, as it places an economic burden on individuals, companies and governments. Because health is a key measure of economic and social development, governments invest in comprehensive policies that include national health strategies, plans, governance instruments and systems.

Health in the economies of South East Europe (SEE) has improved. Yet, social and economic inequalities in health persist, as they do in access to and affordability of healthcare. Preventable, non-communicable diseases (NCDs) remain a significant burden, as lower socio-economic groups suffer from them disproportionately and have less access to healthcare.

While health system responses in the SEE economies have been positive, they have also been partial. SEE policy makers have acknowledged the importance of healthy populations for social cohesion and economic development, and governments across the region have increasingly taken steps to strengthen healthcare. Indeed, many economies have established basic operational healthcare systems. This report, however, suggests that policies are not inclusive or effective enough in their approaches to creating better living and working conditions and, at the same time, promoting health and intervening early to prevent and treat disease.

Five SEE economies score above 2, which signifies that policies and operational health systems are in place (Figure 13.1). However, it also denotes the need to strengthen implementation and to engage in monitoring and readjustment practices. The exception is Kosovo, where policies and a health system are not yet fully in place.

Figure 13.1. **Health Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Of the four sub-dimensions assessed in this dimension, the SEE economies perform relatively well – with scores between 3 and 4 – in the Regional Co-operation Sub-Dimension thanks to their collaboration within the South-Eastern Europe Health Network (SEEHN), of which all, save Kosovo, are members. As for the Universal Health Coverage Sub-Dimension and Health Promotion and Disease Prevention Sub-Dimension, the scores are between 2 and 3 which suggests efforts have been made to establish policy frameworks but that implementation is partial. Finally, the SEE economies score lowest in the Governance and Resources Sub-Dimension, indicating that there are shortfalls in policies to strengthen accountability for health and equity as whole-of-government goals and that healthcare funding is inadequate.

Strengthening health systems, improving health and reducing health inequalities are strategies for increasing economic coherence across SEE. SEE economies need to focus on delivering value and investing in health promotion, disease prevention and the extension of preventive screening, treatment and rehabilitation, through integrated health services and programmes delivered close to communities, as well as through the concentration of services in fewer, specialised centres. They need to produce policy responses and strengthen governance instruments so that they ensure the coherence of health and welfare policies.

Achievements

The SEE economies have seen recent improvements in health and well-being.

SEE economies have acknowledged health as a human right and recognised the importance of healthy populations for social cohesion and economic development. Accordingly, health and healthcare have attracted increasing government attention across the region. The SEE economies have committed to universal health coverage and built basic operational healthcare systems. Government healthcare financing schemes have been set up in all SEE economies, with the exception of Kosovo. The schemes aim to ensure access to basic general healthcare and provide financial risk protection against unexpected or serious illness, with some targeting of low-income and vulnerable population groups.

SEE economies have strengthened institutional arrangements to implement joint actions for health across the government. The determinants of health stretch across all sectors of society. Therefore, comprehensive and co-ordinated multi-sectoral action is required to achieve improvements in health and well-being. This can be done through whole-of-society, whole-of-government and health-in-all-policies approaches. Instruments that promote and enable joint action across sectors have been shown to increase the impact of government investments in enabling healthier lifestyles and reducing health inequities.

SEE economies have begun to form multi-stakeholder coalitions for health and well-being. These coalitions often consist of public, private and non-governmental stakeholders and operate on local and national levels, with the aim of improving the coherence of resources mobilised to improve health and well-being at national and local levels. These multi-stakeholder alliances can also contribute to improved transparency of government decision making and support the advancement of health as a public good and economic resource.

SEE economies implement fiscal, legal and marketing instruments targeting tobacco and alcohol use reduction. SEE economies have engaged in health promotion by implementing recent health literacy campaigns, with a partial focus on NCDs. In each

economy a designated body or department is in charge of health promotion. Clinical guidelines for health providers exist in all SEE economies except Kosovo. They revolve around integrated community-based health promotion interventions.

SEE economies operate health intelligence systems. Strengthening the health intelligence infrastructure is critical for anticipating and responding to opportunities and threats to health, as well as improving policy decision making. Openly accessible health intelligence can also increase the efficiency and accountability of investments for health at the national and local levels. These systems generally provide data on public health statistics, health determinants and health services. Strengthening the health intelligence infrastructure is critical for improved policy decision making and can increase the efficiency and accountability of investments for health at the national and local levels. Stronger intelligence openly accessible and directly linked to policy processes is important for anticipating and responding to opportunities and threats to health.

SEE economies support regional health co-operation through SEEHN. Within the framework of the SEEHN, SEE economies have made a political commitment to extending regional co-operation and enhancing partnerships towards achieving equity and accountability in health, implementing high-quality universal, individual and population-based services to resolve the major health challenges of the SEE economies and raise levels of health and well-being across the region.

Challenges

Recent health improvements have not been to everyone's benefit. SEE economies do not have the policies or incentives to ensure more integrated community-based interventions that would improve inclusive health and well-being.

Demographic changes pose challenges for health systems. These changes such as internal and cross-border migration, ageing populations, and healthcare worker migration demand tailored policy responses. SEE economies struggle to further deliver universal health coverage based on comprehensive primary care services and supported by effective secondary and tertiary care services of good quality. The burden of NCDs is the predominant health challenge, and health promotion and disease prevention strategies are needed to reduce exposure to modifiable behavioural determinants, i.e. smoking, alcohol consumption, poor diet and sedentary lifestyles. Communicable diseases also remain an important issue and effective policy responses need to be integrated into global mechanisms such as the International Health Regulations (IHRs) and the Global Outbreak Alert and Response Network.

Initiatives that promote health are limited. Not only do such initiatives empower people, they also increase health literacy and address the major risk factors and determinants of health. These approaches are essential to addressing the human right to health, as well as reducing the loss of human capital in the working-age population. In response to today's predominant burden of NCDs, there is necessarily growing emphasis on focusing on health promotion and disease prevention. Evidence is also accumulating on the cost effectiveness of such preventive approaches.

Information on health system activities, costs and outcomes matched to needs – ideally at the individual level – are not widely available. Health intelligence systems in the SEE economies lack important features that would improve the efficiency and accountability of investment for health at the national and local levels. These features include the availability of disaggregated data online and interoperability between the

different software platforms being developed by institutions which collect and process health-related information. Stronger intelligence that is openly accessible and directly linked to the policy process is important for anticipating and responding to opportunities and threats to health.

Fiscal, legal and marketing mechanisms that deter tobacco and alcohol consumption are not systematically implemented and enforced. Measures to improve diet and curb the consumption of harmful food products need further development in the SEE economies. Such mechanisms seek to improve the overall health of the population at large and to reduce disparities through special attention paid to those with less education and fewer resources.

Specific strategies for providing free and accessible disease prevention and screening services are not fully developed. Such services can have a significant impact on the health and well-being of a population through preventive approaches and early detection. They support a healthier working-age population and lower healthcare costs in the long term.

Clinical guidelines rarely address vulnerable groups and are seldom systematically updated. Directing policy attention towards preventive determinants of health across sectors has dual benefits: reducing avoidable losses to health and contributing to social inclusion, poverty reduction and inclusive growth.

Health equity impact assessments are scarce. Despite the benefits these powerful tools bring, gaps in disaggregated data and a lack expertise in equity analysis and monitoring hinder their use.

Recommendations

In response to the challenges identified above, a number of strategic steps are needed if equitable improvements in health and well-being in SEE are to be achieved.

Improve holistic health governance. Such governance should reflect whole-of-government and whole-of-society responsibility and accountability for health. It will require structural mechanisms to support the multi-sectoral responsibility and involvement needed. The highest level of political commitment is essential. In particular, an approach that improves the relationship between employment and health is needed. It should include stronger systems and capacities for policy coherence in which the education, labour and development sectors collaborate. Moreover, there must be stronger public health capacities, health promotion and disease prevention.

Develop effective national health policies (NHPs). A frame of reference is provided by Health 2020, the WHO European regional health policy framework. An NHP is based on a comprehensive needs assessment and comprises policies and strategies for promoting health and well-being that are part of universal health coverage. It addresses all the determinants of health, improved multi-sectoral governance and a strengthened effective and integrated health system. Based on a fully participative process of development, an NHP must have detailed national health policy development, a strategic plan for implementation and an operational plan and budget. Also needed is the alignment of strategies in sub-sectors like maternal, paediatric and mental health.

Strengthen national health system management and organisation to achieve effective universal health coverage. Health system access and sustainability is a challenge for SEE governments, given rising costs and demand for health services, with

implications for fiscal and macroeconomic stability. There are weaknesses in the contribution and payment models across the SEE economies, namely with respect to compliance, fairness, efficiency and cost-effectiveness incentives. In other cases, co-ordination between different actors, facilities, health insurance funds and ministries of health is not strong and financing decisions are not transparent.

Further develop free, accessible disease prevention and screening services. Healthcare institutions should provide free, accessible prevention and screening services. They would have a significant impact on the health and well-being of the general population through early detection, thereby supporting a healthier working-age population and lower healthcare costs in the long term.

Fiscal policies, legal frameworks and marketing controls are required to decrease the adverse health effects of modifiable behavioural determinants. They include reducing the demand for and consumption of foods high in saturated fats, trans fats, salt and sugar and they should be based on international best practices and lessons learnt.

Strengthen health service delivery in primary healthcare facilities and hospitals. In service delivery, the development and implementation of healthcare guidelines and protocols are needed, alongside other quality and patient safety interventions and practices.

Strengthen health intelligence systems. Strengthening the health intelligence infrastructure is critical for improved policy decision making and can increase the efficiency and accountability of investment for health at the national and local levels. The ability to collect and analyse disaggregated health data is particularly important. Whenever possible, health-related information should be made publicly available online.

Introduce health equity impact assessments (HEIAs) to help determine how policies, programmes or initiatives affect health and the determinants of health of various population groups and to better define policy measures across sectors that will deliver equity results.

Overview

Good health can be defined as the state of physical, mental and social well-being of a person. It is linked to economic growth through higher labour productivity, demographic changes and higher educational attainment. Cross-country studies using worldwide samples denote that a one year increase in life expectancy corresponds to 4% GDP growth (Suhrcke, Rocco and McKee, 2007). Health investment reduces the time out of employment, increases productivity, supports labour market development and sustainability and encourages inward investment.

Health improvement in SEE is strongly influenced by the macroeconomic context. On average, the SEE economies still lag considerably behind the developed European economies. The reform processes are hampered by the small size of the economies, limited institutional capacities and a lack of human and financial resources. Living conditions for a large proportion of the population remain unsatisfactory. In this context investments in health can deliver dividends in terms of improved economic performance and human capital. Sustainable and universal health systems, improved quality and access to primary and community health services and strong public health policies, which promote health and prevent disease, contribute to improving health and well-being in society. They also help the benefits of higher living standards to be more equally

distributed. Actions to reduce inequalities in health and access to the health sector drive economic growth and sustainability, as well as innovation, research and development in healthcare. Achieving these ends requires improved governance for health through whole-of-government and whole-of-society approaches. Policies should focus on reducing health gaps within the context of the human right to health and the promotion of universal health coverage, meeting targets for inclusion in social and economic life.

A flourishing health sector represents an important component of national economies, contributing to employment, procurement, human resource development, inward investment and SMEs. The healthcare sector in SEE is one of the largest sectors, as in the EU, and makes a significant financial contribution to national and regional economies. One European study (Coote, 2002) shows that the regional health and social care system has an estimated value of approximately EUR 11.4 billion, 10.0% of the total regional GDP of EUR 88 billion, accounting for 12.0% of regional employment, or one in ten workers. The health sector workforce has a higher than average proportion of workers with tertiary-level education. Furthermore, it is a major driver of research and innovation: health-related research and development has the potential to reach 0.3% of GDP, driven by innovation and the highly qualified workforce.

The considerable economic impact of health can contribute to new market development and the growth of SMEs in areas such as new product development. It can also increase mobility like cycling and walking and foster sustainable tourism and energy saving products, including energy efficient public buildings, such as hospitals and kindergartens. Such developments build on local assets for development (i.e. people, knowledge and physical resources like land and buildings) and contribute to inclusive growth programmes, particularly employment creation, human capital development and service innovations. One output here could be a baseline analysis of areas with high potential for improving health and which could be entry points for new market development.

Box 13.1. **Health Policy Dimension in the SEE 2020 Strategy**

The Health Dimension is part of the Inclusive Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Inclusive Growth Pillar is to enhance employment through skills development, employment creation and labour market participation by all, including vulnerable groups and minorities. Good health is an important prerequisite for participation in the labour market. The key headline target of the inclusive growth pillar is an increase in the overall employment rate from 39.5% to 44.4% for the region as a whole by 2020. Insofar as good health increases the probability of being employed – healthy people have a 2.9% greater chance of joining the labour force than their unhealthy peers (Pinzon Fonseca, 2011) – sound health policies can contribute to the SEE 2020 headline target of boosting the overall employment.

The WHO's European Office for Investment for Health and Development is the official SEE 2020 Strategy Co-ordinator for the Health Policy Dimension. The office seeks to provide an evidence-based, systematic and accountable approach to the full integration of the social and economic determinants of health into the development strategies of countries in the WHO European region.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE 2020-Strategy.pdf.

Analysis of health policy in SEE reveals significant links with other policy areas, particularly:

- **Chapter 12. Employment policy** is closely intertwined with health policy. The health and resilience of the working age population is an important element of social and economic life. Workers' health and resilience affects participation in employment, as well as labour market productivity and inward investment. Good health enhances workers' productivity by increasing their physical capacities, such as strength and endurance, as well as their mental capacities, such as cognitive functioning and reasoning ability (Bloom and Canning, 2005). Many studies in recent years on different types of labour and social policies have shown positive effects on the gradient in work-related stress and its longer term consequences. Furthermore, the costs associated with preventable forms of ill health are a priority for all countries in the region. Sick leave is a costly burden for employers: a recent PwC study revealed that sick leave costs United Kingdom employers around EUR 40 billion annually (PwC, 2013). Conversely, where the level of health in families and communities is poor, labour market supply and productivity suffers and participation in society is reduced (Brown et al., 2013).

Health Policy Dimension assessment framework

This chapter proposes an analysis of health in SEE. It does not seek to be exhaustive but considers four broad sub-dimensions based on the Inclusive Growth Pillar of the SEE 2020 Strategy:

- Universal Health Coverage

  Have universal, high-quality health systems been adopted? Do they promote services at all levels of care? Do they focus on improving health in low-income and vulnerable groups?

- Health Governance and Resources

  How much progress has been made in strengthening policies through a whole of government approach to health? To what extent have the economies institutionalised transparency, accountability and equity?

- Health Promotion and Disease Prevention

  Have the SEE economies increased the share of population-based public health and prevention measures in all health sector and government activities? If so, to what extent?

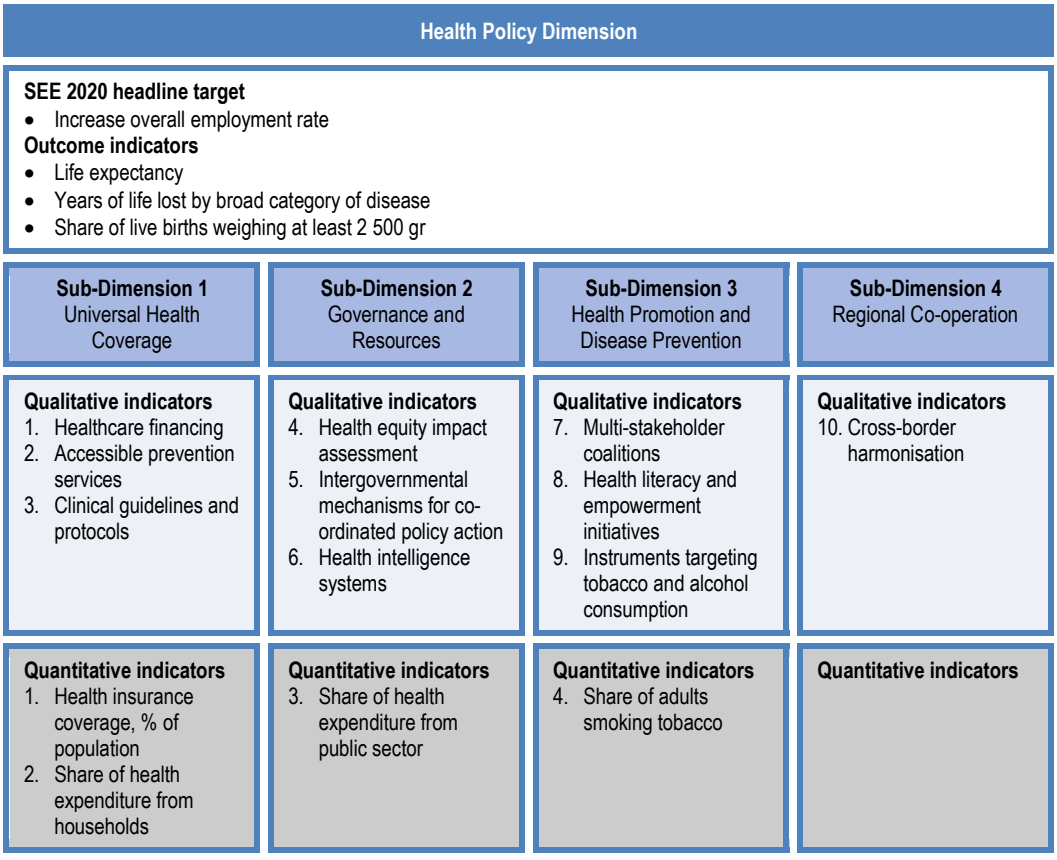
- Regional Co-operation

  To what extent do SEE economies co-operate on health policies and issues?

Figure 13.2 shows how the sub-dimensions and their constituent indicators make up the Health Policy Dimension assessment framework.

Each sub-dimension is assessed through quantitative and qualitative indicators. Collection of the qualitative and quantitative data for the Health Policy Dimension was co-ordinated by the WHO's European Office for Investment for Health and Development in co-operation with the SEEHN and OECD support. Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Figure 13.2. **Health Policy Dimension assessment framework**



Health performance in SEE economies

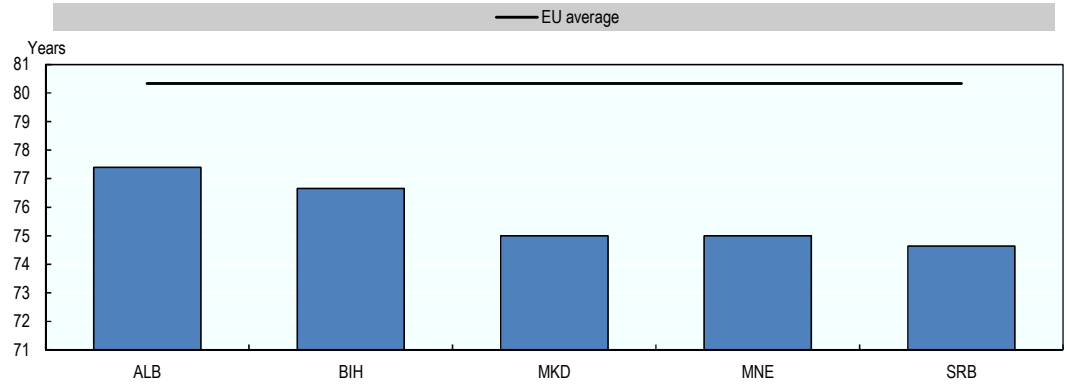
Life expectancy is the most widely used measure of health (OECD, 2015) because it summarises health risks, occurrence and severity of diseases, effectiveness of treatments and interventions. On average, life expectancy at birth reaches around 75 years in SEE (see Figure 13.3). This remains five years below the EU average, indicating that the health status of SEE economies still lags significantly behind that of the EU, although the gap has narrowed slightly from six and a half years in 2002 (CEB/WHO Regional Office for Europe, 2006). The highest life expectancy in SEE economies can be observed in Albania and Bosnia and Herzegovina, with the Former Yugoslav Republic of Macedonia, Montenegro and Serbia trailing at 75 years or just under. Women in SEE live about five years longer than men, which is a trend similar to that in OECD and EU countries.

Today, the burden of NCDs represents the predominant health challenge. Figure 13.4 shows the distribution of years of life lost by broad category of disease in a number of SEE economies.

The determinants of this current burden of NCDs stretch across society. Recent focus has been on the social and behavioural determinants of NCDs and developing responses (WHO Regional Office for Europe, 2013b). The rates of exposure to risks and the consequences of NCDs are all higher in those experiencing social and economic exclusion.

Figure 13.3. **Life expectancy at birth, 2011**

In years



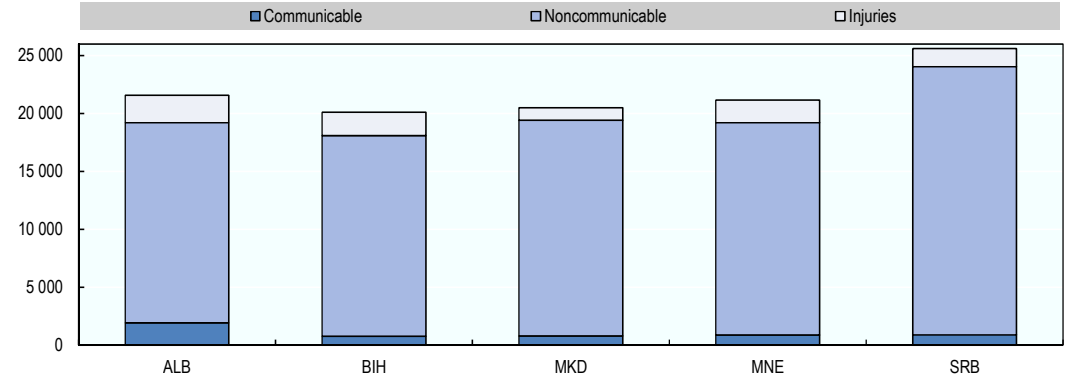
Note: Data for Kosovo not available.

Source: Albanian Ministry of Health; WHO Regional Office for Europe (2015a), *European Health for All Database* (database), www.euro.who.int/en/data-and-evidence/databases/european-health-for-all-database-hfa-db/national-health-indicator-databases; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Figure 13.4. **Years of life lost by broad category of disease, 2012**

Number of cases of premature mortality per 100 000 people



Note: Data for Kosovo not available.

Source: Adapted from WHO (2015a), *World Health Statistics 2015*, http://apps.who.int/iris/bitstream/10665/170250/1/9789240694439_eng.pdf?ua=1&ua=1.

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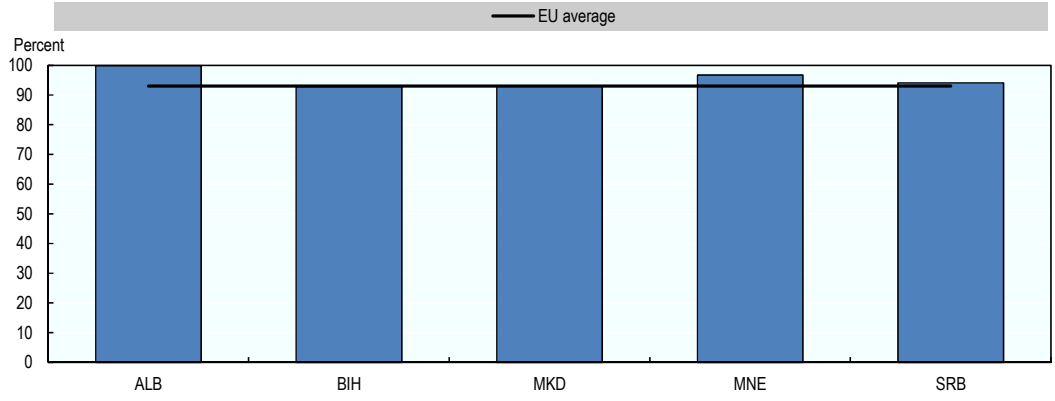
Health promoting interventions, which empower local people, increase health literacy and address the major risk factors and the determinants of health, are essential to reducing the loss of human capital in the working-age population across the whole spectrum of health promotion, disease prevention, diagnosis and therapy and rehabilitation. In response to today's predominant burden of NCDs there is increasing emphasis on measures such as health promotion and disease prevention. Evidence is also accumulating about the cost effectiveness of these preventive approaches (Merkur, Sassi and McDaid, 2013).

There is a growing recognition of the importance of early childhood experience in terms of health and well-being throughout life. Data on low birth weight is an important indicator of infant health due to the close relationship between birth weight, infant mortality and health issues during life (Figure 13.5). Infants with low weights at birth have a greater risk of poor health or death, require longer periods of hospitalisation after birth and are more likely to develop significant disabilities later in life. There have been positive results in terms of birth weight in SEE. Indeed, all SEE economies display higher average birth weights than the EU average.

Data on premature mortality rates from the major NCDs emphasise that these remain a highly significant public health priority in SEE economies and that integrated health promotion and prevention programmes should be strengthened in this area. Premature mortality rates linked to diseases of the circulatory system, for example, remain more than twice as high as in the EU in several SEE economies; premature mortality rates for diabetes remain three to four times as high (WHO, 2015a).

Figure 13.5. **Live births weighing 2 500g or more, 2011**

Percent of live births



Note: Data for Kosovo not available.

Source: WHO Regional Office for Europe (2015a), *European Health for All Database* (database), www.euro.who.int/en/data-and-evidence/databases/european-health-for-all-database-hfa-db/national-health-indicator-databases.

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Universal Health Coverage Sub-Dimension

This section looks at the Universal Health Coverage Sub-Dimension. It assess whether, and to what extent, the SEE economies ensure access to comprehensive, people-centred and integrated health services of good quality for the whole population, without an unmanageable financial burden falling on individuals or families. Such services should focus particularly on the needs of low-income and vulnerable groups, as exposure to risks and the consequences of NCDs is greater for those experiencing social and economic exclusion.

Universal health coverage has a direct impact on the population's health status. Access to health services enables people to be more productive and actively contribute to their communities. At the same time, financial risk protection against unexpected or serious illness prevents people from being pushed into poverty when they have to pay for

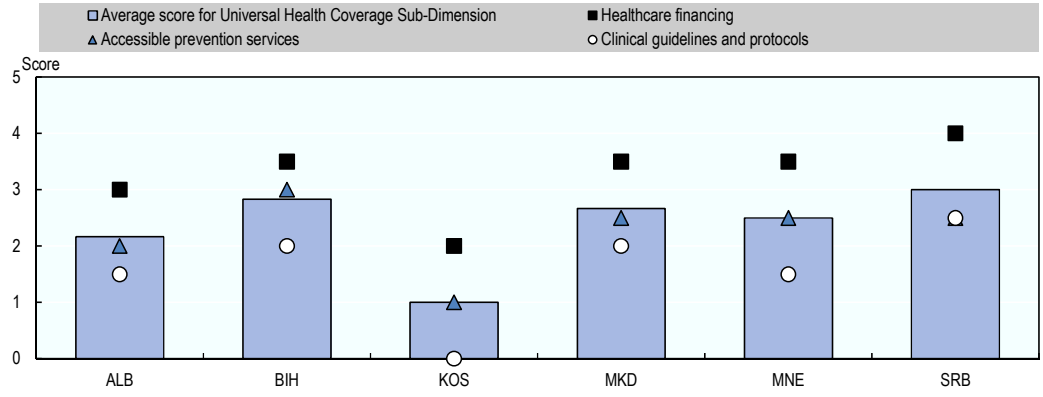
health services out of their own pockets. Universal health coverage is thus a critical component of sustainable development and poverty reduction and a key element of any effort to reduce social inequities in health (Evans and Etienne 2010).

Directing policy attention towards preventable determinants of health across sectors has dual benefits: 1) reducing avoidable losses to health and 2) contributing to social inclusion, poverty reduction and inclusive growth (European Commission, 2015; WHO Regional Office for Europe, 2013a).

All SEE economies, save Kosovo, have operational government health care financing schemes

The **healthcare financing** indicator analyses the development level of healthcare financing schemes. Operational government healthcare financing schemes exist in all SEE economies, with the exception of Kosovo.[2] In Kosovo, the legislative framework for public health insurance has been established, though the scheme is not yet operational. Formal coverage rates vary from 70% in Albania to around 90% in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia, compared to 100% in most OECD economies. All schemes include mechanisms to pool funds and systems of distribution to practitioners are in place. The scheme in Serbia stands out through its focus on supporting vulnerable groups of the population, including children, the unemployed, pregnant women, psychiatric patients, tuberculosis patients and cancer patients.

Figure 13.6. **Universal Health Coverage: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Despite the formal coverage rates, private households' out-of-pocket payments on health as a percentage of total health expenditure remain between twice and three times as high as in the EU, limiting protection from catastrophic expenditures. In Albania, for example, private households' out-of-pocket payments on health represented 52% of total health expenditure in 2012, compared to 16.3% in the EU in 2011. Such high levels of out-of-pocket payments limit financial risk protection and may lead to impoverishment. High out-of-pocket payments are also linked with low salaries for health professionals in SEE, which lead to professional dissatisfaction, poor staff morale, the outflow of health professionals and the request for informal out-of-pocket payments from patients (CEB/WHO Regional Office for Europe, 2006).

The financial crisis and austerity have further highlighted the need to improve the cost-effectiveness and impact of health systems. Delays in seeking healthcare due to additional costs of medicine and treatment, coupled with higher levels of stress and mental health problems associated with the financial crisis and austerity, are producing risk-taking behaviours, which are having a direct impact on the resilience and capacities of individuals and families. This increases the risks of social vulnerability and exclusion across the population and may lower levels of participation in active labour market programmes.

Key options for safeguarding further shortfalls in health and human capital include targeting public expenditures more tightly on the poor and vulnerable. This is through a mix of policies that address health and inclusion gaps, protect access to services by focusing on supply-side efficiency gains – for example, through wiser use of medicines and technologies – rationalise service delivery structures and strengthen transparency and accountability.

SEE economies have not developed specific strategies for providing free and accessible screening and prevention services

The **accessible prevention services** indicator measures the existence of a government strategy to develop regulation and incentives encouraging providers to offer free and accessible prevention and screening services, which can have a significant impact on the health and well-being of a population through early interventions and earlier disease detection. The SEE economies have not yet systematically developed such policies, although these measures may have been incorporated in existing strategies and the first practical initiatives undertaken.

Specific strategies are needed to provide free and accessible screening and prevention services by healthcare institutions. Strategies should be developed through consultation with health providers. Monitoring and evaluation of strategies should be systematically conducted to consistently improve policies. In Bosnia and Herzegovina, there is no permanent mechanism for offering free and accessible screening and prevention services at the state level. The permanent mechanism for offering free and accessible screening and prevention services is organised in the Federation of Bosnia and Herzegovina, Republika Srpska and the Brcko District of Bosnia and Herzegovina. Within the Republika Srpska, however, the programme of prevention and control of NCDs includes the detection and reduction of risk factors and early detection and treatment and referral for more complex diagnostics. The Institute for Public Health of the Republika Srpska has issued a guidebook for healthcare professionals for the detection of risk factors and early detection of NCDs.

In the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, initiatives in this field are based on the overarching health strategies, with action plans addressing different aspects of the healthcare system, including prevention programmes. In the Former Yugoslav Republic of Macedonia one such programme focuses on the prevention and control of NCDs. Based on this programme, a screening-prevention service for the three most common NCDs was introduced for 2014-16. In Montenegro, action plans for both implementing the strategy for preserving and improving reproductive and sexual health and the national strategy to prevent harmful use of alcohol include resources allocated to preventive measures. In Serbia, resources for preventive services are provided by the health insurance fund and a capitation for general practitioners and gynaecologists at the primary healthcare level for the provision of preventive services. The ministry of health is financing special programmes for the early detection of

malignant diseases. Albania has planned to establish national programmes for the prevention and early diagnosis of cardiovascular diseases and cancer. A regulatory framework for free check-ups for 40-60 year olds has been drafted, as well as a screening programme for 40-65 year olds. Moreover, two mobile mammography machines were purchased in 2014 to facilitate off-site breast-cancer screening. Kosovo, for its part, has not yet adopted any policies related to screening and prevention services or implemented any relevant measures.

All SEE governments should further develop cost-effective health-promoting and disease-preventing services; as well as upgrade and strengthen public health policies, operations, services and capacities. The aim will be to reduce premature mortality, increase life expectancy, reduce inequities in health and enhance well-being.

Clinical guidelines and protocols for health providers exist but are rarely developed and updated in a systematic manner

The **clinical guidelines and protocols** indicator assesses if specific clinical guidelines and protocols for health providers have been developed and to what extent the guidelines and protocols are implemented and followed. Evidence-based clinical guidelines and protocols will improve service delivery modalities and make the health system more effective. They will also reduce practice variation, contribute to the reduction of premature morbidity and improve diagnostic and therapeutic accuracy. At the moment clinical guidelines and protocols for health providers on delivering integrated, community-based health promotion and health service interventions exist, but they rarely target low-income and vulnerable groups and are seldom developed and updated in a systematic manner.

Serbia is the only economy where the development and implementation of guidelines and protocols is embedded in a specific policy document: the Strategy for Continuous Quality Improvement and Patient Safety, which includes the goal of developing new and revising existing clinical practice guidelines. There are 69 clinical guidelines, including preventive measures for vulnerable population groups. In the Former Yugoslav Republic of Macedonia and Bosnia and Herzegovina, guidelines have been developed for specific population groups such as children. Albania and Montenegro are in the process of developing guidelines with the support of international donors. Kosovo has not yet developed any clinical guidelines.

Going forward, governments in the region could consider establishing co-ordination bodies, which manage consultations with healthcare providers, raise awareness of the guidelines and protocols in order to reach low-income and vulnerable groups and ensure application.

Table 13.1 summarises the qualitative country scores for healthcare financing, free and accessible screening and prevention services and clinical guidelines and protocols.

Table 13.1. **Universal Health Coverage Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Healthcare financing	3.0	3.5	2.0	3.5	3.5	4.0
Accessible prevention services	2.0	3.0	1.0	2.5	2.5	2.5
Clinical guidelines and protocols	1.5	2.0	0.0	2.0	1.5	2.5

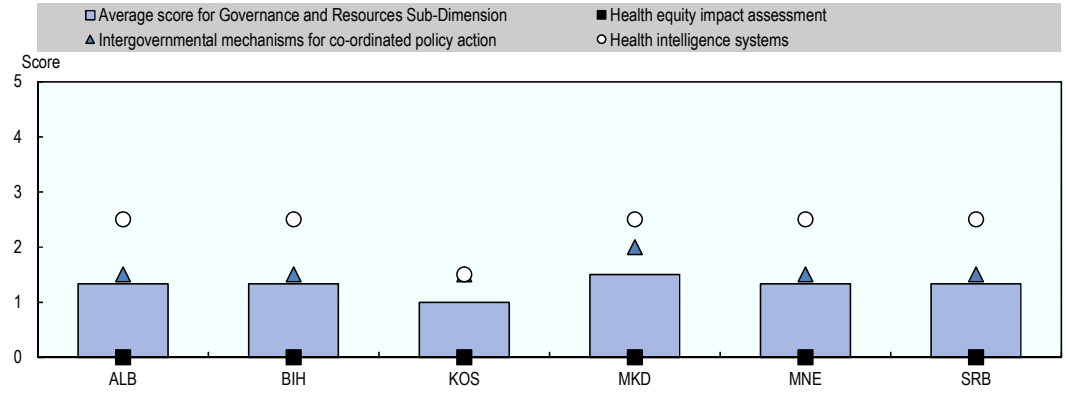
Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Governance and Resources Sub-Dimension

This section looks at the Health Governance and Resources Sub-Dimension. It examines the efforts of the SEE economies to strengthen 21st century governance for health through the development of whole-of-government, whole-of-society and health-in-all-policies approaches. Such approaches aim to address all the determinants of health through a mix of interventions aimed at addressing the social determinants, creating healthy environments where people live and work, increasing the health literacy of individuals and families and removing structural barriers and discriminatory practices in access to disease prevention and treatment, education, employment, and housing services.

Figure 13.7. **Governance and Resources: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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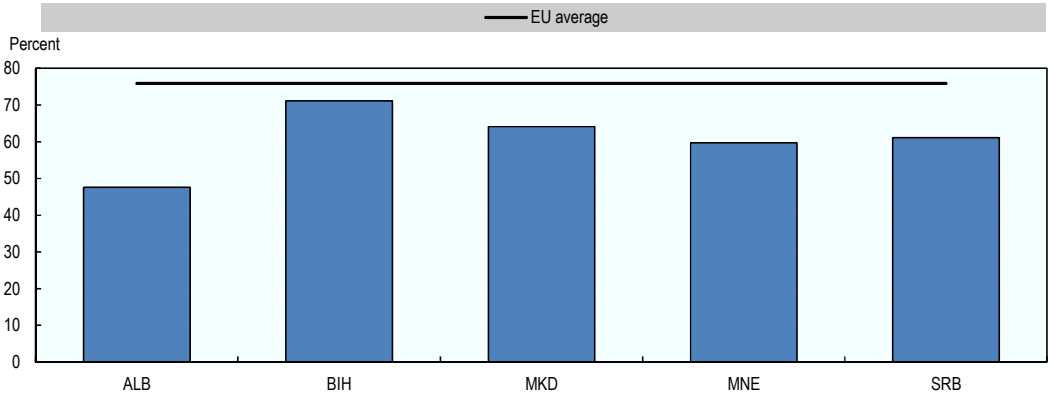
The key drivers and solutions to many of the risk factors for health and health inequities lie within the policy-making domains of other sectors (Commission on Social Determinants of Health [CSDH], 2008; WHO Regional Office for Europe, 2013b). Multi-sectoral and participatory planning methods and instruments, as well as the routine mechanisms that engage local communities, non-governmental organisations (NGOs) and other stakeholders as partners in identifying solutions for improving health and reducing health inequalities, help institutionalise improved accountability and transparency of decision making for health across sectors. The systematic use of instruments such as structured health impact assessments (HIAs) can make an important contribution to these processes.

More traditional hierarchical means of governance are increasingly complemented by other mechanisms, such as soft power and soft law. This includes self-regulation, governance by persuasion, alliances, networks and open methods of co-ordination. As countries make the transition to knowledge-based societies, the role of independent expert bodies – such as local and regional agencies, commissions, regulators and auditors – is increasingly vital in providing evidence, expanding accountability and strengthening democratic governance for health as related to privacy, risk assessment, quality control and HIA.

Public sector spending on health as a percentage of total health expenditure varies between SEE economies (Figure 13.8), with Albania's percentage at 47.6%, significantly less than the other economies. Spending in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia also remains significantly below the EU average, with Bosnia and Herzegovina having the highest level of spending.

Figure 13.8. **Government health spending, 2012**

Percent of overall health spending



Note: Data for Kosovo not available.

Source: WHO Regional Office for Europe (2015a), *European Health for All Database* (database), www.euro.who.int/en/data-and-evidence/databases/european-health-for-all-database-hfa-db/national-health-indicator-databases.

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Health equity impact assessments are not yet carried out in any assessed economy

The **health equity impact assessment** (HEIA) indicator determines if the HEIA instrument has been introduced and if it is systematically conducted to determine how policies, programmes or initiatives across government sectors affect various population groups. HEIAs often include the following elements: focusing on the health determinants and health inequities to be considered; scoping to identify which populations may experience significant unintended health impacts as a result of the planned policy, programme or initiatives; possible mitigation measures; monitoring of mitigation measures; and dissemination to share results and recommendations (Ontario Ministry of Health and Long-Term Care, 2013).

None of the SEE economies assessed have introduced or previously conducted an HEIA. In the future, governments could consider focusing on improving disaggregated data and expertise in equity analysis and monitoring, which seem to be the most pressing issues preventing the implementation of HEIAs.

Intergovernmental mechanisms for co-ordinated policy action on health and health determinants exist but have not been institutionalised

The **intergovernmental mechanisms for co-ordinated policy action** indicator assesses whether intergovernmental mechanisms exist to facilitate co-ordinated policy action on health and health determinants. A body or institution should be designated or

established to take the lead in co-ordination. Further mechanisms to enhance policy co-ordination include: inter-ministerial and inter-departmental committees; cross-sector action teams; integrated budgets and accounting; cross-cutting information and evaluation systems; joined-up workforce development; community consultation; impact assessments; partnership platforms; and legislative frameworks (WHO, 2015b). Instruments that enable joint actions across sectors have been shown to increase the impact of government investments on health promotion activities and the reduction of inequities (Kickbusch and Gleicher, 2011; Council of the European Union, 2010).

All SEE economies have made commitments to implement joint actions with other sectors through adopting health in all policy approaches and strengthening institutional arrangements for equity and accountability for health across government (WHO Regional Office for Europe, 2013b). In practice, all the assessed SEE economies have appointed multi-sectoral temporal working groups, commissions and expert groups responsible for co-ordinating policy action to deal with health and health determinants. For example, in the Federation of Bosnia and Herzegovina, a cross-ministerial working group was established to develop the strategic plan for the improvement of early growth and development of children in the Federation of Bosnia and Herzegovina for the period from 2013 until 2017.

However, these structures are temporary and contributions of members often depend on individual engagements. Only the Former Yugoslav Republic of Macedonia has established a more institutionalised body. The 2010 law on public health mandates public health councils to co-ordinate activities which impact on health and health determinants, at both the local and national levels. One such council has been already established at the national level: the National Public Health Council. Its goal is to manage the health priorities in the country through inter-ministerial actions.

Formal mechanisms, including a dedicated government body with the mandated authority to co-ordinate and support cross-sectoral policy on health and health determinants should be considered in all economies to ensure high-quality policy outcomes in this area.

Health intelligence systems exist in most economies but lack important features to maximise their impact

The **health intelligence systems** indicator assesses whether countries have developed comprehensive health intelligence systems that provide data on public health and the determinants of health, as well as activity and outcome data on health services. Strengthening the health intelligence infrastructure is critical for improved policy decision making and can increase the efficiency and accountability of investments in health at the national and local levels. Stronger intelligence openly accessible and directly linked to policy process is important for anticipating and responding to opportunities and threats to health (WHO Regional Office for Europe, 2013b).

The health intelligence system should provide information on the prices and quality of health services offered at the local, national and regional levels, their impact and how satisfied patients are. This data should be updated regularly and disseminated broadly, particularly to patients. It should be housed on a user-friendly online portal and should enable easy comparison between regions and countries, although this tool is not yet widely applied even in the most advanced economies.

Across the SEE economies health intelligence systems are managed by government public health institutes or equivalent bodies, which are responsible for surveillance, research and health promotion. The institutes collect information on health service availability and utilisation. They also issue annual health maps, annual mortality reports and periodic reports on specific diseases. In Kosovo, a health information system (HIS) is being constructed with the support of the government of Luxemburg.

The reports of public health institutes contain useful information. Nevertheless, a number of problems persist, which, if addressed, would increase the value and impact of their HISs. Although the reports themselves are published online, the raw data are often not readily available. Data can usually not be disaggregated by socio-economic status, need, region, etc. Furthermore, there is a lack of interoperability with other software platforms being developed by institutions collecting or processing health-related information.

Table 13.2 summarises the qualitative scores for health equity impact assessments, intergovernmental mechanisms for co-ordinated policy action and health intelligence systems.

Table 13.2. **Governance and Resources Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Health equity impact assessment	0.0	0.0	0.0	0.0	0.0	0.0
Intergovernmental mechanisms for co-ordinated policy action	1.5	1.5	1.5	2.0	1.5	1.5
Health intelligence systems	2.5	2.5	1.5	2.5	2.5	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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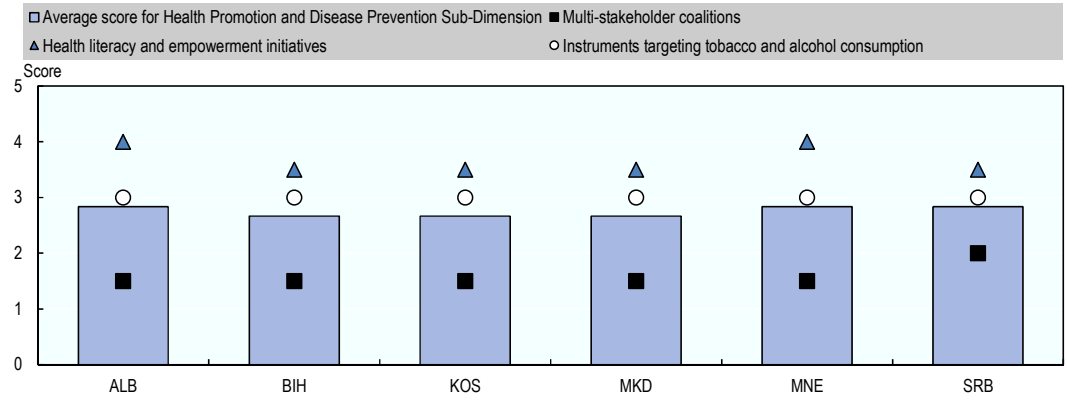
Health Promotion and Disease Prevention Sub-Dimension

This section looks at the Health Promotion and Disease Prevention Sub-Dimension. It examines progress towards increasing investment in population-based public health and disease prevention measures such as a total percentage of all health sector and government activities. Strengthened institutions are central to improving the efficacy and sustainability of public health goals.

Multi-stakeholder coalitions for health and well-being exist sporadically and primarily at the national level

Given the complex and wide-ranging factors that determine health opportunities and risk, there is a need for new forms of alliances for health that span the public, private and voluntary sectors. The **multi-stakeholder coalitions** indicator assesses whether economies have taken the initiative to form multi-stakeholder coalitions for health and well-being. Such coalitions should consist of public, private and non-governmental stakeholders and should ideally operate on local and national levels. Such alliances can improve the coherence of resources mobilised to improve health and well-being at the national and local levels. These multi-stakeholder alliances can also contribute to improved transparency of government decision making and support the advancement of health as a public good and economic resource (Kickbusch and Gleicher, 2011).

Figure 13.9. **Health Promotion and Disease Prevention: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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SEE governments have a track record of establishing coalitions with private and non-governmental actors, working to promote health and well-being. Several economies have had coalitions that focus on health promotion (e.g. Albania and Kosovo have established coalitions for anti-tobacco campaigns). Other coalitions have targeted specific diseases and groups (the Federation of Bosnia and Herzegovina and the Republika Srpska have involved NGOs in the implementation of polices related to diabetes, mental health, HIV and tuberculosis). Most coalitions occur at the national level, although local initiatives have occurred and have been useful. However these initiatives take place sporadically and lack a single governmental body designated to take the lead on co-ordination. In Serbia there are also sub-national coalitions in the form of local health councils, which bring together health services and other actors, with a particular focus on health needs and primary care responses at the level of municipalities.

Health literacy and empowerment initiatives are being conducted in all SEE economies

The **health literacy and empowerment initiatives** indicator assesses whether the government has conducted regular health literacy initiatives and empowerment campaigns to promote interventions to counter NCDs and increase the involvement of local communities as partners in improving health. The indicator is one of the strongest within the area of health promotion and disease prevention. Health promotion is high on the political agenda of the SEE economies and in each a designated body or department is in charge. Health literacy is particularly important where NCDs account for the largest share of avoidable diseases. Effective health literacy campaigns are essential to reducing the loss of human capital in the working-age population due to NCDs (European Commission, 2015).

All of the SEE economies have recently implemented health literacy campaigns, with a partial focus on NCDs. In Serbia, for example, national health promotion programmes include health promotion campaigns focused on reduction and/or elimination of risk factors for NCDs (e.g. World Health Day, World Movement Day, World and National No Tobacco Day, World Heart Day and World Food Day). Health literacy is also part of the

health promotion campaigns. In Albania, the health promotion department of the ministry of health and the regional public health directorates design and implement relevant campaigns. The recent focus has been on reducing smoking. Albania has an online calendar of promotional activities, which is updated regularly. Another economy which stands out is Montenegro, through its introduction of the mandatory subject "healthy lifestyles" in school curricula. Other SEE economies should consider implementing such good practices.

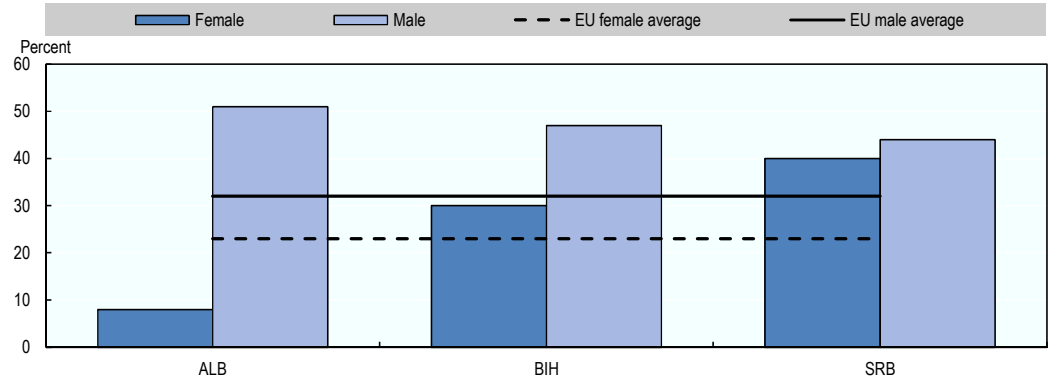
Measures to curb tobacco and alcohol demand are implemented widely, but healthy diets should be promoted, too

The **instruments targeting tobacco and alcohol consumption** indicator determines whether fiscal policies, legal frameworks and marketing controls have been developed to decrease demand for tobacco, alcohol and foods high in saturated fats, trans fats, salt and sugar.

Smoking is engrained in SEE regional social norms, resulting in some of the world's highest tobacco-use rates. In 2015, the share of men smoking tobacco across Albania, Bosnia and Herzegovina, and Serbia was on average 15% higher than the EU average. On average, fewer women smoked than men with the largest difference of prevalence rates in Albania and very similar rates in Serbia (Figure 13.10).

Figure 13.10. **Smoking prevalence in adults 15 years and older, 2015**

Percent of population



Note: Data for Kosovo, the Former Yugoslav Republic of Macedonia and Montenegro not available.

Source: WHO (2015b), *Global Health Observatory Data Repository* (database), http://apps.who.int/gho/data/node.main.65.

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Mechanisms targeting tobacco include increases in prices, health warnings, smoke-free environments and a ban on all forms of tobacco promotion. Mechanisms targeting alcohol include increases in taxes, bans on promotion and restricted access to retailed alcohol. For food, mechanisms should include using food pricing and labelling and marketing controls to promote healthier diets. Such fiscal, legal and marketing instruments underpinned by regulations and incentives are important institutional tools to manage the drivers of major risk factors and determinants of health (WHO Regional Office for Europe, 2012).

Fiscal policies, legal frameworks and marketing controls specifically targeting alcohol and tobacco have been developed in all SEE economies. For tobacco, these include increases in prices, health warnings, smoke-free environments and bans on tobacco promotion. All economies, with the exception of Kosovo, which is not a member of the United Nations, are signatories to the WHO Framework Convention for Tobacco Control. For alcohol, restrictive measures include increases in taxes, bans on promotion and restricted access to retailed alcohol. Mechanisms targeting harmful food products, which include pricing, labelling and marketing controls to promote healthier diets, have not yet been developed widely and should be developed further in the future.

Table 13.3 summarises the qualitative indicators for multi-stakeholder coalitions, health literacy and empowerment initiatives, and instruments targeting tobacco and alcohol consumption to prevent diseases and promote health.

Table 13.3. **Health Promotion and Disease Prevention Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Multi-stakeholder coalitions	1.5	1.5	1.5	1.5	1.5	2.0
Health literacy and empowerment initiatives	4.0	3.5	3.5	3.5	4.0	3.5
Instruments targeting tobacco and alcohol consumption	3.0	3.0	3.0	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Regional Co-operation Sub-Dimension

This section looks at the Regional Co-operation Sub-Dimension. It examines whether, and to what extent, the SEE economies harmonise their health legislation and regulation, standards and procedures with a view to develop regional mutual recognition and trust and to minimise non-tariff barriers to trade. It also reviews and conducts a comparative analysis of all public health laboratories and evaluates the need for harmonisation. Another crucial aspect is cross-border information exchange, including technical information on health and disease, health governance good practices, and political dialogue.

Cross-border harmonisation of health legislation, standards and procedures and information exchange policies

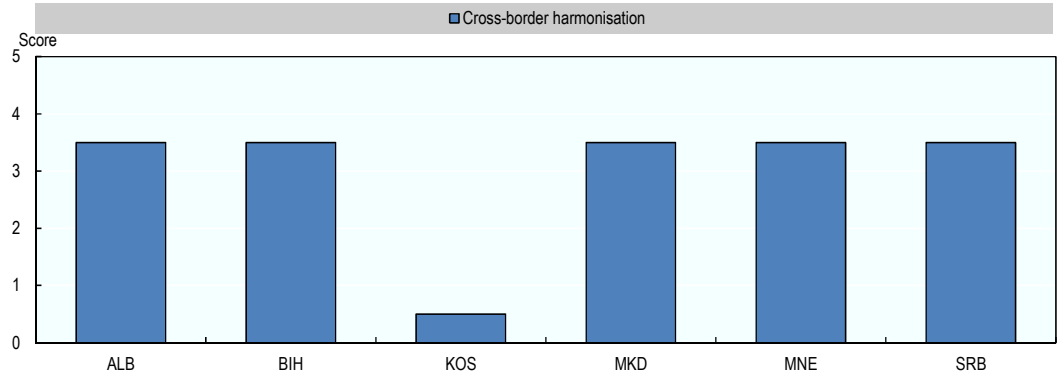
The only qualitative indicator is **cross-border harmonisation**. It encompasses:

- mutually recognised cross-border control procedures relating to goods that have importance for human health
- a common IT platform and database for continuous and emergency alert and response
- the development and launch of an SEE regional information database on cross-border public health issues and best practices.

The South-Eastern Europe Health Network (SEEHN) was established in 2001 as a regional co-operation platform. The economies of the Western Balkans, with the exception of Kosovo, have made a political commitment to extend sub-regional co-operation and enhance partnerships towards achieving equity and accountability in

health through implementing a whole-of-government approach and a focus on NCDs. The Banja Luka Pledge (2011) was signed to this effect. SEEHN economies are establishing regional health development centres in key areas of public health. Eight regional health development centres have been or will soon be established. Progress is measured based on whether a clear and binding roadmap on harmonising cross-border legislation exists and is being implemented.

Figure 13.11. **Regional Co-operation: Sub-Dimension indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322569

Table 13.4. **Regional Co-operation Sub-Dimension: Indicator score**

	ALB	BIH	KOS	MKD	MNE	SRB
Cross-border harmonisation	3.5	3.5	0.5	3.5	3.5	3.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Conclusions

Policy makers from SEE have acknowledged the importance of healthy populations and healthcare has attracted increasing government attention across the region. Health promotion seems high on the political agenda and health co-operation is embedded within the SEEHN. Many economies have established basic operational healthcare financing schemes, developed clinical guidelines for health providers, made commitments to implement joint actions with other sectors and established basic health intelligence systems.

Overall, however, governance for health and national health planning need to be significantly strengthened, with a focus on effective multi-sectoral institutions to support whole-of-government, whole-of-society and health-in-all-policies approaches. Further efforts are needed to achieve universal health coverage and extend financial health protection to all citizens. Primary healthcare, health promotion and disease prevention need further development.

The burden of preventable, NCDs is a major health challenge for the region and governments have not yet developed adequate specific strategies for providing free and accessible prevention and screening services. Furthermore, measures to support vulnerable groups could be strengthened through targeted policy interventions and by introducing HEIAs. Health intelligence systems could also be enhanced to better anticipate and respond to both health opportunities and threats.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 14.

Effective public services in South East Europe

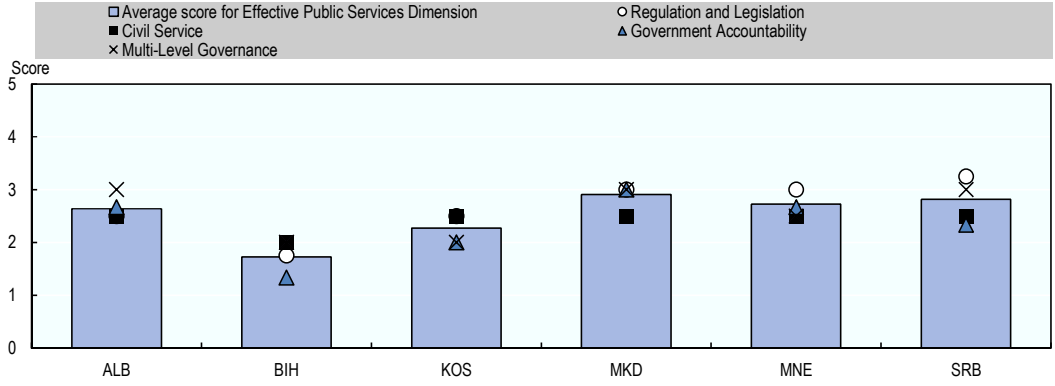
Transparency, effective rule of law, low corruption and high civil society participation characterise high-quality public governance, which is made up of political, institutional and legal arrangements. This chapter on the Effective Public Services Dimension considers four sub-dimensions in its assessment of public services performance and policy development. The Regulation and Legislation Sub-Dimension gauges the development of tools to improve existing and future legislation such as the regulatory guillotine, regulatory impact analysis, forward-planning mechanisms and public consultations. The Civil Service Sub-Dimension describes human resource management and performance appraisal systems that seek to match public servant skills with policy goals. The Government Accountability Sub-Dimension analyses access to public information, e-government services and commitment to the Open Government Partnership. The Multi-Level Governance Sub-Dimension investigates local government autonomy by measuring tax decentralisation and alignment with the European Charter of Local Self-Government.

Main findings

Efficient and effective public administration is fundamental to successfully delivering public services, implementing structural reforms and building trust in government through integrity and transparency. Moreover, the quality of public services delivered by open, responsive institutions plays an important role in increasing competitiveness, enhancing investment attractiveness and supporting a business friendly environment.

South East Europe (SEE) economies have improved regulatory frameworks underpinning effective public services and have begun to simplify administrative procedures and to introduce regulatory impact assessments (RIAs) (Figure 14.1). They also seek to improve their e governance frameworks to increase public sector transparency and allow more direct interaction with citizens. Recent amendments to civil service laws support the goal of creating professional civil services with merit based recruitment and promotion procedures to offset the politicisation of public administration. However, it is not always clear to what extent these procedures are applied in practice. In addition, the administrative and financial independence of sub-national governments is hindered by underfunding and heavy reliance on the central authorities.

Figure 14.1. **Effective Public Services: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Achievements

The SEE economies have made progress in public administration reform to improve the business environment.

SEE economies have simplified administrative and regulatory frameworks. Four SEE economies have applied different forms of regulatory guillotine to streamline the existing stock of regulations and lay the foundations for a more systematic revision of the regulatory landscape.

SEE economies mandate public-private consultations in policy making. The parameters for public consultations have been defined in specific procedures and government portals have been upgraded to facilitate this process.

SEE economies have expanded the scope of e-government services. National strategies and action plans adopted across the region place an emphasis on e-governance.

Specific efforts have been undertaken not only to increase the number but also the sophistication of e-services.

SEE economies have increased merit-based recruitment in the civil service. New amendments address civil service professionalism across the region by introducing merit-based recruitment and promotion systems and promoting fairer wages in order to enhance professional integrity and prevent corruption.

Challenges

Despite improvements, SEE economies face challenges in fully developing regulations, institutions and the civil service.

Government-parliament consultations are often avoided in practice. Despite legislative requirements for forward planning and co-operation between the government and parliament, laws are often rushed through, which limits necessary consultations.

Regulatory impact assessments (RIA) are not applied systematically across policy areas, in spite of legislation designed to promote their use. Moreover, Albania and Bosnia and Herzegovina do not have a legislative framework for RIAs in place.

Recruitment and professional appraisal processes are not always based on merit and open competition. Relevant human resource management (HRM) procedures have been adopted but are often not implemented, which limits the best talent from accessing civil service positions.

Open Government Partnership (OGP) commitments are not being followed through. The effectiveness of the public service in the region is affected by the low degree of implementation of OGP action plans which aim to promote transparency, accountability and citizen engagement.

Fiscal decentralisation and compliance with the European Charter of Local Self-Government is limited. The overall regulatory framework in most SEE economies approaches full compliance with the charter. However, the transfer of functions and funding to local government is at an early stage.

Recommendations

Measures addressing the identified challenges can increase the quality of regulations, the robustness of institutions and public sector professionalism in the region.

Facilitate institutional co-ordination for better policy making through more effective planning of intended legislative activity. Sending proposals to parliament in a timely fashion would help to raise awareness of proposed new laws and facilitate co-ordination with relevant ministries.

Improve legislative quality through broader impact assessments. Governments in the region could consider applying RIA in a more systematic way, in order to identify and assess the expected cost and effects of proposed legislation.

Increase and improve the use of online portals for public consultations. Giving private stakeholders enough time to review draft legislation and simple ways of submitting comments is essential in ensuring that legislation corresponds to the needs of any relevant industry.

Strengthen civil service human resources management (HRM) capacities. Governments could ensure HR recruitment and training planning clearly states what will be accomplished within a given time-frame. It would also be beneficial to consider periodic assessments of HRM practices and training activities and to carry out follow-up actions. Greater efforts could also be made to fully implement frameworks for merit-based recruitment and promotion to provide fair wages.

Fully implement Open Government Partnership (OGP) action plans. The OGP process would benefit from a greater level of private sector and civil society organisation involvement. Such efforts not only increase access to information and legislation, but also help simplify administrative procedures.

Improve fiscal decentralisation framework implementation. Reinforce framework monitoring mechanisms to allow for corrective action and effective implementation. Such measures would strengthen governance arrangements by taking into account regional, social and economic disparities.

Work towards full compliance with the European Charter of Local Self-Governance. This would help SEE economies ensure more efficient delivery of public goods and more equal regional development.

Further enhance the promotion and monitoring of e-government services. Specific awareness-raising initiatives could be envisaged to promote citizens' access to e-government services and their participation in e-government projects. Regular monitoring of existing e-government services would be used to identify improvements.

Overview

Quality public governance is characterised by transparency, effective rule of law, lack of corruption and civil society participation. There is widespread consensus that the quality of governance composed of political, institutional and legal arrangements has a positive causal link with the level of overall socio-economic development (Rodrik, 2008). The prominent economist, Daron Acemoglu further defines essential elements of governance as political institutions including collective decision-making processes and restraints on powerful interest groups; state capacity encompassing government's ability to supply public goods; and the regulation of economic institutions as in government facilitation or obstruction of certain economic activities (Acemoglu, 2008).

All successful policy reform depends on governance, which is the very means by which policy reform is developed, implemented and monitored. This chapter focuses on who makes policy and the quality of their public service delivery, which cuts across all areas of government. Public governance is thus closely linked to all the policy areas in this *Competitiveness Outlook 2016*, particularly:

- **Chapter 15. Anti-corruption policy**, addresses a subset of effective governance policy which is closely related to those covered in this chapter. For example, it focuses on transparent rules, which this chapter seeks to facilitate through e-governance. It can automate public services across all levels of government, facilitating consistent, high-quality services as well as minimising individual discretionary powers and opportunities for corruption.
- **Chapter 5. Digital society** aims to develop society's use of information communication technology (ICT) and infrastructure. This chapter specifically considers how ICT can support public service delivery and access to information.

- **Chapter 1. Investment policy and promotion** is facilitated by strong public governance. Lighter administrative burdens on businesses and more transparent, predictable regulatory environments are associated with higher levels of foreign direct investment (FDI) inflows (Benassy-Quere, Coupet and Mayer, 2007; Busse and Groizard, 2008; Globerman and Shapiro, 2002; OECD, 2015).

Box 14.1. **Effective Public Services Dimension in the SEE 2020 Strategy**

The Effective Public Services Dimension is part of the Governance for Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of this pillar is to facilitate economic growth through quality governance as a cross-cutting prerequisite to all SEE 2020 Strategy objectives. The Effective Public Services Dimension in particular focuses on components that help develop a business-friendly environment through quality public service delivery, professional public officials, reduced discretionary powers and inter-institutional co-ordination. The SEE 2020 headline target is to increase the Worldwide Governance Indicator on government effectiveness from 2.3 in 2010 to 2.9 in 2020.

The SEE 2020 Strategy further specifies key areas in effective public services. These include public official skills trainings, e-governance at all government levels, subsidiary principle compliance, fiscal decentralisation, and policy and regulatory development capacities.

The official SEE 2020 Strategy co-ordinators for the Effective Public Services Dimension are the Regional School of Public Administration (ReSPA) and the Network of Associations of Local Authorities of South East Europe (NALAS). ReSPA seeks to improve regional co-operation, shared learning and public administration development to support EU integration. NALAS aims to promote the decentralisation process through a regional network and local government knowledge centre.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, Regional Cooperation Council, Sarajevo, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Effective Public Services Dimension assessment framework

This chapter proposes an analytical framework for effective governance and public services in the SEE region. It does not seek to be exhaustive, but considers four broad sub-dimensions based on the effective public service objectives of the SEE 2020 Strategy.

- Regulation and Legislation

  To what degree has a regulatory guillotine been implemented to eliminate unjustified regulation? Are data-based policy-making tools in use? How do public consultations shape policy development? What forward-planning mechanisms between the government and the national and subnational parliaments are in place?

- Civil Service

  What human resource management procedures are in use to prioritise merit in hiring? How useful are performance appraisal systems in identifying civil servant strengths and weaknesses? Is training available and required?

- Government Accountability

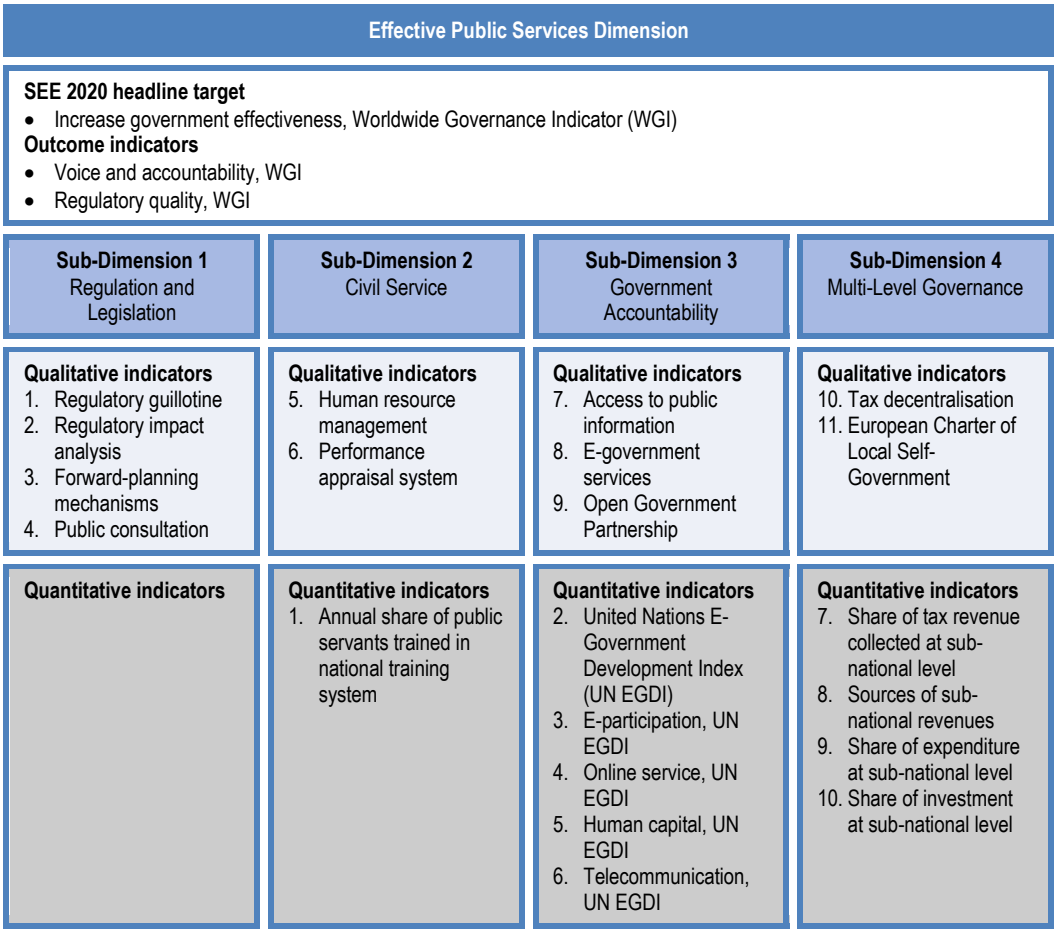
  How advanced are Open Government Partnership engagement and action plan implementation? What level and variety of e-government services are available? How easily accessible are different types of public information?

- Multi-Level Governance

  How autonomous are local governments? Is taxation decentralised? How compliant are economies with the European Charter of Local Self-Government?

Figure 14.2 shows how the sub-dimensions and their constituent indicators make up the effective public services assessment framework.

Figure 14.2. **Effective Public Services Dimension assessment framework**



Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional School of Public Administration (ReSPA) and the Network of Associations of Local Authorities of South East Europe (NALAS) collected the qualitative and quantitative data on effective public services.

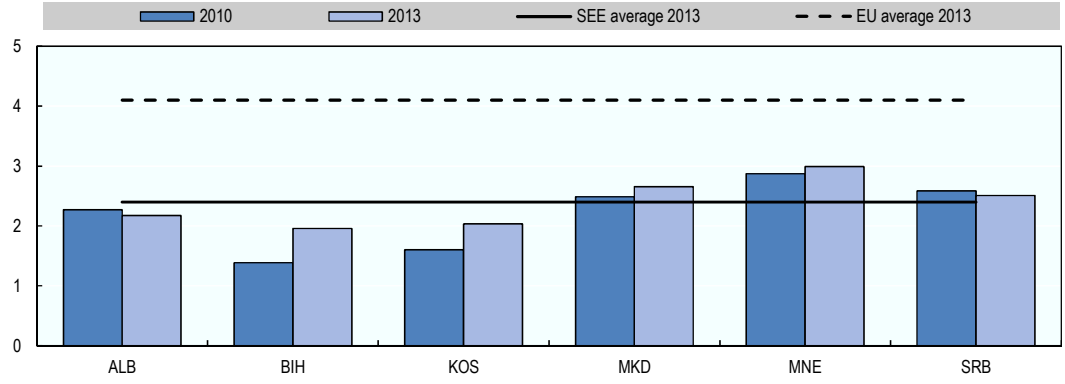
Quantitative indicators are based on national or international statistics. Qualitative indicators have been collected and scored in ascending order on a scale of 0 to 5.[1] All qualitative indicator scores in the Effective Public Services Dimension are whole numbers.

Public services performance in SEE economies

Governance is multi-faceted and complex, leading to many ways to measure its effectiveness. The Worldwide Governance Indicators (WGI) project addresses six broad areas of governance. They reflect data from over 30 underlying data sources, encompassing perceptions from a wide range of stakeholders (Kaufmann, Kraay and Mastruzzi, 2010). Three indicators provide a broad overview of the performance of public governance considered in this chapter: government effectiveness, voice and accountability, and regulatory quality. Across SEE economies, the WGI scores were mostly stable from 2010 to 2013, a reflection that government performance can take significant time to change. A greater improvement rate in the SEE economies is needed to achieve SEE 2020 headline targets.

The government effectiveness indicator looks at perceptions of the quality of public services, the civil service, and policy development and implementation, as well as government credibility of policy commitment (Kaufmann, Kraay and Mastruzzi, 2010). From 2010 to 2013, government effectiveness has remained almost at the same level for four economies and has marginally improved in two (Figure 14.3), although the level is below the EU–28 average. Montenegro leads the region, with Kosovo and Bosnia and Herzegovina having the lowest level but the highest growth.

Figure 14.3. **Government effectiveness, 2010 and 2013**



Note: The RCC adapted the WGI percentile rank scale of 0-100 to a scale of 0-5 for the SEE 2020 Strategy.

Source: Adapted from World Bank (2015), *Worldwide Governance Indicators* (database), http://info.worldbank.org/governance/wgi/index.aspx#reports.

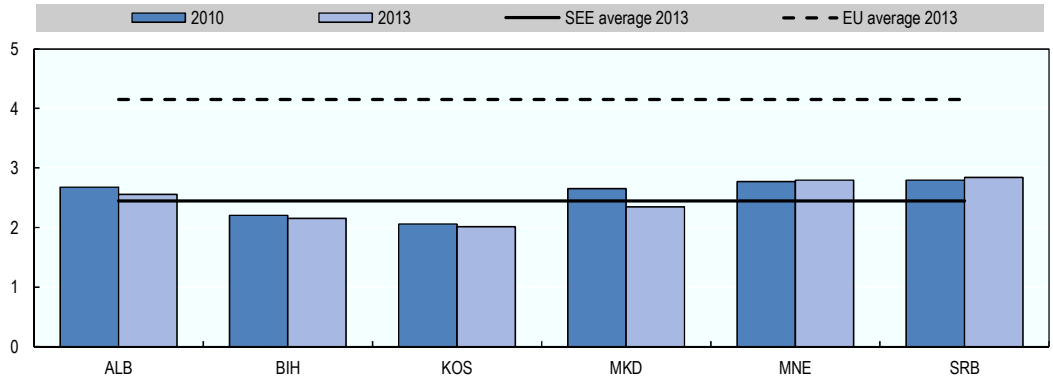
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The voice and accountability indicator considers perceptions of how much citizens participate in selecting their government and how free expression, association and the media are (Kaufmann, Kraay and Mastruzzi, 2010). From 2010 to 2013, government effectiveness has remained almost at the same level for five economies and has marginally decreased in the Former Yugoslav Republic of Macedonia (Figure 14.4). The level is below the EU average.

The regulatory quality indicator assesses perceptions of the government's ability to create and implement regulations that allow for private sector development (Kaufmann, Kraay and Mastruzzi, 2010). From 2010 to 2013, all SEE economy scores held constant (Figure 14.5.). While there was little improvement across the region, the average SEE

performance this indicator is the best out of the three worldwide governance indicators considered in this chapter.

Figure 14.4. **Voice and accountability, 2010 and 2013**

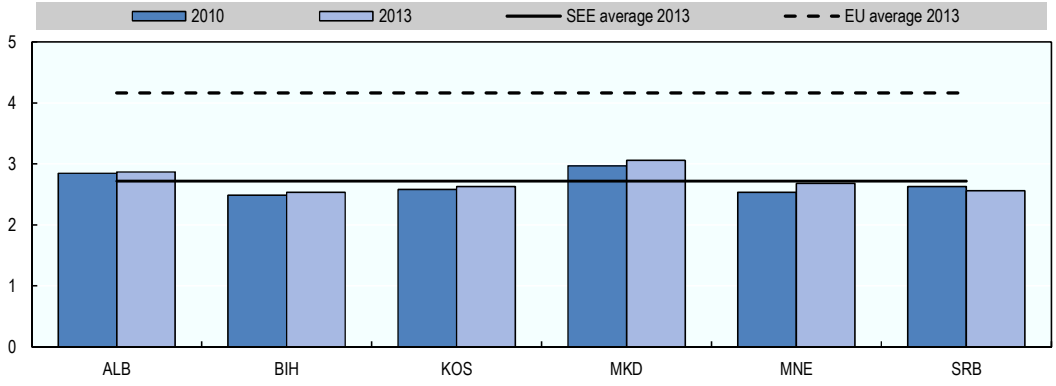


Note: The RCC adapted the WGI percentile rank scale of 0-100 to a scale of 0-5 for the SEE 2020 Strategy.

Source: Adapted from World Bank (2015), *Worldwide Governance Indicators* (database), http://info.worldbank.org/governance/wgi/index.aspx#reports.

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Figure 14.5. **Regulatory quality, 2010 and 2013**



Note: The RCC adapted the WGI percentile rank scale of 0-100 to a scale of 0-5 for the SEE 2020 Strategy.

Source: Adapted from World Bank (2015), *Worldwide Governance Indicators* (database), http://info.worldbank.org/governance/wgi/index.aspx#reports.

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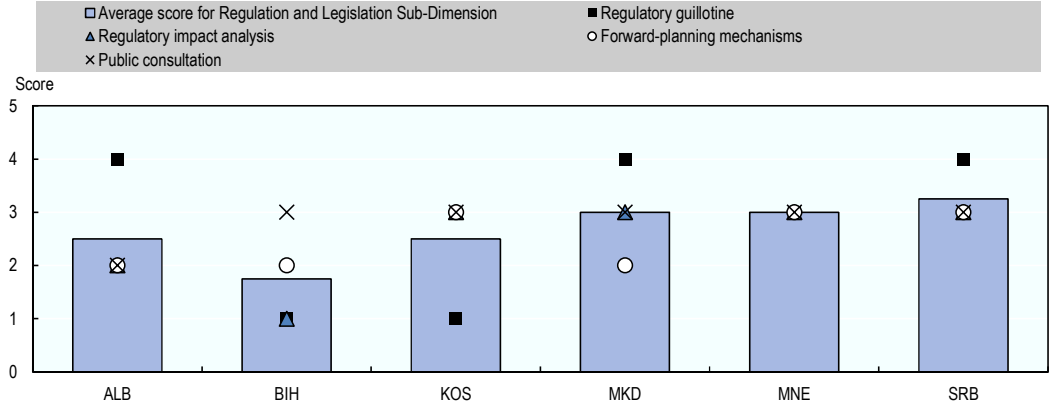
Regulation and Legislation Sub-Dimension

Transparent, predictable regulation facilitates competitive markets and innovation by lowering costs of doing business. Complex or inconsistently applied regulation discourages entrepreneurship by shifting resources away from productive uses (OECD, 2015). This section looks at the Regulatory and Legislative Sub-Dimension. It examines the overall performances of the SEE economies by assessing how they fare against four qualitative indicators.

- **Regulatory guillotine** is a systematic, comprehensive government-executed cataloguing of all existing regulation and subsequent justification of retaining each piece of regulation. Any piece of regulation not reported or failing to primarily protect the public safety is abolished.
- **Regulatory impact analysis** (RIA) is a forward-looking tool to facilitate continued high-quality regulation creation. It clarifies the underlying regulatory objectives sought for new proposed legislation and regulation. Before submitting legislation proposals to the government or for public consultations, the RIA identifies and systematically assesses policy options with an analytical method, such as benefit/cost analysis, to select the most effective policy option to address the objective (OECD, 2008).
- **Forward-planning mechanisms** are a means of raising awareness for proposed new laws by giving parliament greater advance notice and affording it the opportunity to provide feedback. Forward-planning mechanisms specify the means of legislative programme communication to parliament and sub-national governments through clear identification of responsible working parties and ministers. At its most basic level, state governments issue a general programme outlining the areas of action in the upcoming legislature.
- **Public consultations** during policy development are an important feedback process that helps update policy design by considering on-the-ground information from citizens and addressing policy stakeholder needs.

Half of the SEE economies score about 3 with the other half scoring 2.5 or lower (Figure 14.6). All economies in the higher-scoring group – Serbia, Montenegro and the Former Yugoslav Republic of Macedonia – have begun to implement each policy area in the sub-dimension. Albania has all the strategies in place and has begun to implement the regulatory guillotine. Kosovo, for its part, has begun to implement most elements, but the regulatory guillotine is still in its infancy. Bosnia and Herzegovina has strategies for only half of the policy areas.

Figure 14.6. **Regulation and Legislation: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Regulatory analysis frameworks are not systematically implemented

Half the SEE economies, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, have begun to implement both regulatory guillotine frameworks and RIA frameworks. Only Bosnia and Herzegovina has yet to adopt frameworks for both regulatory guillotine and regulatory impact analysis.

Table 14.1. **Regulation and Legislation Sub-Dimension: Regulatory analysis indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Regulatory guillotine	4.0	1.0	1.0	4.0	3.0	4.0
Regulatory impact analysis	2.0	1.0	3.0	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia all have strategies with comprehensive regulatory guillotine procedures in place at varying stages of implementation and monitoring. Kosovo and Bosnia and Herzegovina have both sporadically implemented a regulatory guillotine process in selected sectors and levels of governments but national co-ordination systems for a comprehensive, regular process are not in place.

Four SEE economies have RIA frameworks in place and are working towards full implementation and monitoring. In Albania, the government is beginning to implement its framework while in Bosnia and Herzegovina, the government is working to set and implement required analyses to accompany each new law proposed.

Urgent timelines bypass forward-planning mechanisms and constrain public consultation

All SEE economies have a legal framework with implementation plans encompassing forward-planning mechanisms and public consultations in the legislative development process. Approaches and degree of implementation vary from economy to economy.

Table 14.2. **Regulation and Legislation Sub-Dimension: Dialogue indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Forward-planning mechanisms	2.0	2.0	3.0	2.0	3.0	3.0
Public consultations	2.0	3.0	3.0	3.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Three economies have scored a level of 3 in forward-planning mechanisms – Kosovo, Montenegro and Serbia. The score means that clear and comprehensive guidelines on communication procedures between government and parliament are in place and in use. Responsibilities are more clearly defined between the different ministries and state bodies than within them. Despite the existence of government bodies that facilitate co-ordination between ministries and parliaments in Albania, Kosovo, Montenegro and Serbia, monitoring is often of poor quality. Ad hoc efforts, such as the recently established Public

Policy Secretariat in Serbia, have improved communication, co-ordination and monitoring through increased use of electronic procedures.

However, laws are very often rushed through parliament, bypassing its necessary oversight in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia.

All the SEE economies have legislation that requires public consultations in the drafting stage. Whether public consultations are conducted varies on the legislative timeframe, the subject of the legislation, who participates, and how feedback is recorded and incorporated.

The way forward in regulatory and legislative quality

As SEE economies look to the future, they could make their use of the regulatory guillotine and regulatory impact analyses systematic. Bosnia and Herzegovina and Kosovo could adopt a framework including the regulatory guillotine. Bosnia and Herzegovina could adopt a holistic approach to regulatory impact analyses.

Furthermore, using RIA as a reference, governments could work to allow adequate time for public consultation earlier on in the legislative development process to afford parliament enough time to supply meaningful feedback on new legislative proposals.

Civil Service Sub-Dimension

Civil servants are a government's most valuable asset in developing policy and delivering public services. A system of administrative policies, management practices and oversight agents provides incentives and penalties to encourage public servants to professionally carry out their duties and observe high standards of conduct. Initiatives to promote professionalism within public services range from the establishment of sound public management systems and practices to a career system based on the merit principle, which fairly and impartially recruits and promotes public servants through the recognition of good work and correction of poor performance. Just and clear human resource policies on suitable compensation, training, disciplinary procedures, etc. lead to a better quality of civil service better able to meet government goals (United Nations, 2000).

This section looks at the Civil Service Sub-Dimension. It examines the performance of the SEE economies by assessing how they fare against two qualitative indicators.

- **Human resource management** aligns the number and types of people needed to reach government goals across policy areas.
- **Performance appraisal system** clarifies civil servant roles and links them to organisational objectives so that managers can measure and guide employee performance.

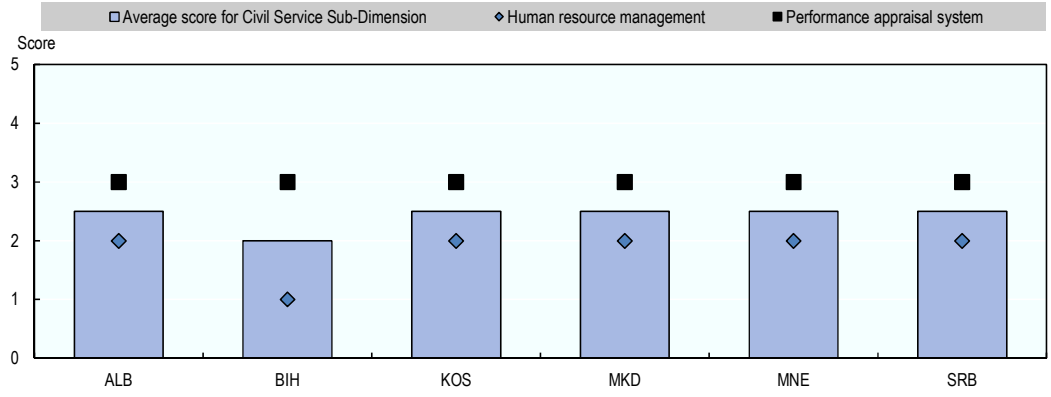
Furthermore, national training systems seek to bring civil service skills up-to-date with the evolving skills to successfully carry out their job.

All SEE economies are working towards implementing civil service performance appraisal systems and human resource management (Figure 14.7.). All economies have a performance appraisal system framework in place and in use, as reflected in their scores of 3. All economies scored a 2 in human resources management, which denotes frameworks in place but not fully implemented. Bosnia and Herzegovina is the exception with a score of 1, as it does not yet have a framework in place.

Civil service management frameworks are in place but not fully implemented

All SEE economies are further advanced in their implementation of performance appraisal management than human resource management.

Figure 14.7. **Civil Service: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Table 14.3. **Civil Service Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Human resource management	2.0	1.0	2.0	2.0	2.0	2.0
Performance appraisal system	3.0	3.0	3.0	3.0	3.0	3.0

Source: OECD assessment conducted in the SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All SEE economies, except Bosnia and Herzegovina, have defined roles and career streams for each employee group. They have also put competency architecture in place to support strategic human resource planning throughout the public service. Kosovo has several pilot projects implementing a HRM information system with the support of external donors. Bosnia and Herzegovina lacks an adopted proposal on implementing strategic HRM processes within the public service. Evidence is scarce of HR planning processes clearly impacting and guiding civil service hiring, learning and career development. Furthermore, across the SEE economies recruitment and promotion processes are characterised by a lack of transparency and persistently high level of civil service politicisation.

All economies have legislation that requires performance appraisal, which is conducted for at least half of the civil service. All public servants in all the economies have the right to appeal against unfair performance appraisal decisions. However, performance appraisals in practice often remain formal with no tangible influence on either career development or salaries.

All SEE economies have institutions responsible for managing the national training system. Training systems entail developing and implementing annual plans aligned with the overall strategy, managing training records and co-ordinating training activities.

However, across the SEE region training budgets are reliant on international donors and have fallen in the past few years, so reducing numbers of training days and civil servants trained – most economies train fewer than 10% of the civil service. Regional organisations such as ReSPA organize ad hoc, bilateral regional training or national training systems.

The way forward in civil service professionalism

As the SEE economies look to the future, they could build their HRM capacity in order to implement frameworks that increase merit-based recruitment and promotion and analyse civil service issues. They could strengthen the links between their performance appraisal systems and career development and salaries. National civil service training systems could be better aligned with needs and extended to a greater number of civil servants. Sharing best practices regionally could further facilitate HRM development.

Government Accountability Sub-Dimension

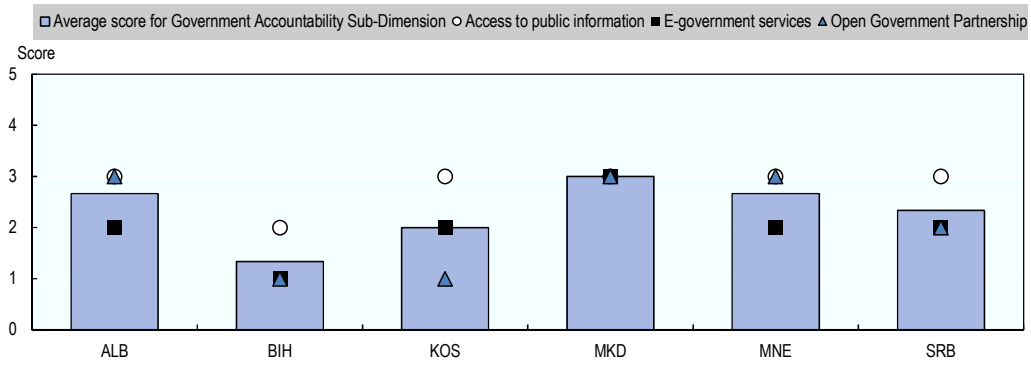
Modern public services delivery is characterised by formalised, unbiased procedures to facilitate easier and faster access to public services. Information communication technology can play a major role in increasing government accountability through automated Internet public service and information provision as well as a connection to international platforms for government transparency reforms.

The Government Accountability Sub-Dimension examines overall performances of the SEE economies by assessing how they fare against three qualitative indicators.

- **Access to public information** leads to more informed citizens who are in a better position to exercise their rights, carry out their responsibilities and engage in policy development. Effective freedom of information laws define how people can file a request for information balanced with specified restrictions (OECD, 2011).
- **E-government services** standardise internal processes and data which yield greater internal efficiencies and more accessible, standardised and transparent service delivery (OECD, 2009).
- The **Open Government Partnership** (OGP) is an international platform for domestic reformers committed to making their governments more open, accountable and responsive to citizens. Participating countries are required to develop an OGP action plan through a multi-stakeholder, open, participatory process. These action plans aim to drive reforms in the areas of transparency, accountability and citizen engagement by elevating the principle of open government to the highest levels of political discourse (OGP, 2014).

The Government Accountability Sub-Dimension is, on average, the lowest scoring sub-dimension in the Effective Public Services Dimension. It is also the one with the greatest range, which reflects the wide variations in performance, and the one with the most room for improvement. The Former Yugoslav Republic of Macedonia with a score of 3 leads the region and has begun to implement frameworks in all three policy areas. Bosnia and Herzegovina has the lowest score with just over 1, which reflects the fact that it has a framework in place only in the access to public information indicator (Figure 14.8).

Figure 14.8. **Government Accountability: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Access to public information leads the way in government accountability

Access to public information is the highest-scoring area, as it is the only one where all economies have a framework in place. In the OPG indicator, neither Kosovo nor Bosnia and Herzegovina have yet adopted frameworks (Table 14.4).

Table 14.4. **Government Accountability Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Access to public information	3.0	2.0	3.0	3.0	3.0	3.0
E-government services	2.0	1.0	2.0	3.0	2.0	2.0
Open Government Partnership	3.0	1.0	1.0	3.0	3.0	2.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All SEE economies have legislation in place for the right to access public information with reasonable administrative fees. Despite being the first in the region to adopt such a law in 2000, Bosnia and Herzegovina is now lagging behind in implementation across all institutions and levels of governments. However, in all the SEE economies, exemptions from access to information are not clearly defined and monitoring bodies and activities are lacking. The Office of the Prime Minister in Kosovo prepares an annual report on the achievements of the right to access public documents.

The United Nations E-Government Survey has produced the E-Government Development Index since 2001. The index is composed of three key dimensions which can also be considered individually: online service availability, telecommunication infrastructure and human capacity (UN, 2014). Of the 193 UN member countries analysed in 2014, the rankings of the SEE UN member economies – all economies save Kosovo – range from Bosnia and Herzegovina's 97th position to Serbia's 69th, with Montenegro a regional outlier in 45th place. From 2012 to 2014, the five SEE economies increased their E-participation Index Scores, with Albania making the most improvement, second only to the regional leader Montenegro. Scores changed very little in the same time period in the Online Service Index, the Human Capital Index and the Telecommunication Infrastructure Index (UN, 2015).

All SEE economies have a framework for e-government services in place apart from Bosnia and Herzegovina which has legislation set to be adopted. The Former Yugoslav Republic of Macedonia leads the region in implementation. The SEE economies have basic sets of e-services – mostly government-to-business services. Most e-services are one-way interaction forms, with the exception of some services in Serbia (environment and construction permits, licence applications, customs declarations, etc.) and the Former Yugoslav Republic of Macedonia (treasury and programmatic budgeting, electronic cadastre and related registers of ownership). Upcoming donor projects in the region the IPA or World Bank, are set to target e-government services and could lead to their improvement in the near future.

The Former Yugoslav Republic of Macedonia, Montenegro and Albania, are implementing their first OGP action plan and developing a second. Serbia concluded its first action plan and began implementing it in late 2014 with the first completion rates available in June 2015. According to the latest OGP progress reports, Albania had the highest share of substantial or complete commitments (53.3%), followed by Montenegro (35.7%) and the Former Yugoslav Republic of Macedonia (22.8%). Albania also adopted OGP commitments with moderate or transformative potential impact and finalised implementation of a large share of commitments. Kosovo is the only economy which is not yet an OGP member, although the government did officially start its OGP membership application process in July 2014.

Box 14.2. **E-services in Estonia**

Estonia's e-governance strategies have made its public administration one of the most modern of the present day. With almost 100% of e-services available for citizens and businesses, 94% of personal income tax returns declared online, and 25% of votes in the last parliamentary elections being cast online, Estonia revolutionised the interaction between citizens and the government.

Estonia's success is underpinned by a decentralised authentication and interoperable digital system, the eID, which allows citizens and the business community to access e-services simply by swiping their national ID on a card reader. As a former communist country, with limited commercial activity and a legacy of heavy bureaucracy, Estonia based the development of its governance on the building of open and transparent e-services. A few key success factors stand out, starting with the relevant regulations adopted right after Estonia gained independence in 1991, supported by a strong political will. Gradually, legislative efforts were doubled by training efforts (i.e. the "Tiger leap" initiative) to familiarise citizens with the use of e-services. Moreover, the Estonian government also provided financial and tax incentives for citizens to promote the use of the eID and connected services. On the institutional side, one of the key aspects of the Estonian initiative is the public-private partnership and international collaboration. For example, banks collaborated with the government to ensure and build trust in e-banking, by offering free of charge smartcard ID readers.

However, introducing e-governance is a complex process. Addressing privacy concerns, transparency issues, building trust and ensuring the right legislation in place are a few of the challenges of any country embarking on e-governance reforms. When starting from scratch, as would be the case for the SEE economies, it is important that a user base for the e-portal is built quickly to ensure the cost-effectiveness of the reform and cover the initial investment. To incentivise the use of the eID system, the Estonian government offered a 30% discount on public transportation for those who registered. This action was followed by an increase of 213% of users in one year.

Source: McKinsey&Company (2012), *Insights and publications – innovation in government: India and Estonia* (webpage), www.mckinsey.com/insights/public_sector/innovation_in_government_india_and_estonia.

The way forward in government accountability

As SEE economies look to the future, awareness and promotion of the e-government portals and services could be increased. SEE economies have a high number of commitments related to the four OGP values (public participation, accountability, and technology and innovation for openness and accountability), but there is often no implementation timeline with clear annual benchmarks. Member economies could thus strengthen their OGP commitments and timetable to facilitate further e-governance implementation.

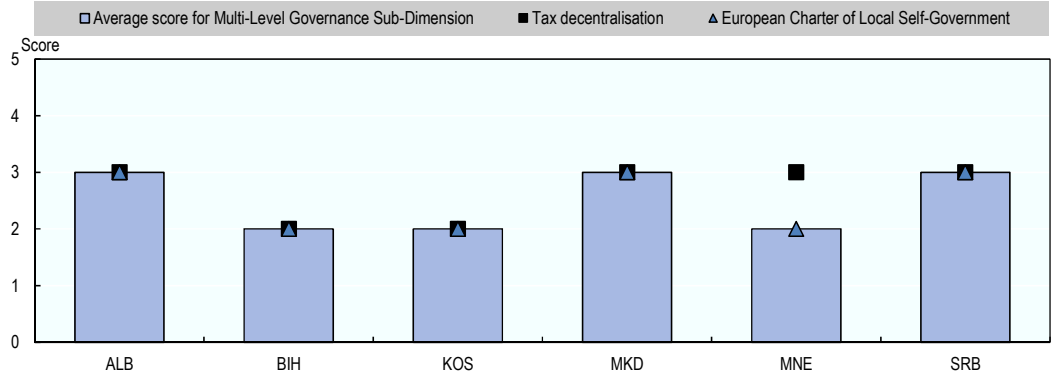
Multi-Level Governance Sub-Dimension

Decentralisation aims to bring decision and policy making closer to local residents and the business community so that policies match needs more closely. It devolves responsibilities and capacities across levels of government. Clear allocation of powers and responsibilities is critical to well-co-ordinated multi-level governance (Rodrigo et. al, 2009). Furthermore, functional local self-governance is a prerequisite for accession to the European Union.

This section looks at the Multi-Level Governance Sub-Dimension. It examines the performances of the SEE economies by assessing how they fare against two qualitative indicators.

- **Tax decentralisation** addresses tax-sharing arrangements between national and local government levels, including revenue and spending mechanisms. The tax decentralisation indicator seeks to capture explicit and implicit institutional arrangements that are in place (OECD, 2013).
- The **European Charter of Local Self-Government** seeks to establish common European standards for measuring and safeguarding the political, administrative and financial independence of local authorities. Local authorities are the tier of government closest to citizens and the one that gives them the best opportunity of participating effectively in decision making that affects their everyday environment (Council of Europe, 1988).

Figure 14.9. **Multi-Level Governance: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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All the SEE economies have frameworks in place in both policy areas. Kosovo and Bosnia and Herzegovina have yet to fully implement both frameworks, while Montenegro has implemented tax decentralisation. Albania, the Former Yugoslav Republic of Macedonia and Serbia implement both frameworks (Figure14.9).

Municipal administrative capacities could be strengthened

All SEE economies legally recognise the principle of local self-government. Municipalities could be strengthened both at central and local levels, particularly in the areas of financial control, strategic planning, human resources management and economic development (Table 14.5).

Table 14.5. **Multi-Level Governance Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax decentralisation	3.0	2.0	2.0	3.0	3.0	3.0
European Charter of Local Self-Governance	3.0	2.0	2.0	3.0	2.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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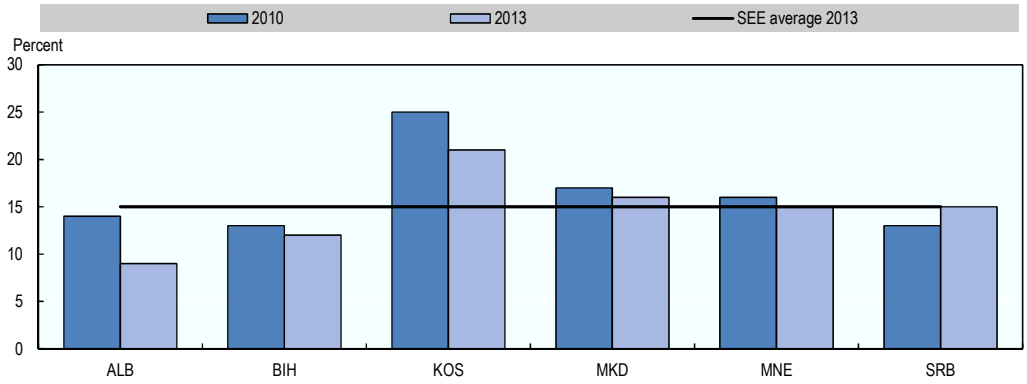
Most of the SEE economies have an overall regulatory framework almost fully compliant with the European Charter of Local Self-Government. Five out of the six SEE economies ratified the European Charter with the Former Yugoslav Republic of Macedonia the first to do so in 1997. In the last 15 years, the four other economies – Albania (2000), Bosnia and Herzegovina (2002), Serbia (2007) and Montenegro (2008) – joined the Council of Europe and adhered to the principles of the Charter on Local Self-Government. Despite not being a member of the Charter, the activity of local self-government bodies in Kosovo is based on the Kosovo Constitution and legislation which respect the principles of the European Charter of Local Self-Government.

Three of the economies have made further efforts to improve the real transfer of responsibilities and funding to the local level. Several competences have been transferred to the local level in Albania (e.g. water distribution, forest and waste management). Debates are also underway on the possible pooling of municipalities' resources. Further efforts to increase political and fiscal decentralisation are being made in the Former Yugoslav Republic of Macedonia, while Serbia has increased numbers of civil servants at the local level. Montenegro follows closely behind, implementing new rules related to the election of local representatives' elections as well as new municipal financing rules. In Bosnia and Herzegovina, some incentives are also directed towards the establishment of a shared tax at the local level. However, the share of expenditure and investment on the sub-national level remains below the OECD average (Figures 14.11 and 14.12).

In SEE, the share of sub-national-level revenues in total public revenue is roughly 15%, below the EU average of around 25% (Figure 14.10). Local governments in the region derive their revenues from four different sources: general grants, earmarked grants, shared taxes and own-revenues. Most local level own-revenues are related to the real estate market through property tax, construction permits and other business operations. However, property tax revenue remains below the EU average, with the exception of Montenegro (NALAS, 2014).

Figure 14.10. **Tax revenue collected at sub-national level 2010 and 2013**

Percent of overall national tax revenue



Source: National administrations, Ministries of Finance, Network of Associations of Local Authorities of South East Europe.

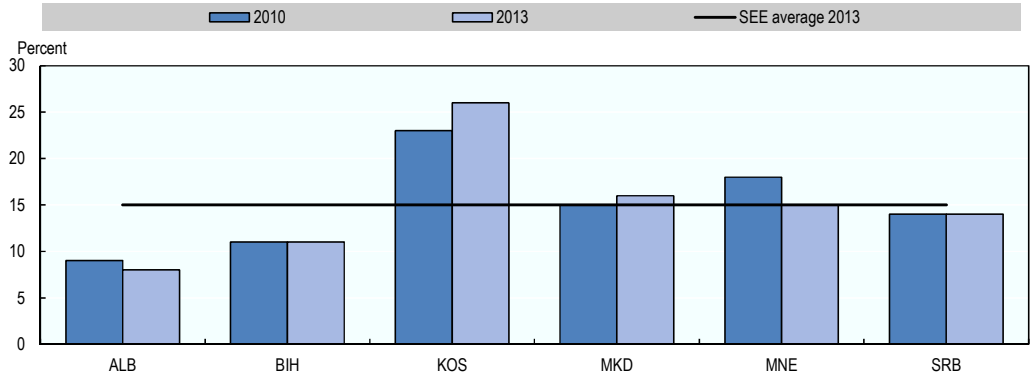
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Local governments in Kosovo and the Former Yugoslav Republic of Macedonia seem to receive the highest share of total public revenues, suggesting there is more effort invested at the local level. At the other end of the spectrum, local governments in Albania receive a low share of public revenues. However, it has recently developed its National Cross-cutting Strategy for Decentralisation and Local Governance 2014-20, meant to strengthen its fiscal decentralisation.

A closer look at the composition of local public revenues gives an insight into the actual financial autonomy of the local governments. The Former Yugoslav Republic of Macedonia and Kosovo governments receive the highest share of earmarked grants from the central government, limiting their financial autonomy by imposing an over-regulated block grant. On the other hand, Montenegro has a limited share of conditional grants and a high percentage of revenues drawn from own-resources, mostly from asset sales and rentals, land development fees and personal income tax surcharges.

Figure 14.11. **Expenditure at the sub-national level, 2010 and 2013**

Percent

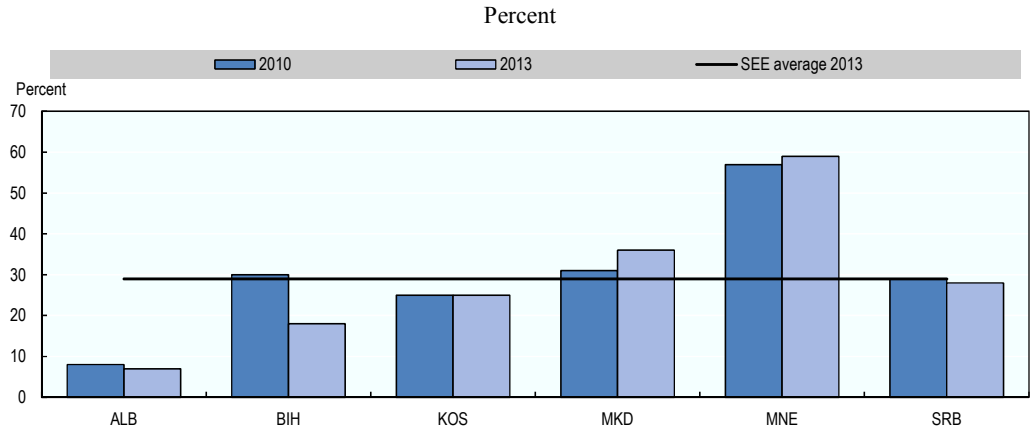


Source: National administrations, Ministries of Finance, Network of Associations of Local Authorities of South East Europe.

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Municipal disparities remain a regional issue, especially because the higher density population in capital cities distorts tax yields. General grants, which aim to level tax distribution inequalities, remain limited in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia.

Figure 14.12. **Investment at sub-national level, 2010 and 2013**



Note: Data for Albania for the year 2013 as of 2012.

Source: National administrations, Ministries of Finance, Network of Associations of Local Authorities of South East Europe.

StatLink http://dx.doi.org/10.1787/888933322678

The way forward in multi-level governance

As SEE economies look to the future, efforts could be taken towards decreasing the dependency on the central authority and further strengthening the political, administrative and financial independence of local authorities. Implicit benefits come from maximising social welfare by allowing governance to develop more efficiently closer to citizens, taking into account regional, social and economic disparities.

Conclusions

During the last ten years, SEE economies have progressively improved their public administration. Efforts are more visible in the simplification and improvement of administrative and regulatory frameworks through the use of specific policy tools, such as the regulatory guillotine, regulatory impact analysis and private public consultations in policy making. Merit-based recruitment and promotion systems are also at the core of the reform agenda aiming to reduce civil service politicisation. Efforts are backed up by an increase in transparency opportunities thanks to the use of online platforms for government services.

Nevertheless, a series of challenges remain. Measures are only partly implemented and policy tools are not systematically used across policy areas. Laws are often passed in urgent procedures, so limiting the government-parliament consultation process. Recruitment and promotion practices remain formal at times, with no spillover to career opportunities and wages. Despite a high commitment to increase e-governance structures through the adherence to OGP membership, too many measures are undertaken by the

SEE economies without being effectively followed through. The transfer of functions and the necessary funding to local government is at an early stage.

Ensuring that the relevant measures are fully implemented and respected within the civil service in SEE could significantly improve the quality of services and build trust. In return, effective public administration would contribute to inclusive growth and the building of resilient economies.

Note

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Chapter 15.

Anti-corruption policy in South East Europe

Corruption is the abuse of entrusted authority for personal benefit. This chapter on the Anti-corruption Policy Dimension analyses five sub-dimensions of anti-corruption policy development and implementation. The Transparent Rules Sub-Dimension describes such corruption-preventive instruments as corruption risk assessment and corruption proofing of legislation. The Competitive Procedures Sub-Dimension examines measures to curb corruption in public procurement. The Revision and Control Sub-Dimension assesses the frequency and quality of investigations as a result of public control and auditing. The Public Awareness Sub-Dimension analyses government efforts to inform the public on negative effects of corruption on society and ways to avoid getting involved in bribery. The Implementing Institutions and Regional Co-operation Sub-Dimension measures the development of implementing institutions, inter-agency co-operation and information exchange, regional co-operation and mutual legal assistance.

Main findings

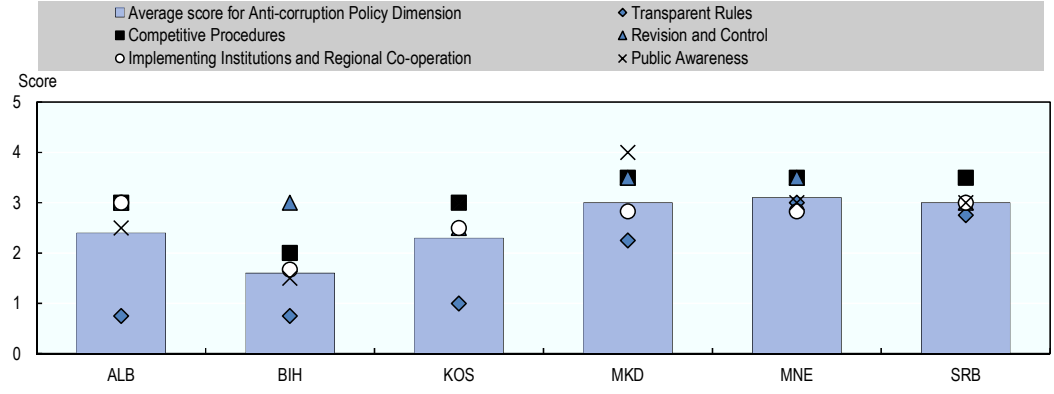
Corruption adversely affects foreign investment (Hellman, Jones and Kaufmann, 2002), public expenditure (Mauro, 1998) and trade (Kaufmann, 2004). Fighting it, therefore, is essential to the broad goal of promoting growth. Corruption can increase public spending and business costs, and damage overall government efficiency.

Governments in South East Europe (SEE) have recognised the importance of anti corruption measures in their national policy documents and legal frameworks by developing corruption risk assessment tools and establishing specialised anti-corruption agencies. However, many bodies active in the fight against corruption – notably those in Albania, Bosnia and Herzegovina and Kosovo – remain understaffed or underfunded. In addition, in their previous efforts to fight corruption, the three economies have implemented instruments without consistent, periodic monitoring or evaluation. Today, their national anti-corruption strategies make monitoring a priority for the future. Monitoring and evaluating the public procurement framework and anti-corruption activities themselves could be intensified to increase the effectiveness of anti-corruption measures in the region (Figure 15.1).

Corruption proofing of legislation remains an underdeveloped instrument in South East Europe. The highest-scoring indicators in the assessment of the Anti-corruption Policy Dimension pertain to the Competitive Procedures and to the Revision and Control sub-dimensions (Figure 15.1). The reason is that state auditing institutions are generally compliant with the Lima Declaration of the International Organisation of Supreme Audit Institutions (INTOSAI).

Co-operation between agencies involved in the fight against corruption is an area in need of improvement in the region. In most cases, a central body has been set up or will be established in the near future to co-ordinate the anti-corruption effort. However, effective co-ordination is still lacking in some cases due to the high number of institutions involved and their sometimes conflicting priorities.

Figure 15.1. **Anti-corruption Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322688

Achievements

The SEE economies have seen recent improvements in setting up frameworks to combat corruption.

SEE economies have taken steps to establish legal and institutional frameworks in the fight against corruption. Most of them have made progress over recent years in establishing and conducting corruption risk assessments.

The SEE economies have introduced e-procurement systems. The legal frameworks governing public procurement have seen improvements. Out of the six SEE economies, Albania and the Former Yugoslav Republic of Macedonia have further advanced their proactive e-procurement services, while the other four are currently updating or planning the implementation of full electronic case-handling procedures.

Challenges

Despite progress in establishing anti-corruption frameworks, SEE economies have challenges in fully implementing them.

Public procurement remains vulnerable to corruption. Developments in e-procurement have improved substantially in the region, though public procurement remains an area that is particularly vulnerable to corruption. Systematic monitoring and evaluation of public procurement should be improved regionally.

Limited budgets reduce the scope of the work of the agencies involved in the fight against corruption. Strained financial resources and the lack of qualified staff are common challenges that curtail the effect of the initiatives undertaken by anti-corruption agencies.

Regional co-operation between anti-corruption agencies is limited. Agencies may need access to information outside of their jurisdictions to pursue corruption. Regular co-operation which complies with best practices and international conventions is thus a key element of well-functioning anti-corruption institutions.

The application of corruption-proofing tools, such as legislation proofing and risk assessment, is not common practice in all SEE economies. Most of the corruption risk assessments are carried out through sporadic international projects, though they should be continuously deployed over long periods of time. Legislation proofing is a key process in diminishing the incidence of corruption, yet to date it is lacking in three SEE economies.

Recommendations

A number of strategic steps are needed to further strengthen anti-corruption policy development and implementation.

Ensure that systematic monitoring and evaluation of public procurement takes place. Making use of the full potential of e-procurement procedures could facilitate monitoring and evaluation and reduce the risk of corruption.

Support the capacity building of anti-corruption institutions. To ensure the success of anti-corruption bodies, the SEE economies could consider further bolstering their resources.

Ensure effective co-ordination between institutions involved in the fight against corruption. Although legislative frameworks have improved and resulted in institutional focal points, the SEE economies could consider further streamlining and centralising the network of communications and agreements between institutions involved in the fight against corruption.

Complete the national legal framework governing anti-corruption instruments and ensure effective implementation. Although the use of corruption risk assessments and corruption proofing of legislation has been endorsed by all six SEE economies, its effective implementation could be driven forward.

Overview

As there is no universally accepted definition of corruption, most international conventions prefer to identify a range of corrupt offences. Corruption, for the purposes of this report, will refer to the misuse of entrusted authority for personal benefit (OECD, 2015a). Because corruption negatively affects foreign investment (Hellman, Jones and Kaufmann, 2002), public expenditure (Mauro, 1998) and trade (Kaufmann, 2004), fighting it is essential to the broad goal of promoting growth. In broader terms, corruption is institutional, represents a cost for society and the private sector, and spans most of the policy dimensions covered in this publication, particularly:

- **Chapter 14. Effective public services** and procurement processes of integrity are an obligation of the government. The necessary procurement skills and powers should be made available to the relevant authorities. Anti-corruption efforts in public procurement have been supported by the substantial development of e-procurement in the region. Nevertheless, public procurement remains an area vulnerable to corruption. An effective civil service needs to be transparent and ensure merit-based recruitment and promotion procedures to curb civil servants' vulnerability to corruption.
- **Chapter 1. Investment policy and promotion** is facilitated by low corruption. Countries with low levels of corruption boast larger inflows of foreign direct investment (Castro and Nunes, 2013). Therefore, engaging in anti-corruption policies can pave the way for FDI.
- **Chapter 3. Education and competences** is a powerful driver of economic growth, conversely "corrupt schools and universities hinder prosperity, cause long-term damage to societies and raise the cost of education at the expense of equity and quality" (OECD, 2012). Moreover, when students experience corrupt behaviour at an early age, they are more likely to internalise tolerance towards corruption. Corrupt behaviour can thus become a social norm that is passed on to the next generation (Transparency International, 2013).

Box 15.1. Anti-corruption Policy Dimension in the SEE 2020 Strategy

The Anti-corruption Dimension is part of the Governance for Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of this pillar is to facilitate economic growth through quality governance as a cross-cutting prerequisite to all SEE 2020 Strategy objectives. The Anti-corruption Dimension in particular focuses on components that help develop a business-friendly environment through reduced corruption in public administration. The SEE 2020 headline target is to increase the Worldwide Governance Indicator on government effectiveness from 2.3 in 2010 to 2.9 in 2020.

The SEE 2020 Strategy further specifies key areas in anti-corruption. These include transparent rules of public service access, increased public awareness, competitive procedures in public procurement, independent programme auditing and law enforcement capacities.

The Regional Anti-Corruption Initiative (RAI) is the official SEE 2020 Strategy partner of the SEE 2020 Anti-corruption Policy Dimension. Based in Sarajevo, RAI is an intergovernmental organisation that deals solely with anti-corruption issues.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf .

Anti-corruption Policy Dimension assessment framework

This chapter analyses anti-corruption efforts in SEE. It does not seek to be exhaustive, however. It confines itself to assessing five broad sub-dimensions based on the Governance for Growth Pillar of the SEE 2020 Strategy:

- Transparent Rules

  How well do SEE economies perform in corruption risk assessment and corruption proofing of legislation? How many integrity plans are being produced based on corruption risk assessments and how large is the share of draft laws screened for corruptibility factors?

- Competitive Procedures

  How large is the share of government contracts awarded through negotiated procedures? To what extent is e-procurement used?

- Revision and Control

  How many public institutions are independently audited in SEE economies? How many investigations are launched, in comparison to all audits performed?

- Public Awareness

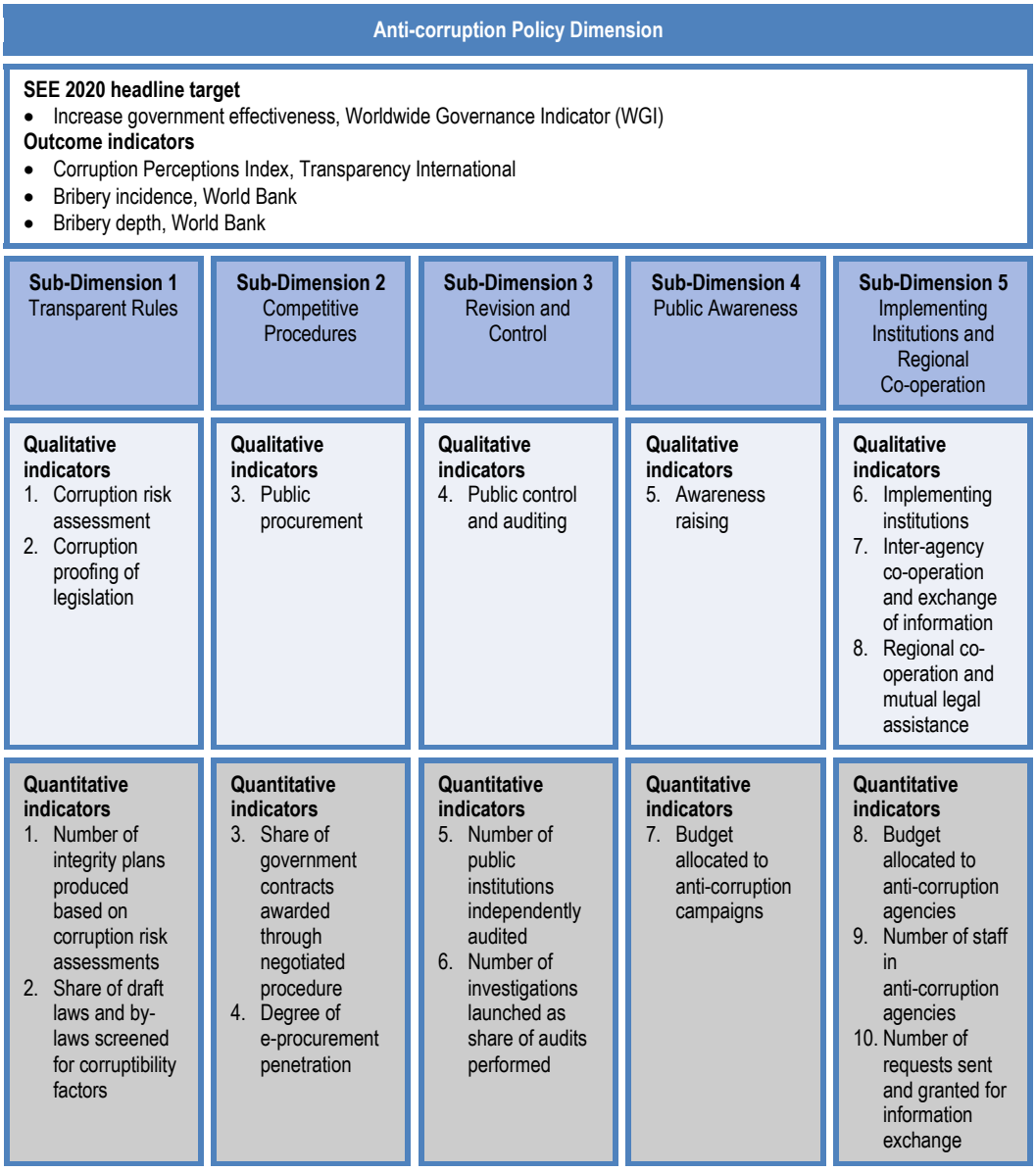
  To what extent are public awareness campaigns against corruption conducted in SEE economies? How big is the budget allocated to anti-corruption campaigns in SEE economies?

- Implementing Institutions and Regional Co-operation

  How big is the budget allocated to anti-corruption agencies by SEE economies? How large are the human resources of anti-corruption agencies in SEE economies? How many requests are sent and granted for information exchange between SEE economies?

Figure 15.2 shows how the sub-dimensions and their constituent indicators make up the Anti-corruption Policy Dimension assessment framework.

Figure 15.2. **Anti-corruption Policy Dimension assessment framework**



Each sub-dimension is assessed through quantitative and qualitative indicators. With the support of the OECD, the Regional Anti-Corruption Initiative (RAI) collected qualitative and quantitative data on the Anti-corruption Policy Dimension.

Quantitative indicators are based on national or international statistics. Qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

Anti-corruption performance in SEE economies

Government effectiveness is the SEE 2020 headline target for this policy dimension. As such, its achievement is key to assessing the presence of corruptibility factors within state bodies and shaping the appropriate policies. Government effectiveness looks at civil society perceptions of issues such as the quality of public services, the independence of

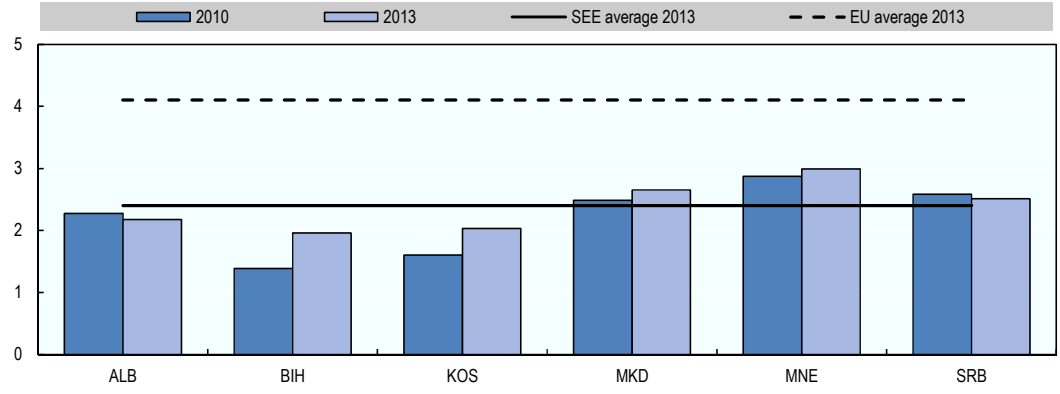
the civil service from political pressures, the quality of policy formulation and implementation and the credibility of the government's commitment to such policies (Kaufmann, Kraay and Mastruzzi, 2010).

Since 2010, the region has made progress in the government effectiveness indicator of the World Bank's Worldwide Governance Indicators (WGI) (see Chapter 14). The lowest SEE performer against the indicator in 2010 was Bosnia and Herzegovina, with a score of 1.39. Though it was again one of the weaker performers in 2013, it nevertheless improved its score to 1.96. Meanwhile, Montenegro, the highest performer against the WGI government effectiveness indicator, increased its score from 2.89 to 2.99 between 2010 and 2013. Only two economies, Albania and Serbia, obtained marginally lower scores against the indicator in 2013 than in 2010 (see Figure 15.3). The regional score, however, remains behind the EU average.

The overall quality of government effectiveness fell in the wake of the recent economic crisis, signalling that the perception and confidence of citizens in their governments was shaken by the economic turmoil. The limited increase in government effectiveness between 2010 and 2013 could act as a warning sign that the economies should increase the transparency level of their public services and pursue an open governance framework, with accountable policy development processes that include the larger business community and civil society organisations.

This chapter assesses the SEE economies' anti-corruption performance through three outcome indicators: the Corruption Perceptions Index (Transparency International), bribery incidence (World Bank) and bribery depth (World Bank).

Figure 15.3. **Government effectiveness, 2010 and 2013**



Note: The RCC adapted the WGI percentile rank scale of 0-100 to a scale of 0-5 for the SEE 2020 Strategy.

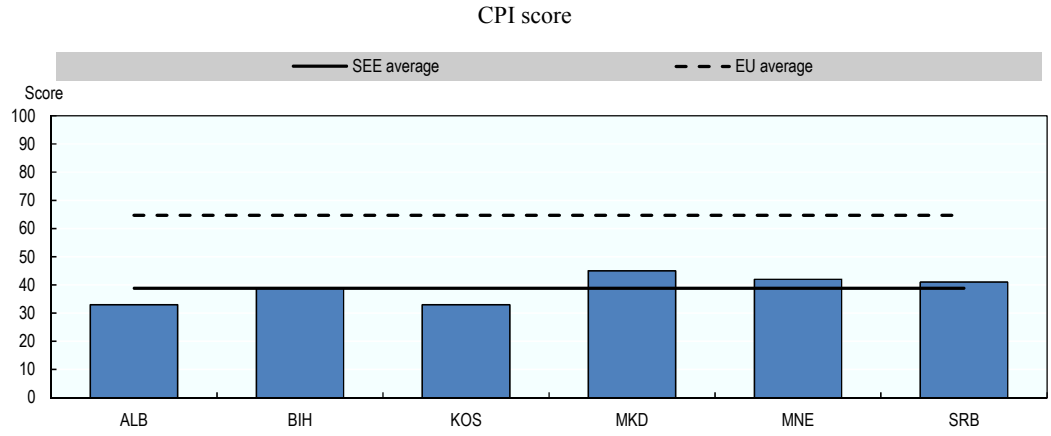
Source: Adapted from World Bank (2015a), *Worldwide Governance Indicators* (database), http://info.worldbank.org/governance/wgi/index.aspx#reports.

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The Corruption Perceptions Index, one of the most prominent studies of corruption, surveys individuals on their perceptions of institutional corruption and undue political influence. Countries are given a score, ranging from 0 (highly corrupt) to 100 (absolutely upstanding) based on a survey administered to the general public and various data sources. In 2014, the six SEE economies recorded an average score of 39, compared to the EU average of 65 (Figure 15.4). The score placed the SEE economies in the top half of the ranking. Among the countries, the Former Yugoslav Republic of Macedonia was

the region's best performer in the Corruption Perceptions Index, with a score of 45. Montenegro and Serbia also registered higher scores. The weakest performers in SEE were Albania and Kosovo, each with a score of 33. The scores suggest that citizens in the region perceive high degrees of corruption within their state institutions, pointing to dysfunctions and inefficiencies in public governance.

Figure 15.4. **Corruption Perceptions Index (CPI), 2014**



Note: Scores indicate the perceived level of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean). Based on data reported for the period 2012 until 2014.

Source: Transparency International (2014), *Corruption Perceptions Index 2014: Results* (webpage), www.transparency.org/cpi2014/results.

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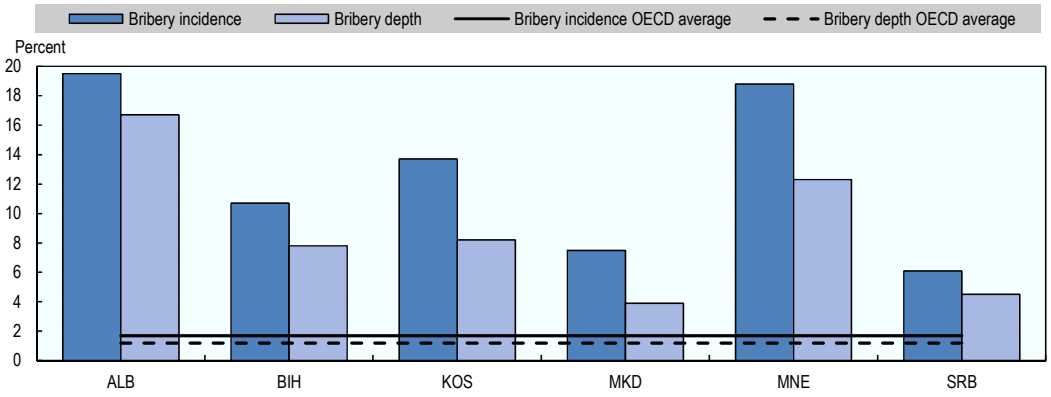
The incidence and depth of bribery are important factors that affect the perception of public services and, thereby, government effectiveness (Figure 15.5). The Enterprise Surveys, conducted by the World Bank, are surveys of local firms responding to questions related to their experiences with bribery. Bribery incidence refers to the percentage of firms experiencing at least one bribe request during six transactions, dealing with utilities access, permits, licences and taxes. Bribery depth refers to the percentage of the same six transactions where a gift or informal payment was requested.

The best performers were Serbia and the Former Yugoslav Republic of Macedonia, though all the economies were below the OECD average against the bribery incidence and depth indicators. Albania and Montenegro were the poorest performers in the SEE in both indicators. In Albania, 19.5% of firms reported having experienced at least one bribery request (bribery incidence), and a request for a bribe was reported to have been requested in 16.7% of transactions (bribery depth). The OECD average was 1.7% in bribery incidence and 1.2% in bribery depth, suggesting a wide discrepancy between the SEE region and more developed economies. Bribes and informal transaction payments remain common in the region, eroding investor trust and hampering the business environment.

The rest of this chapter seeks to offer insights into the observed performance by analysing aspects of the underlying policy framework for anti-corruption in the SEE region. The analysis is built on five sub-dimensions of the Anti-corruption Policy Dimension: Transparent Rules, Competitive Procedures, Revision and Control, Public Awareness, Implementing Institutions and Regional Co-operation.

Figure 15.5. **Bribery incidence and depth, 2013**

Percent



Note: Bribery incidence refers to the percentage of firms experiencing at least one bribe payment request during six transactions, dealing with utilities access, permits, licences and taxes. Bribery depth refers to the percentage of transactions (out of six transactions dealing with utilities access, permits, licences, and taxes) where a gift or informal payment was requested.

Source: World Bank (2015b), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

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Transparent Rules Sub-Dimension

Establishing transparent rules means "to move away from discretion to rule-based political and administrative decision making by conducting risk assessment actions and adopting public, simple and enduring rules" (RCC, 2013). The Transparent Rules Sub-Dimension assesses the overall performances of the SEE economies through two indicators.

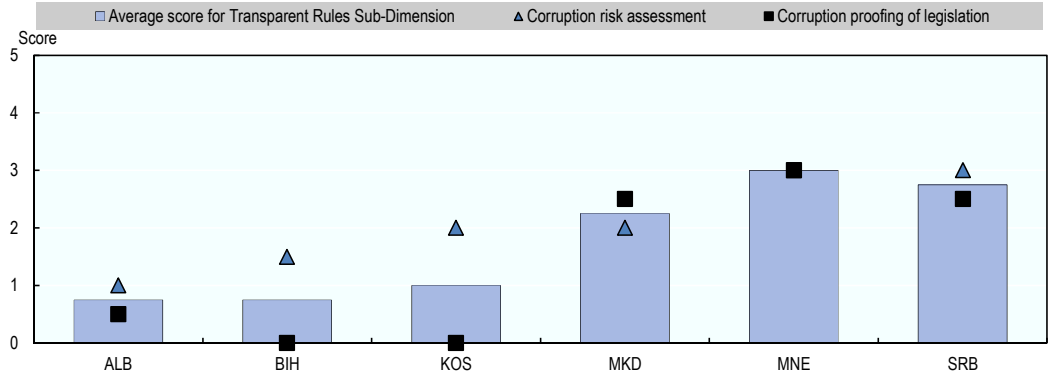
- **Corruption risk assessments** are diagnostic and corruption-preventive instruments that seek to identify weaknesses in an institution that may offer opportunities for corruption (McDevitt, 2011). Moreover, they are useful for anti-corruption practitioners to concentrate their efforts on particular institutional processes and functions. In this respect, integrity plans in public institutions play a vital role. Many countries have given legal undertakings, made political commitments or – at least officially – endorsed methodologies to develop integrity plans for public institutions. They encourage the institutions to adopt an integrity plan that:
  - assesses the institution's exposure to corruption
  - names persons responsible for the plan
  - describes typical work processes, approaches to decision making and assessments of exposure to corruption
  - proposes measures to enhance integrity and detect, prevent and eliminate risks of corruption in a timely manner.

  National anti-corruption institutions generally have the authority to check the adoption and implementation of integrity plans.

- **Corruption proofing of legislation** helps to identify possible corruptibility factors, such as ambiguous linguistic formulations, faulty reference provisions, excessive discretion of public authorities, insufficient control mechanisms or inadequate sanctions for violations (Hoppe, 2014).

Wide disparities in Transparent Rules Sub-Dimension average scores separate the SEE economies. This is because the highest-scoring economies – the Former Yugoslav Republic of Macedonia, Montenegro and Serbia – have taken positive steps to implement the frameworks, while implementation is much less advanced in Albania, Bosnia and Herzegovina, and Kosovo. All the SEE economies have endeavoured to conduct corruption risk assessments, mostly through international projects. However, more efforts could be directed at institutionalising the use of tools to make legislation corruption proof.

Figure 15.6. **Transparent Rules: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322727

Integrity plans are being adopted by an increasing number of institutions in the SEE region. Nonetheless, the effective implementation of these instruments remains to date incomplete in a number of economies, although the adoption of integrity plans by public institutions is an objective in the current anti-corruption strategies of all six economies (in Kosovo the development of integrity plans are part of the Support to Anti-Corruption Efforts in Kosovo [SAEK] project). Improving the identification of factors conducive to corruption with risk assessments will help to produce transparent rules that reduce the incentive to partake in corrupt practices.

On average, the economies score 2.1 against the corruption risk assessment indicator, which indicates that most have adopted a regulatory framework. The conduct of corruption risk assessments is not yet common practice in SEE, though some economies have put in place a system for their implementation.

The higher-scoring group – the Former Yugoslav Republic of Macedonia, Montenegro and Serbia – have not only adopted relevant legislation but have also conducted regular corruption risk assessments. As of July 2014, integrity plans had been adopted by 35 institutions in Montenegro, while 74 of the 102 state authorities compelled under the law to introduce integrity plans had appointed integrity manager. In Serbia, about half of all public entities (2 121 out of 4 483) had drawn up integrity plans by

April 2013, although the anti-corruption agency law does not prescribe sanctions for failing to adopt an integrity plan.

The three higher-scoring economies also lead in corruption proofing of legislation, which remains a generally underdeveloped instrument in the SEE region, as demonstrated by the regional average score of 1.4.

Table 15.1. **Transparent Rules Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Corruption risk assessment	1.0	1.5	2.0	2.0	3.0	3.0
Corruption proofing of legislation	0.5	0.0	0.0	2.5	3.0	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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In Serbia, the anti-corruption agency has the mandate to "launch initiatives for amending and enacting regulations in the field of combating corruption" and to "co-operate with other state bodies in drafting regulations in the field of fight against corruption" (Article 5 of the Law on the Anti-Corruption Agency). Moreover, Serbia's Anti-Corruption Strategy 2013-18 underlines the "obligation for all authorities proposing regulations to carry out an analysis of effects on corruption in the process of drafting a regulation on the basis of a methodology developed by the Agency" (Article 4.1). Consequently, all laws and bylaws are formally subject to corruption proofing.

Montenegro does not apply a specific corruption proofing mechanism, although the secretariat for legislation issued legal and technical rules for drafting legislation. Montenegro also allows feedback from public consultations on draft laws. As for the Former Yugoslav Republic of Macedonia, even though it does not make all draft laws subject to corruption proofing, its State Commission for the Prevention of Corruption is competent to issue opinions on laws "important for corruption prevention" and "for prevention of conflict of interests" (Art. 49 of the Law on Prevention of Corruption). Thus, state authorities drafting relevant laws are obliged to submit their drafts to the state commission for review.

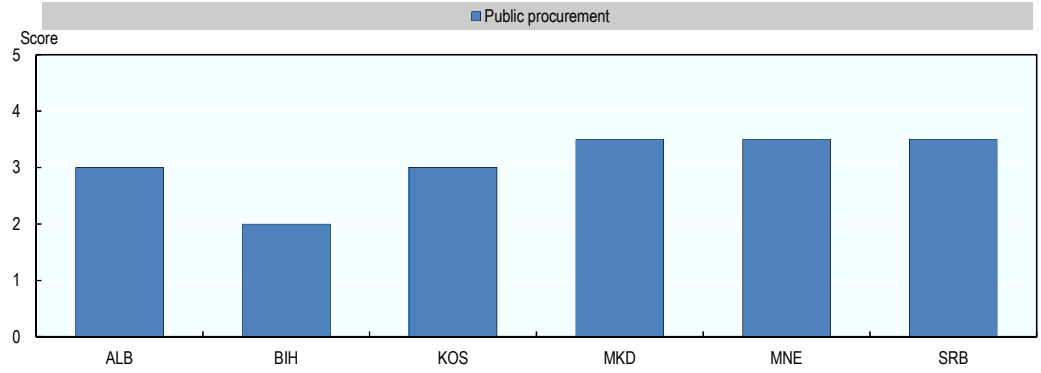
In Kosovo, corruption risk assessment was conducted for the first time in November 2012 in sectors such as tax administration, health and the judiciary. In Albania, corruption risk assessments are not generally conducted, although the current anti-corruption strategy makes it a priority. Under the Project against Corruption in Albania (PACA), funded by the EU and implemented by the Council of Europe, a risk assessment overview and document were drafted. However, there is no corruption proofing of legislation in Albania – or in Kosovo or Bosnia and Herzegovina. However, Albania's Draft National Strategy against Corruption 2014-17 specifies corruption proofing as a means for the government to strengthen the fight against corruption.

Going forward, economies could put more emphasis on the corruption proofing of legislation. Corruption-proofing processes are encouraged by anti-corruption experts from interested institutions, the private sector and civil society. The screening process, which may be conducted by an anti-corruption agency, generally results in a set of recommendations to help ensure the strength of the legislation, reducing its vulnerability to corruption.

Competitive Procedures Sub-Dimension

The Competitive Procedures Sub-Dimension assesses measures to curb corruption through the **public procurement** qualitative indicator. Public procurement is widely prone to corruption, for instance when government procurement contracts are negotiated without prior published notice rather than through calls for tender that are open to a wide range of actors.

Figure 15.7. **Competitive Procedures: Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The average score in the Competitive Procedures Sub-Dimension is 3.1, which indicates that the economies have generally adopted transparent public procurement frameworks and made progress in implementing them. Most of the economies have also considerable developed e-procurement legislation and procedures, though public procurement remains an area that is vulnerable to corruption.

Table 15.2. **Competitive Procedures Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Public procurement	3.0	2.0	3.0	3.5	3.5	3.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Public procurement corruption frameworks are in place but insufficiently monitored, while e-procurement is underdeveloped

The legal framework for public procurement has been developed and is comprehensive in most economies in SEE, though enforcement and monitoring remain challenging. With the exception of Bosnia and Herzegovina, the rest of the economies have set up appeals systems and provide public information regarding government contracts.

In Albania, public procurement is conducted through the online platform of the Agency of Public Procurement. In Montenegro, an information technology (IT) system which enables the constant monitoring of procurement procedures was introduced in 2012

and updated in 2013. In Serbia, the public procurement portal has been upgraded and a law on public procurement entered into force in April 2013, strengthening the powers of the Public Procurement Office (PPO). In Bosnia and Herzegovina, a functional public procurement agency has been established. It has developed an electronic system and is governed by the law on public procurement, adopted in 2014.

However, available data for the Former Yugoslav Republic of Macedonia, Montenegro and Serbia show that, in practice, the number of e-procurement negotiations remains limited (e.g. only 12% out of the total number of government procurement contracts at the state level in 2013 in the Former Yugoslav Republic of Macedonia). Likewise, except for the Former Yugoslav Republic of Macedonia, the number of contracts negotiated through calls for tender is still significantly smaller than those awarded through direct government lead negotiations.

Moving forward, governments could ensure the systematic monitoring and evaluation of public procurement. Good practices in public procurement include the use of a central e-portal for issuing public calls for tender in order to increase transparency.

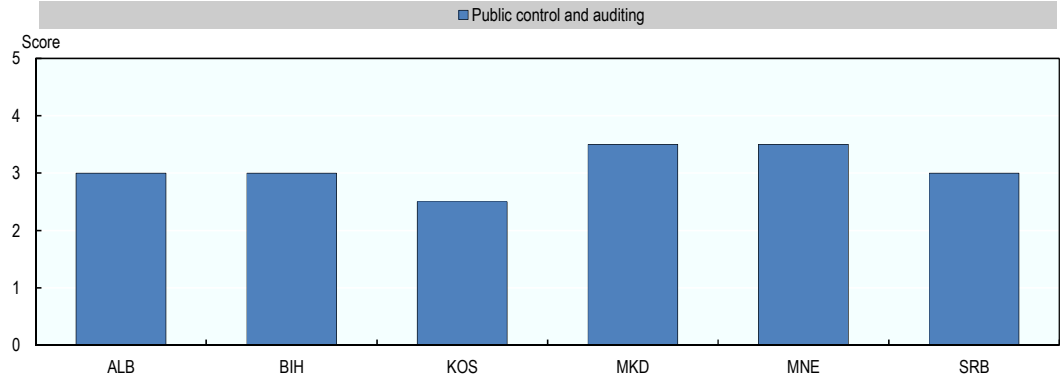
Revision and Control Sub-Dimension

This section looks at the Revision and Control Sub-Dimension. It examines whether audits to uncover corrupt practices and deter future corruption are effective help in the fight against corruption. The Revision and Control Sub-Dimension uses a single qualitative indicator, **public control and auditing**, to assess whether, and to what extent, suspicion of corruption in institutions triggers investigations.

Audits should be conducted in line with the International Organisation of Supreme Audit Institutions (INTOSAI) and the Lima Declaration of Guidelines on Auditing Precepts. The Lima declaration is an important convention as it provides guidance on the purpose of audits, the independence of supreme audit institutions (SAIs) and its members, on auditing methods, audit staff and on the relationship of SAIs to parliament.

The regional average score for Revision and Control Sub-Dimension is 3.1, which indicates that, in most of the six SEE economies apart from Kosovo, *ex ante* and *ex post* audits are carried out in compliance with the Lima Declaration. State audit institutions are generally compliant with the declaration.

Figure 15.8. **Revision and Control: Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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In the Former Yugoslav Republic of Macedonia, the main audit institution is the State Audit Office (SAO), which is formally autonomous and independent. In 2007, the German Federal Audit Institution conducted a peer review of the performance of the SAO. Its findings laid the ground for the new state audit law adopted in 2010, upgrading provisions and establishing the financing methods, the general auditor's mandate, and auditing methods. In Montenegro, the state audit institution is governed by law and works in accordance with the principles of the Lima Declaration. In Serbia, the state audit institution law, enacted in 2005, established the state audit institution as the highest state audit authority for public finances. The institution has 216 employees, of whom 179 are employed in audit services.

The audit institution of Albania is operational and seems well-staffed. The High State Control Office conducts *ex ante* and *ex post* audits in compliance with INTOSAI's Lima Declaration and the results are reported to government ministers. In Bosnia and Herzegovina, the audit office is well equipped with material and human resources. The audit office has been member of INTOSAI since 2001 and employs 71 staff. In Kosovo, the audit office seems well staffed and is taking steps to continuously improve its professional capacities.

Table 15.3. **Revision and Control Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Public control and auditing	3.0	3.0	2.5	3.5	3.5	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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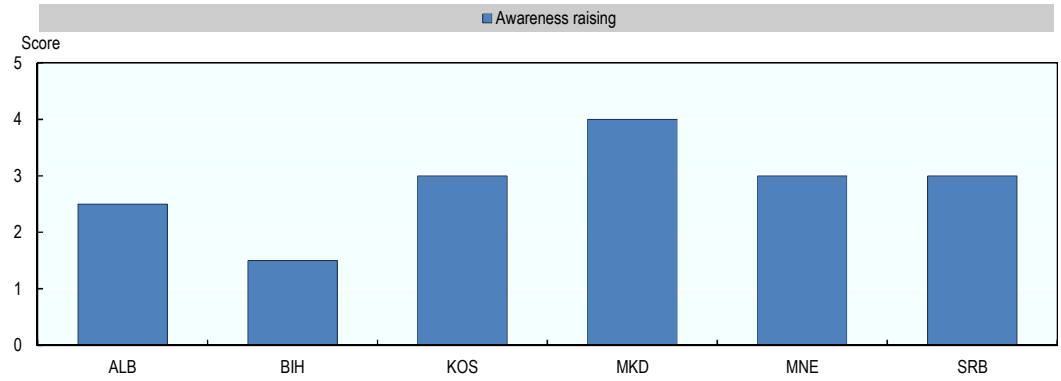
Strained financial resources and a lack of qualified staff are still common challenges. Looking to the future, a number of economies in SEE could take steps to boost the capacity of anti-corruption institutions in general and audit institutions in particular.

Public Awareness Sub-Dimension

Because citizens can be whistle-blowers, they are instrumental in the fight against corruption. Disseminating knowledge and raising awareness of measures to prevent corrupt behaviour is thus a critical element in the fight against corruption. Governments can boost public awareness through campaigns and seminars or by disseminating literature and publishing reports to educate the public on ways to avoid getting involved in bribery and on the negative effects of corruption on society. In addition, the introduction of effective legal protection for whistleblowers is considered "an essential element for safeguarding the public interest, promoting a culture of public accountability and […] is proving crucial in the reporting of misconduct, fraud and corruption" (OECD, 2015b). To date, all six economies have either adopted or proposed a whistleblower protection law.[2] The Public Awareness Sub-Dimension assesses the SEE economies' policies for raising awareness and understanding of corruption. It does so through a single qualitative indicator, **awareness raising**.

As the economies seek to attack corruption at the source, public perception and awareness-raising activities may be considered a vital component in their overall anti-corruption strategies. In that regard, the main objective of awareness-raising campaigns is to change public attitudes from tolerance to resistance and the rejection of corrupt behaviour.

Figure 15.9. **Public Awareness: Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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The average score in the Awareness Raising Sub-Dimension is 2.8, indicating that the economies have generally been active in carrying out awareness-raising campaigns and in producing easily accessible materials for public officials, business and civil society on the negative impact of corruption.

Table 15.4. **Public Awareness Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Awareness raising	2.5	1.5	3.0	4.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Awareness-raising is widely conducted, but campaigns are rarely monitored evaluated

The economy with the highest score in the sub-dimension is the Former Yugoslav Republic of Macedonia. It has run a number of public anti-corruption campaigns and implemented measures for reporting corruption and bribery (e.g. "report corruption" phone lines for many institutions prone to corruption). The campaigns have also been monitored through post-campaign questionnaires in which the educational benefits of campaigns are assessed.

In Montenegro, a number of campaigns have been carried out – e.g. "Not a cent for a bribe", which entailed the distribution of flyers, leaflets, posters, billboards, video and audio clips. Staff also received training to ensure the quality of educational and awareness-raising efforts. In Bosnia and Herzegovina, the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption has actively co-ordinated a number of anti-corruption campaigns. The agency is still in its early stages, however.

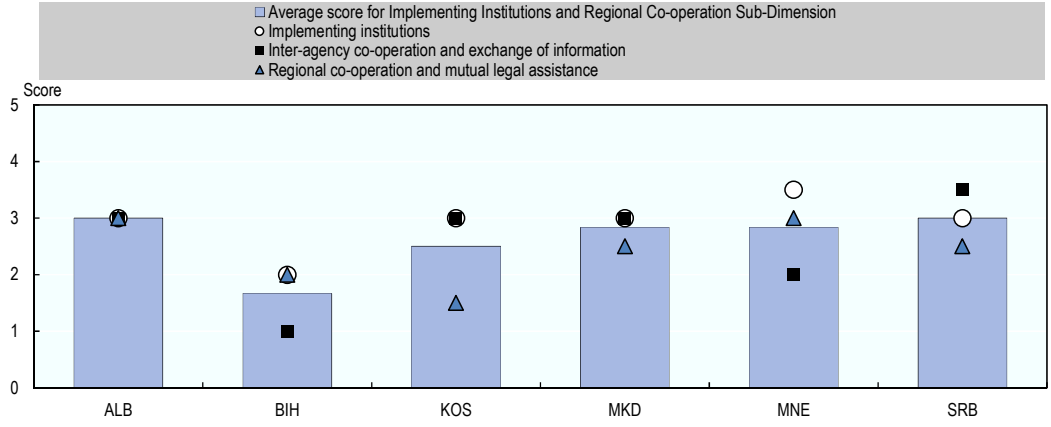
Going forward, the SEE economies could consider improving the continuous monitoring of awareness campaigns which is essential to corrective action and to the full effectiveness of campaigns.

Implementing Institutions and Regional Co-operation Sub-Dimension

Specialised anti-corruption agencies can help fight institutional corruption. In this regard, important qualities of implementing institutions include adequate financial and personnel resources, specialised training for employees, independence from undue influence, as well-monitoring mechanisms to ensure effectiveness. The Implementing Institutions and Regional Co-operation Sub-Dimension assesses the effectiveness of anti-corruption institutions and collaborative regional action. It does so through three qualitative indicators:

- **Implementing institutions** is a term that covers law enforcement and preventive institutions. "The law enforcement model takes different forms of specialisation, and can be implemented in detection, investigation and prosecution bodies. This model can also combine specialised anti-corruption detection, investigation and prosecution in one body. Sometimes the law enforcement model also includes elements of prevention, co-ordination and research functions" (OECD, 2013). In contrast to enforcing bodies, preventive institutions can be subdivided into anti-corruption co-ordinating councils, dedicated corruption-prevention bodies and public institutions which contribute to the prevention of corruption though not explicitly referred to as anti-corruption institutions (ibid.).
- **Inter-agency co-operation and exchange of information** refers here to the manner in which a country's different institutions work together and are able to align their competencies to fight corruption. Adequate human resources are essential for an anti-corruption body to increase co-operation with other competent authorities.
- **Regional co-operation and mutual legal assistance** is critical to tackling corruption crimes effectively, as officials may need information and data from outside their jurisdictions to pursue anti-corruption cases at home or nationals abroad. In that light, regional co-operation and mutual legal assistance refers here to the number of requests sent and granted for information exchange.

Figure 15.10. **Implementing Institutions and Regional Co-operation: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322761

The average score in the Implementing Institutions and Regional Co-operation Sub-Dimension is 2.6, which indicates that most SEE economies have established and authorised specialised anti-corruption bodies and secured inter-agency co-operation. While the specialised agencies in Albania, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia have implemented internal mechanisms supporting operational effectiveness, Bosnia and Herzegovina has less financial and human capital for implementing its anti-corruption strategy. Regional co-operation is often lacking.

Anti-corruption bodies are operational in all the SEE economies, but funding and qualified staff are an issue and regional co-operation is in its infancy

Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia lead the way thanks to efforts to ensure operational anti-corruption agencies and proper inter-agency co-operation. In the Former Yugoslav Republic of Macedonia, the State Commission for Prevention of Corruption (SCPC) has initiated the Protocol on Cooperation in Prevention and Repression of Corruption and Conflict of Interests. To date, the protocol has been signed between the SCPC and 18 other relevant institutions aiming at improving co-operation in the fight against corruption. Good practice can also be found in Albania, where a national co-ordinator for anti-corruption is in place, working with state bodies and independent institutions at central and local levels. A network of anti-corruption focal points has also been put in place in all line ministries and independent institutions.

Table 15.5. **Implementing Institutions and Regional Co-operation Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Implementing institutions	3.0	2.0	3.0	3.0	3.5	3.0
Inter-agency co-operation and exchange of information	3.0	1.0	3.0	3.0	2.0	3.5
Regional co-operation and mutual legal assistance	3.0	2.0	1.5	2.5	3.0	2.5

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323705

In Serbia, the anti-corruption agency reports that it has the staff, material, financial and technical resources to function.

In Kosovo, the Anti-Corruption Agency, a special anti-corruption task force and a national co-ordinator for the fight against corruption have all been established, though their effectiveness is not systematically monitored. The anti-corruption agency co-operates with law enforcement agencies, specifically the Kosovo police and the Kosovo state prosecutor.

A multilateral institutional framework to tackle corruption has also been established in Montenegro. It includes the Directorate for the Anti-Corruption Initiative, the Directorate for the Prevention of Money Laundering and Financing of Terrorism, the Commission for the Prevention of Conflicts of Interest and the state audit institution. Moreover, a number of agreements and memoranda of co-operation exist between the institutions in charge of the fight against corruption and crime (police, prosecution, customs administration and tax administration), but co-operation between them is weak. However, under the terms of Article 107 of the Law on the Prevention of Corruption, the Agency for the Prevention of Corruption will start working on 1 January 2016 and

assume the tasks of the Commission for the Prevention of Conflicts of Interest and the Directorate for the Anti-Corruption Initiative, which will cease to exist. This centralisation of activities is a good example of how co-ordination in the fight against corruption could be improved.

Bosnia and Herzegovina lags behind when it comes to co-ordination and co-operation. Its Agency for the Prevention of Corruption and the Co-ordination of the Fight against Corruption has only 19 employees and the annual budget for its operations is EUR 578 000, low compared to the scope of its responsibilities. There is only limited and occasional co-operation between institutions in the fight against corruption.

As officials may need access to information and data outside of their jurisdictions to pursue anti-corruption cases at home or of nationals abroad, international co-operation is a critical element of well-functioning anti-corruption institutions. In the SEE region, regional co-operation remains stymied by bureaucratic procedures and under-capacity. All SEE economies, with the exception of Kosovo, are signatories to the United Nations Convention against Corruption (UNCAC). Most governments have also signed a large number of bilateral memoranda of co-operation with their peers in other jurisdictions, but bodies in charge of processing mutual legal assistance (MLA) requests are strained by lack of capacity. Statistics on the number or percentage of MLA requests that are granted are commonly unavailable.

Montenegro, for example, is party to a number of international conventions and bilateral agreements – e.g. with Croatia, Italy, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia. The economy is also developing a document management system (LURIS) for monitoring multilateral agreements and providing more effective evaluation of the process and better statistics. In Albania, a good percentage of MLA requests are granted and the staff of the Ministry of Justice has received training on the matter, though not specifically for corruption.

Kosovo, which is not a member of the United Nations, has 23 agreements with other jurisdictions in the fields of mutual legal assistance, extradition, transfer of sentenced persons and the implementation of juridical decisions in criminal matters. In Kosovo, the Department for International Legal Co-operation (DILC), which is part of the Ministry of Justice, processes all requests for international legal assistance. With the exception of Kosovo, all the SEE economies are members of the Group of States against Corruption (GRECO), established by the Council of Europe in 1999. GRECO seeks to improve the capacity of its members to fight corruption by monitoring their compliance with Council of Europe anti-corruption standards through a dynamic process of mutual evaluation and peer pressure. However, in co-operation with the EU, the Council of Europe is carrying out the Project against Economic Crime in Kosovo, which monitors and assists Kosovo's anti-corruption agency and other relevant institutions in the implementation of international anti-corruption standards.

Going forward, regional co-operation should be regular and comply with international conventions and best practices. The SEE economies could enter into MLAs for information sharing on legal matters and the extradition could be engaged on a systematic basis. Efforts could be taken to appoint a national anti-corruption co-ordinator in each economy to streamline and centralise the network of communications and agreements between institutions involved in the fight against corruption.

Conclusions

Overall, SEE economies have taken positive steps to establish legal and institutional frameworks for the fight against corruption by creating anti-corruption agencies and adopting risk assessments. E-procurement systems have also been developed, but implementation is in its early stages.

However, a few areas for improvement remain to be tackled in the anti-corruption policy field. The public procurement system remains vulnerable to corruption as public procurement processes and contracts are not monitored closely enough. Regional co-operation between anti-corruption agencies is limited, with reduced budget and limited qualified staff further eroding their scope of action in the fight against corruption. Corruption-proofing tools such as legislation and risk assessments are still not systematically used despite existing laws mandating their use.

Addressing these challenges could help establish trustworthy civil services in the region, enhancing the business environment and fostering economic growth.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good 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 draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).
2. A detailed analysis of whistleblower protection is beyond the scope of this policy outlook. See Worth (2015) for an overview of laws, practice and recent initiatives on this matter in South East Europe.

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(03 2016 01 1 P) ISBN 978-92-64-25051-2 – 2016

Competitiveness and Private Sector Development

Competitiveness in South East Europe

A POLICY OUTLOOK

Future economic development and the well-being of citizens in South East Europe (SEE) increasingly depend on greater economic competitiveness. Realising the region's economic potential requires a holistic, growth-oriented policy approach. Economies in the SEE region adopted the SEE 2020 Strategy, which sets out a regional plan to achieve ambitious growth goals.

This first edition of *Competitiveness in South East Europe: A Policy Outlook* seeks to help SEE policy makers assess progress made towards their growth goals and benchmark them against regional peers and OECD country good practices. The 15 policy dimensions addressed in this report encompass a wide range of areas key to economic competitiveness. The participatory assessment process brought together OECD experts, regional policy networks and organisations, policy makers, independent experts and private sector representatives to create a balanced view of performance.

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Co-funded by the European Union

ISBN 978-92-64-25051-2
03 2016 01 1 P

9 789264 250512