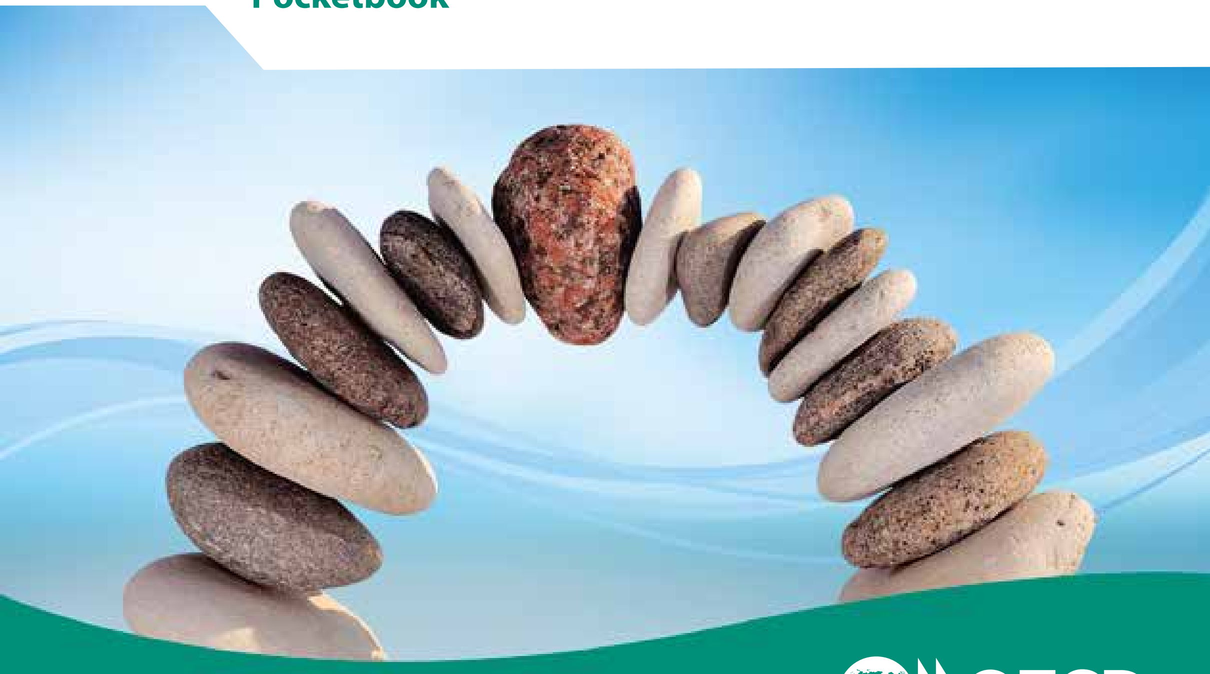
Competitiveness and Private Sector Development

Competitiveness in South East Europe

A POLICY OUTLOOK 2018

Pocketbook



OECD

BETTER POLICIES FOR BETTER LIVES

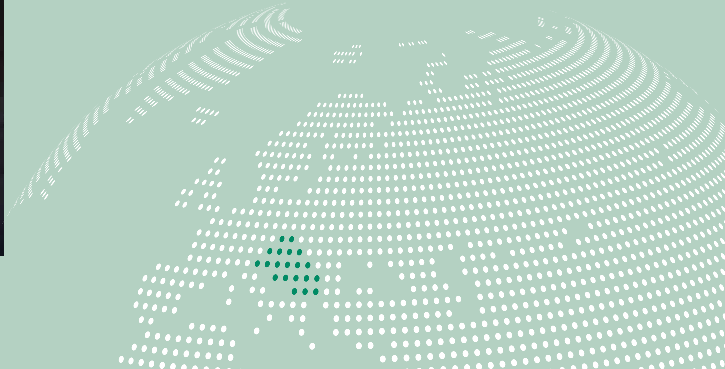
"This pocketbook presents a salient summary of the OECD flagship publication **Competitiveness in South East Europe: A Policy Outlook 2018**, *which analyses economic governance, regulation and investment in South East Europe and forms a critical body of work to support structural reforms that can foster inclusive growth and improve people's lives. While the region is still beset with slow annual growth rates and an average GDP per capita at only one-third of the EU's, there has been a noted increase in intergovernmental co-operation. Conclusions from the Outlook emphasise that reform progress, though somewhat asymmetrical, can be clearly observed across the 17 assessed policy dimensions. These results are encouraging and I recommend the* **Competitiveness in South East Europe: A Policy Outlook** *as a resource to be shared for all those interested in forging more inclusive, prosperous, sustainable and resilient economies for the people of South East Europe."*

Angel Gurría, OECD Secretary-General

OECD
BETTER POLICIES FOR BETTER LIVES

''Economic development in South East Europe is fundamental for a common European future and is the basis for the wellbeing of all its citizens. This publication offers a comprehensive analysis of the economic governance and performance of the region. It clearly highlights the progress achieved and its potential for further improvements. For the region to reach its full economic potential, a growth-oriented policy approach is needed, with an emphasis on structural reforms. The European Commission supports its partners in this endeavour through the annual Economic Reform Programme exercise. The Competitiveness Outlook is a useful tool for them as they identify their own needs and priorities going forward."

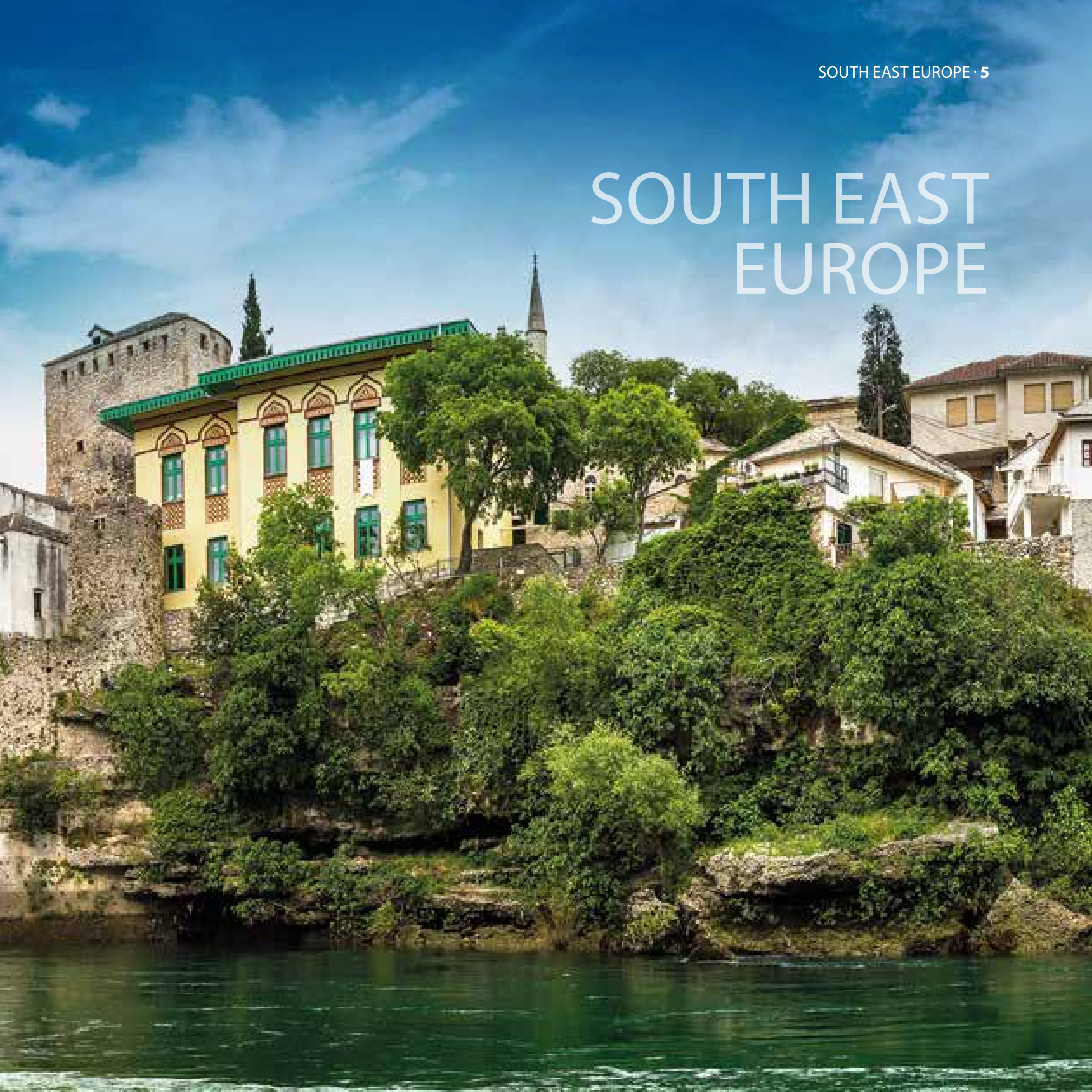
Christian Danielsson, European Commission Director-General



SOUTH EAST EUROPE

POLICY DIMENSIONS

SOUTH EAST EUROPE



SOUTH EAST EUROPE TRENDS

A common European future

In the wake of Yugoslavia's disintegration and the transition towards a free market economy, the SEE region faced a decade of conflict and economic stagnation.

At the turn of the new millennium, the return of peace laid the foundations for regional stability and economic growth. However, the 2008 financial crisis hit the region hard: GDP fell in 2009 and growth remained sluggish for years afterwards.

A decade after the crisis, a return to economic growth brought with it new investment opportunities. Despite progress, the region's economic development today is less positive than in neighbouring transition economies. Weak implementation and inadequate monitoring continue to hamper structural reforms, while human capital and labour market deficits limit the capacity for economic growth.

South East Europe needs to improve its competitiveness in the institutions and policies that most affect economic development. This can be achieved by implementing strategic reforms across a variety of areas key to competitiveness, such as transport, education or trade.

2018 therefore presents an important window of opportunity for South East Europe. Surrounded by EU member states and linked through a common heritage and history, the region's prospect for integration into the European Union and its shared goals of peace, prosperity and stability become fused.

In recognition of the region's strategic importance, the European Commission has adopted a new enlargement perspective which emphasises structural reforms as the driving force towards European Union accession.

Building on this new momentum, the economies of South East Europe are committed to an accelerated reform process aimed squarely at reinvigorating competitiveness for a more dynamic and innovative economy.

Through their pledge of further economic reforms and in view of European Union accession, the SEE region today stands poised to embrace a common European future built on the promise of shared prosperity and inclusive economic growth.

CHALLENGES AND OPPORTUNITIES

Building a new growth model: Competitiveness in South East Europe

Building a new growth model for the region hinges on raising the competitiveness of SEE economies. Enhancing competitiveness is essential for the region to move up the economic value chain, connect with regional and global markets and escape the "middle-income trap" which will generate strong and sustainable prosperity.

In order to support this transition, SEE governments will need to tackle some common **cross-cutting challenges** such as:

- weak policy design co-ordination and implementation
- human capital and labour market deficiencies
- inadequate transition towards a knowledge-based economy
- barriers to business financing and misalignments in the tax system
- an uneven playing field for economic actors
- insufficiently integrated regional trade, transport and energy networks
- a lack of environmental considerations in economic and sectoral policies.

In view of these challenges the report offers key findings and recommendations, including how current policies can be improved to **support economic governance reform** and how policy makers can draw on regional experience to **tailor solutions that better serve local communities**.

Towards EU accession: a window of opportunity

Renewed momentum towards EU accession presents an important window of opportunity for SEE economies to jointly address challenges within the **framework of a regional growth strategy**.

SEE economies can leverage important resources along the way including:

- access to EU structural funds to support the integration process
- proximity to the world's largest single market, i.e. nearly 500 million consumers
- EU research funds and network, such as Horizon 2020
- a political environment conducive to the resolution of bilateral issues and good neighbourly relations.

OECD SOUTH EAST EUROPE REGIONAL PROGRAMME

A partnership for prosperity and stability

The **OECD SEE regional programme** is part of the Global Relations Secretariat which supports the Secretary-General in advancing the Organisation's global reach.

The OECD has been working with South East Europe since 2000 to develop and successfully implement policies for private sector development and investment in order to unleash economic growth and promote competitiveness.

The co-operation between the OECD and key regional stakeholders is based on a strong dialogue at the technical and political level, and on its capacity to produce impartial, high quality analyses.

As a result of the joint work with regional counterparts, the programme has produced actionable policy reports with recommendations for future policy actions and helped design and implement reforms to strengthen private sector development, competitiveness and to raise living standards.

www.oecd.org/south-east-europe

A TOOL FOR MONITORING PROGRESS IN BUILDING COMPETITIVE ECONOMIES

The second edition of the *Competitiveness in South East Europe: A Policy Outlook* offers the **most wide-ranging assessment** of economic policy performance in the Western Balkans to date.

Spanning six SEE economies: Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia, the publication forms a critical body of work to support structural reforms in the region.

- composed of **17 policy dimensions** key to economic competitiveness
- draws on **in-depth evidence-based analysis** resulting in concrete and implementable policy recommendations
- builds on a **highly participatory** evaluation process
- offers a **road map** for regional economic policy reforms
- acts as an important reference for the European Commission to **support the EU enlargement process**
- is a catalyst for inter-ministerial co-operation and intra-regional integration
- offers **guidance for investors** to make educated investment decisions
- establishes a **toolkit for donors and international development agencies** to prioritise funding choices
- amasses a complete body of knowledge contributing to academic scholarship, research and debate.

* 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.

METHODOLOGY

Scope

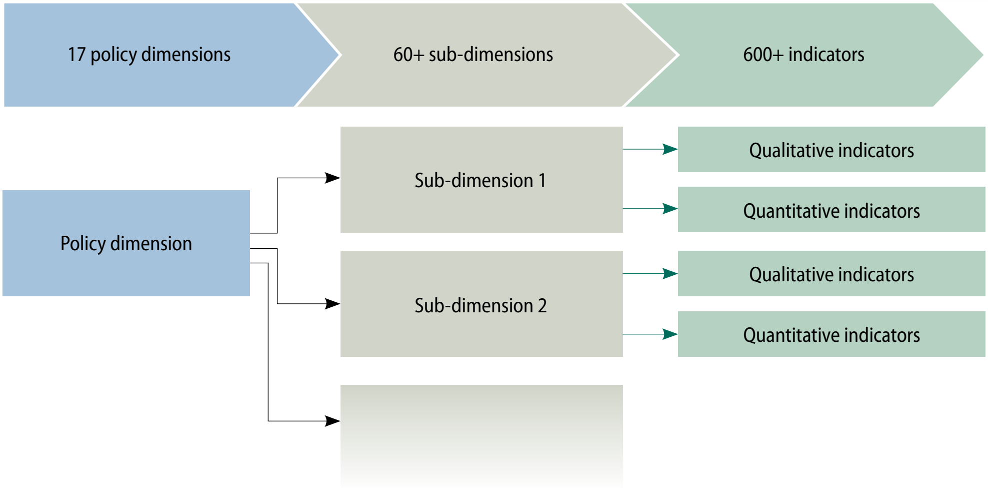
In order to **boost an economy's competitiveness**, policy reforms need to build on each other and be co-ordinated across different areas, rather than be conducted in isolation. Acknowledging this holistic imperative and seeking to provide policy makers with a single window through which to assess and,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

A holistic view of competitiveness

BUSINESS ENVIRONMENT	SKILLS AND CAPACITY	ECONOMIC SECTOR	GOVERNANCE
Investment policy and promotion	Education and competencies	Transport policy and performance	Public services
Trade policy and facilitation	Employment policy	Energy policy	Anti-corruption policy
Access to finance	Science, technology and innovation	Environmental policy	
Tax policy	Digital society	Agriculture	
Competition policy		Tourism	
State-owned enterprises			

Methodology

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



The overall assessment approach

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

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

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

DEVELOPMENT MILESTONES

1 Assessment framework development

The OECD South East Europe regional programme, in consultation with regional organisations and networks, and OECD experts from specialised directorates, develop an assessment framework composed of qualitative and quantitative indicators.

2 Assessment

Governments conduct self-assessments and the OECD carries out independent assessments in parallel.

3 Reconciliation

The OECD organises meetings in each SEE economy to reconcile discrepancies between the draft government self-assessments and the draft OECD independent assessments and to fill any remaining information gaps. Participants include regional organisations, government representatives, the private sector, academia and independent experts. These meetings are followed by the SEE Competitiveness Outlook Week, which brings stakeholders from across the region to the OECD in Paris to discuss findings at the regional level.

4 Final analysis and drafting

The OECD analyses information and drafts the *Competitiveness in SEE Policy Outlook* with input from regional organisations and OECD experts.

5 Competitiveness in South East Europe

A Policy Outlook

PARTICIPATORY ASSESSMENT

Assessment process for the qualitative indicators

The scores of qualitative indicators are determined through **two parallel but complementary assessments**.

The **government self-assessment** are completed by different agencies and ministries involved in policy development and implementation of each dimension.

The **independent assessment** (carried out by country consultants) serves as a framework of checks and balances against the government assessment.

The report ensures **inclusiveness** by taking into account the views of a multiplicity of stakeholders, especially the private sector, civil society, academia and expert observers, as well as other relevant stakeholders.

Taken together, the *Competitiveness in South East Europe: A Policy Outlook 2018* is a singular resource to be shared widely for all those interested in building a more inclusive and prosperous SEE region. It is our sincere belief that through fact driven analysis and evidence-based reforms, South East Europe will emerge stronger, more resilient and ready to compete in the global economy of tomorrow.

A methodology combining quantative data to measure impact with qualitative scores to analyse policy settings

Qualitative indicators

Measure policy settings, processes and institutions, asking whether these exist and whether they have been adopted, implemented, monitored and regularly updated.

Level 0	No framework
Level 1	Draft or pilot framework
Level 2	Framework is in place or operational
Level 3	Implementation of policy framework is advanced
Level 4	Evidence of framework monitoring and readjustment
Level 5	Independent impact evaluation; good practices

Quantitative indicators

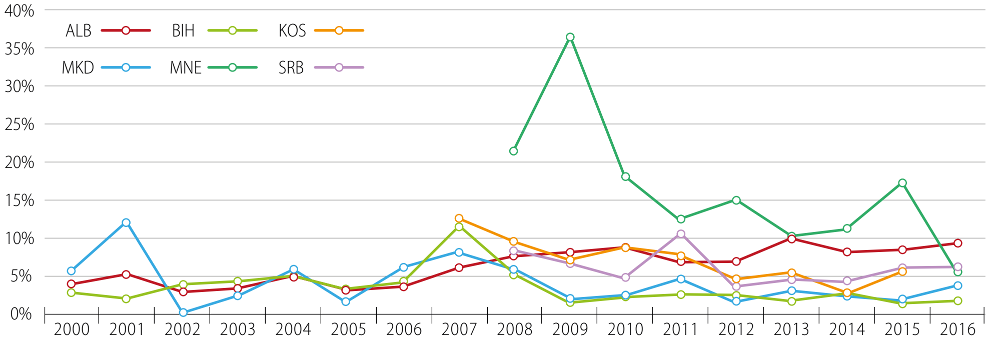
Assess input factors into policies, processes of policy making, institutional conditions, and policy outputs.

POLICY DIMENSIONS

Investment is central to economic growth and sustainable development. It expands an economy's productive capacity, drives job creation and secures overall competitiveness. To these ends, the investment policy and promotion dimension examines the existence of policies for market access and exceptions to national treatment, investor protection and intellectual property rights. With regard to investment promotion, the dimension assesses strategies and institutional frameworks, investment promotion activities, investment facilitation services and measures to promote linkages between foreign and domestic firms. Across the assessed SEE economies, flows of foreign direct investment (FDI) have increased in the last decade, indicating a more favourable business environment for foreign firms. Moreover, procedures for setting up companies have been streamlined. Despite progress, more could be done to further strengthen the linkages between foreign and domestic firms.

KEY STATISTICS

FDI inflows as a percentage of GDP, 2000-2016

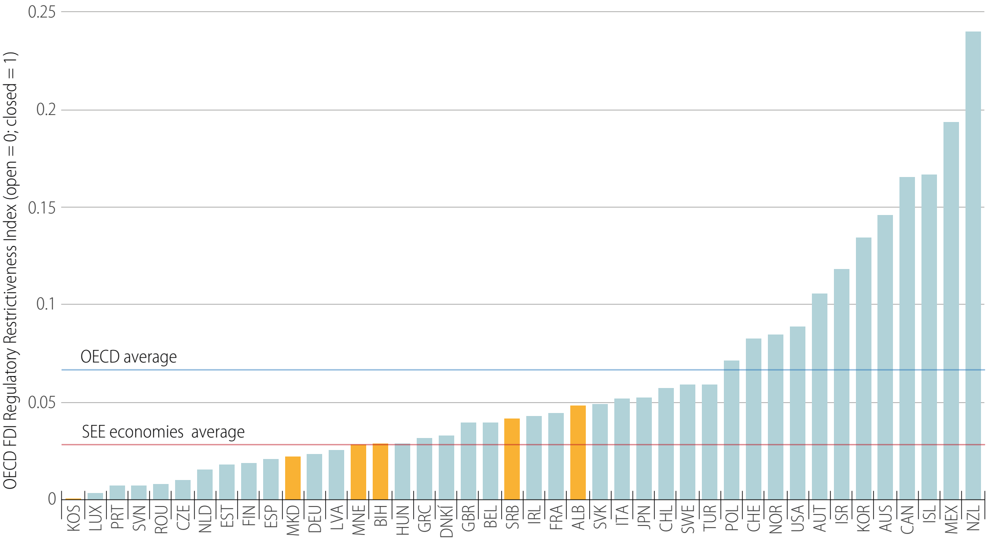


Note: Data for Kosovo are available from 2007 to 2015; data for Montenegro and Serbia are available from 2008.

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

OECD FDI Regulatory Restrictiveness Index
The six assessed SEE economies are among the most open to FDI as measured by the OECD FDI Regulatory Restrictiveness Index. All six SEE economies maintain only a handful of restrictions, making their FDI regimes less restrictive than that of the average OECD economy. They also compare favourably against the average of the 22 EU Member States covered by the index. As such, the rules concerning foreign investors on their own are unlikely to constitute a major impediment to attracting investments in most of the SEE economies.

OECD FDI Regulatory Restrictiveness Index



Note: The OECD *FDI Regulatory Restrictiveness Index* only covers statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening and approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment climate (e.g. the implementation of regulations and state monopolies, preferential treatment for export-oriented investors and SEZ regimes) are not considered. Data reflect regulatory restrictions as of December each year.

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

ACHIEVEMENTS

- **SEE economies have taken a clear pro-investment stance and provide open and non-discriminatory environments for foreign investors.** Remaining restrictions on FDI are below the OECD average; they are not unusual and do not constitute a major impediment to foreign investment.
- **Sound legal frameworks for investment are provided, including for property and intellectual property (IP) rights protection.** Investor protection standards are high and expropriations of companies are rare and subject to sound and predictable rules. IP laws and regulations follow international practice and are becoming aligned with the European Union's standards.
- **All SEE economies have well-established investment promotion agencies (IPAs) that conduct the core functions of investment promotion and facilitation.** Sound investment promotion strategies with well-delineated priorities and targets have been designed and most economies are putting increasing efforts in proactive promotion and investor outreach.
- **Setting up a company is, in most cases, easy and predictable.** Procedures to start a business have been streamlined and are generally transparent and straightforward. The authorities also maintain a constructive dialogue with the private sector to inform it of pending reforms, collect feedback on legislative proposals and discuss challenges faced by investors. Some economies provide focused aftercare services to identify and support business expansion.

REMAINING CHALLENGES AND RECOMMENDATIONS

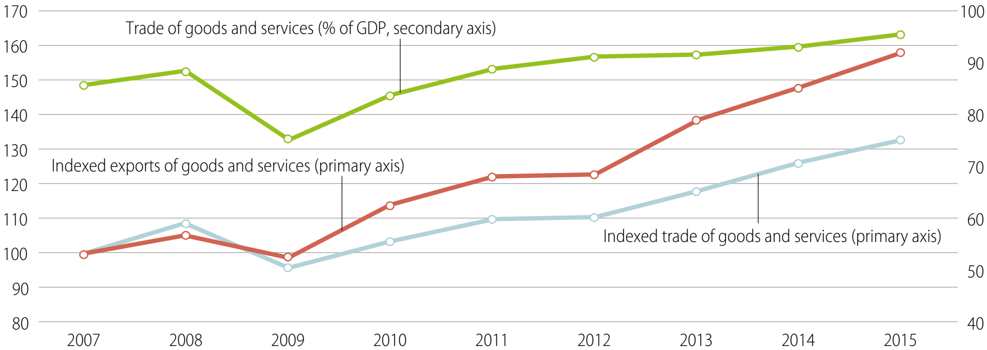
- **SEE economies should further improve the clarity, transparency and predictability of the regulatory framework for investment.** For example, no economy in the region has established a foreign investment negative list to delimit clearly the sectors where foreign investment is prohibited or conditioned, and which discriminatory conditions apply.
- **Prompt procedures and consistent interpretation of the law need to be more systematically ensured, especially when it comes to enforcing commercial contracts.** There is an important backlog of court cases and reported regular political interference. Judges would benefit from additional training to deal with commercial and IP cases.
- **Co-ordination among IP related institutions should be strengthened and further efforts are needed to sensitise businesses and the public, and provide them with better access to information on IP rights.** IP-related institutions currently lack capacity to fully enforce IP rights and conduct awareness raising activities.
- **IPAs need adequate resources and capacity to conduct key investment promotion and facilitation functions, such as investor targeting and aftercare.** Sectoral competences need to be reinforced and institutional co-ordination enhanced to avoid overlaps of activities and to ensure that obstacles faced by investors are promptly removed. Incentive regimes are often complex and incentives are granted mostly without (at least publicly disclosed) cost-benefit analyses.
- **Further measures are needed to enhance the impact of FDI through the creation of linkages between foreign investors and domestic firms.** Authorities in SEE should further support small businesses and develop comprehensive business linkages programmes. IPAs should increasingly integrate matchmaking in their activities and align their FDI promotion strategy with local linkages opportunities.

TRADE POLICY & FACILITATION

Fair, reciprocal and predictable cross-border trade arrangements are important pillars of a healthy regional economy. Consequently, the trade policy and facilitation dimension assesses the implementation, evaluation and co-ordination of cross-border trade, including the monitoring of domestic law to meet OECD good practice. Throughout the SEE region, the economies perform best on non-tariff measures and export promotion, including the removal of technical barriers to trade. However, the ex-post monitoring of free trade agreements, as well as the transparency and effectiveness of public-private consultation mechanisms, could be improved. The region would also benefit from limiting undue regulatory restrictions on services, such as easing barriers on the free movement of people.

KEY STATISTICS

Key trends in external SEE trade in goods and services (2007-15)



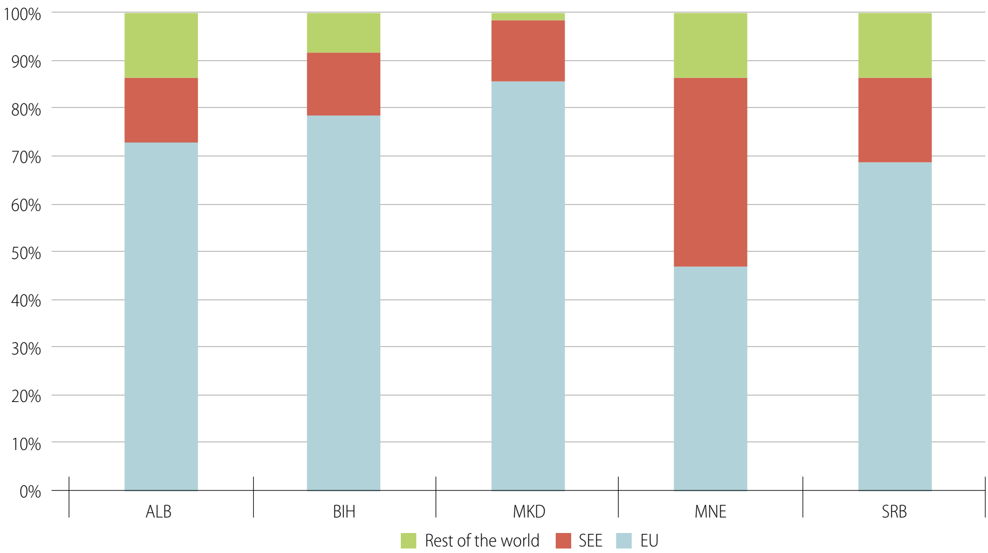
Note: External trade is calculated as the sum of total imports and exports of all SEE economies. Bosnia and Herzegovina data for 2015 have been estimated and will be updated when new data are available.

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

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

For the majority of the SEE economies, the European Union (EU) is the main trading partner, accounting for 70% or more of all trade.

South East Europe's main trading partners and export destinations (2015)



Note: Data for Kosovo are not available.

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

ACHIEVEMENTS

- **Trade policy institutional frameworks are functioning well.** The inter-institutional co-ordination of trade policy formulation is solid in most economies, usually through official committees or working groups led by the ministry in charge of trade policy (either the trade or economy ministries). There are formal instruments for consultation with the private sector and civil society, and the majority of the economies have recently established trade facilitation committees.
- **The six SEE economies have made progress in removing technical barriers to trade.** The institutional frameworks for standardisation and accreditation have been strengthened and the rules, procedures and operations of the standardisation and accreditation bodies are aligned overall with international and European Union (EU) practices. Most of the economies have adopted more than 80% of European Standards. However, many economies still have room to improve their conformity assessment infrastructure.
- **The SEE economies are relatively well integrated into the world trading system.** All are signatories of the Central European Free Trade Agreement (CEFTA), through which they have achieved full tariff liberalisation on trade in manufactured products and agricultural goods. Albania, the Former Yugoslav Republic of Macedonia and Montenegro are also World Trade Organization (WTO) members.
- **Export promotion agencies/bodies have been established in all SEE economies.** Their work is focused on promoting overall exports, while support services are primarily provided to small and medium-sized enterprises (SMEs) and established exporters.

CHALLENGES AND RECOMMENDATIONS

- **Further remove non-tariff barriers to trade.** Economies in the region have been less successful in reducing non-tariff barriers related to the implementation of sanitary and phytosanitary (SPS) measures than they have been at implementing technical standards and regulations and trade facilitation measures. Capacities for risk-based control, both for inland and for border inspection, are still being developed. The majority of economies need to develop a variety of risk assessment tools and to connect up the information systems of the various SPS agencies.

- **Strengthen mechanisms for evaluating the impact of trade measures and free trade agreements (FTAs).** The units in place for trade analysis are usually understaffed and often lack adequate resources for conducting systematic impact assessments. Ex-post monitoring of the impact of FTAs is rarely conducted in the majority of the economies and often no agency has been appointed to lead the monitoring exercise. Furthermore, high-quality statistical trade data are scarce.

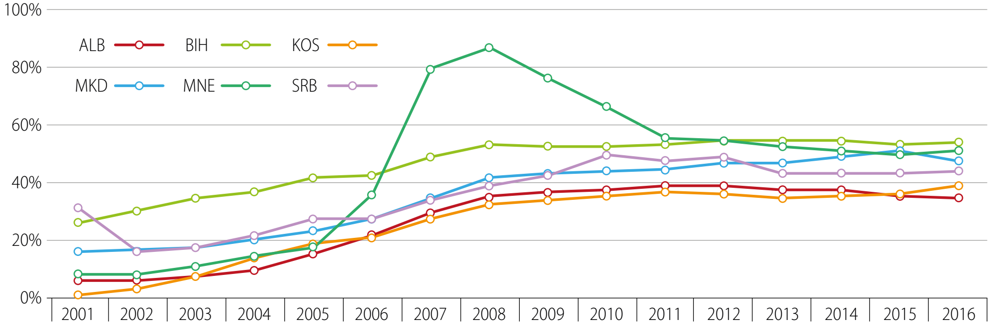
- **Improve the transparency and effectiveness of public-private consultation mechanisms.** The SEE economies do not monitor how open and transparent these consultation mechanisms are and most of them do not make summaries of consultations on draft laws publicly available. More active involvement of the private sector in the trade policy implementation and evaluation phase is also needed.

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

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

KEY STATISTICS

Domestic credit to the private sector (2001-16)



Note: World Bank data for 2006 are not available for KOS; data for 2016 are not available for KOS, MKD and MNE, so data from 2015 are used instead.

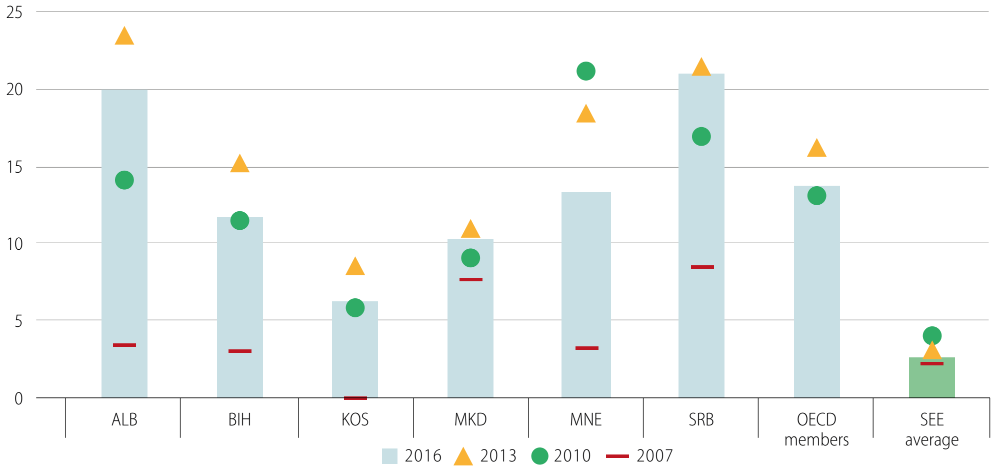
Source: World Bank (2017), *World Development Indicators* (database), **http://data.worldbank.org/data-catalog/world-development-indicators.**

While domestic credit to the private sector, a proxy indicator for the depth of financial intermediation, grew strongly in the period 2001-08 – on average by a total of 18% – it then on average contracted slightly, by approximately 1% total between 2009 and 2016. Montenegro saw the most pronounced boom and contraction of domestic credit of the six assessed SEE economies: domestic credit to the private sector represented 87% of gross domestic product (GDP) in 2008, but had contracted to 51% in 2016.

Credit contraction after the financial crisis has translated into a significant increase in non-performing loans (NPLs) in the six SEE economies. Between 2007 and 2013 the average share of NPLs in the economies more than tripled from 5.1% of total loans to 17.6%.

Bank non-performing loans (2007, 2010, 2013, 2016)

% of total gross loans



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

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

ACHIEVEMENTS

- **All of the SEE economies have taken steps to establish institutional and regulatory frameworks for access to finance.** They have developed frameworks for timely payments and insolvency and also made progress in developing asset registers and credit information systems.
- **Efforts have been made to improve insolvency frameworks** to tackle lengthy bankruptcy procedures and reduce administrative backlogs. Progress has also been made in delineating between liquidation and restructuring, and introducing clear priority schemes.
- **All of the SEE economies have implemented SME financing support programmes.** These are primarily credit guarantee schemes and grants or loans at reduced interest rates.

CHALLENGES AND RECOMMENDATIONS

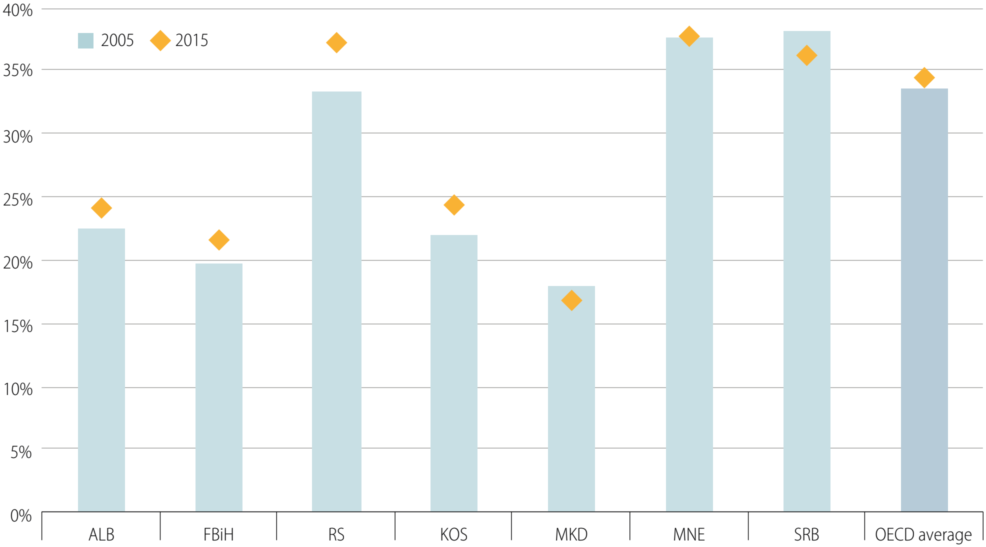
- **Complete the implementation of legal frameworks for ensuring timely payments and managing insolvency.** Despite various efforts to reduce them, lengthy processes and legal backlogs make restructuring and liquidation burdensome for bankrupt SMEs and increase the risk of bankruptcy among cash-constrained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

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

KEY STATISTICS

Tax revenues increased as a share of GDP between 2005 and 2015 in most of the six SEE economies. The revenues raised vary widely across economies, however. Revenues are particularly low in the Former Yugoslav Republic of Macedonia (16.7% of GDP) and the Federation of Bosnia and Herzegovina (21.5% of GDP). On the other hand, in Serbia (36.2% of GDP), the Republika Srpska (37.1% of GDP) and Montenegro (37.6% of GDP) they are above the OECD average (34.3% of GDP).

Tax revenues as a percentage of GDP in SEE economies (2005 and 2015)



Note: FBiH – the Federation of Bosnia and Herzegovina; RS – the Republika Srpska. For both entities in Bosnia and Herzegovina the data are for 2010 and 2015; for Kosovo and Montenegro, the data are for 2006 and 2015.

Source: Government statistical offices and ministries in the region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

ACHIEVEMENTS

- **Tax revenues as a share of gross domestic product (GDP) have been increasing**, although in most of the six SEE economies they remain below the OECD average.
- **The six SEE economies have made significant efforts to strengthen their tax administration**, particularly in the areas of function and organisation, compliance assessment and risk management, and taxpayer services.
- **The implementation of a VAT registration threshold in the six SEE economies means that VAT administration can concentrate resources on larger businesses.** VAT registration thresholds lower compliance costs for small businesses and ensure a more effective use of administrative resources and audit capacity.
- **The six SEE economies are working together to strengthen the functioning of their tax administrations.** Tax administrations across the region are sharing experiences and exchanging information on best tax practices.

CHALLENGES AND RECOMMENDATIONS

- **Evaluate the design of corporate tax incentives.** Corporate tax incentives are generous across the six SEE economies. As the economies already have low CIT rates – intended to create an attractive investment climate – there is little need for profit-based tax incentives to stimulate investment, such as tax holidays or targeted preferential rates. Profit-based tax incentives lower revenues from CIT without necessarily increasing investment significantly, and they also create negative spill over effects and tax avoidance opportunities. Existing profit-based tax incentives should either be turned into expenditure-based ones, such as accelerated or enhanced tax depreciation or investment tax credits, or be phased out altogether.
- **Analyse the combined impact of PITs and SSCs on labour market outcomes.** Despite relatively low PIT rates across the region, the economies levy high SSCs in order to finance their benefit systems. This results in a high tax burden on labour income, which may have particularly strong negative impacts on low-skilled and low-income workers who might be priced out of the formal labour market.

The economies should evaluate whether they could lower SSCs by increasing PITs and making it more progressive, introducing an earned income tax credit, and/or reducing SSCs for low-income earners.

- **Consider reducing the gap between taxes on labour and capital income.** This gap provides a strong incentive for entrepreneurs to incorporate their business and to earn capital instead of labour income.
- **Broaden the VAT base.** VAT in all the six SEE economies is levied on a narrow tax base as a result of the widespread use of reduced rates and exemptions.
- **Develop tax policy tools to assess tax systems and their economic impacts.** Better tax revenue data, tools that assess the effective tax burdens on labour and capital, the implementation of micro-simulation models, and more systematic tax expenditure reporting are priorities for all six SEE economies.
- **Continue to strengthen tax administrations to improve tax collection and compliance.** Further efforts in guaranteeing independence and transparency of the tax administration and strengthening taxpayer services should be a priority.
- **Bring informal workers and businesses into the tax base.** Strengthening the design of CIT and PIT must be an integral part of a strategy to encourage informal businesses to operate in the formal economy. Strengthening the tax administration will result in a broader tax base overall.
- **Bring international taxation rules in line with international best practice.** The six SEE economies have transfer pricing and thin capitalisation rules in place but they are not aligned with international best practice.
- **Evaluate the use of a worldwide tax system and implement measures to protect the domestic tax base.** The SEE economies might want to weigh the advantages and disadvantages of moving from a worldwide to a territorial tax system.
- **Strengthen co-ordination and co-operation among the economies in the region.** By working together, the six SEE economies would benefit from more effective tax enforcement and lower overall tax avoidance and evasion. Enhanced tax policy dialogue on CIT incentives, for instance, could help to create a more attractive investment climate across the region.

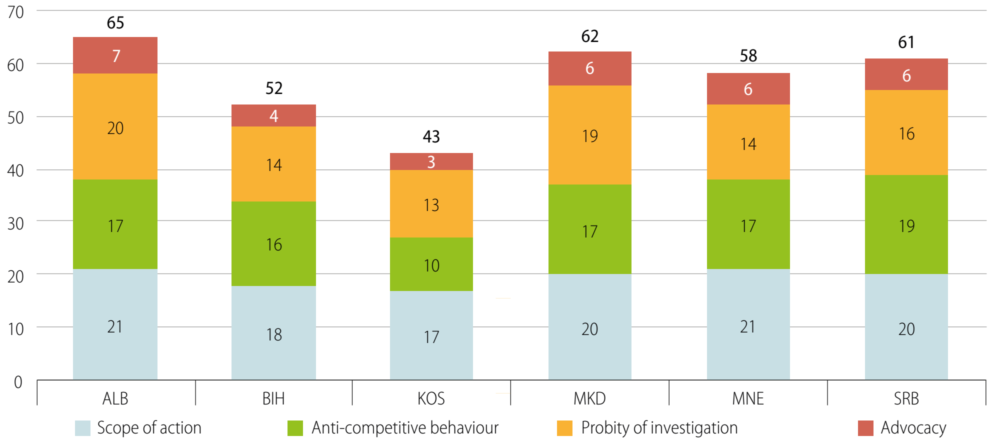
COMPETITION POLICY

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

KEY STATISTICS

The six economies of South East Europe appear to have in place most of the basic building blocks of a functional competition policy regime, although some gaps persist and enforcement records appear limited.

Competition policy: number of adopted criteria



Note: The assessment in this chapter is based on the answers to the questionnaires, with each "yes" counting as an adopted criterion. The maximum number of adopted criteria is 68. See the methodology chapter for information on the Competitiveness Outlook assessment and scoring process.

Source: OECD (2018), *Competitiveness in South East Europe: A Policy Outlook 2018*, http://dx.doi.org/10.1787/9789264298576-en.

All six SEE economies have the necessary powers to investigate possible antitrust infringements and mergers, however, only the competition authorities in Albania, Montenegro and Serbia have made use of dawn raids in the last five years, which is considered the most robust and valuable way of detecting hard-core cartels.

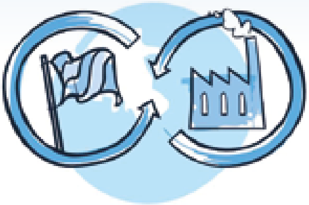
All assessed SEE economies, except Kosovo, scrutinise new public policies that may affect competition, although they have insufficient resources to carry out thorough, effective assessments of laws and regulations at the central government level.

ACHIEVEMENTS

- **The six SEE economies have put all of the necessary major legal provisions in place for a competition law regime that works.** The provisions for anti-competitive agreements and abuse of market dominance are closely aligned with those in the Treaty on the Functioning of the European Union. The provisions on mergers also follow international standards.
- **Most authorities can and actually do conduct market studies and comment on the competitive effects of laws and regulations.** The legal framework enables the SEE competition authorities to act as competition advocates in their economies.
- **Competition authorities are formally independent.** Governments do not formally intervene in the decision-making process or give directions.

CHALLENGES AND RECOMMENDATIONS

- **Further improve the competition law enforcement record.** Despite the established legal foundations of competition policy in the region, challenges remain in their implementation. As the enforcement track record is one of the most important indicators of an effective competition regime, strengthening it should be a priority for the competition authorities.
- **Put in place guidance for stakeholders on the competition authorities' enforcement practices.** Publishing explanatory documents that help businesses, their legal advisers and the public to understand how competition law is applied is an important aspect of enforcement practice. However, only half of the SEE competition authorities have published comprehensive sets of guidelines to that effect.
- **Ensure that competition authorities have sufficient resources.** In most of the SEE economies, financial and human resource constraints may limit the scope of action and the quality of work that can be expected.
- **Give more weight to the competition authorities' recommendations.** When the competition authorities comment on barriers to competition in laws, regulations or industry sectors, these recommendations are not always taken into consideration.



STATE-OWNED ENTERPRISES

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

KEY STATISTICS

In most of the assessed SEE economies, state ownership policies and rationales have not been developed. Although in many cases a degree of "ownership policy" can be gleaned from laws, cabinet decisions and other secondary legislation, these are rarely consolidated into one concise document. In general, the overall objectives for state enterprise ownership put forward by OECD and non-OECD governments fall into the following categories: 1) supporting national economic and strategic interests; 2) ensuring continued national ownership of enterprises; 3) supplying specific public goods or services (after deeming that the market cannot supply the same goods or services); 4) performing business operations in a "natural" monopoly situation; and 5) other operations such as creating or maintaining a state-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient.

Rationales for state ownership of enterprises

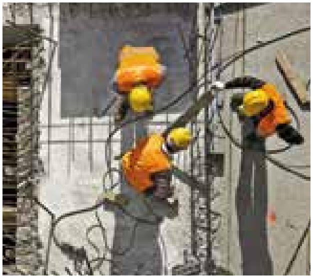
	Supporting economic and strategic interests	Ensuring continued national ownership of enterprises	Supplying specific public goods or services (in the absence of private suppliers)	Performing business operations in a "natural" monopoly situation	Other
Albania	✓		✓		
Bosnia and Herzegovina	✓ (FBiH & RS)	✓ (RS)		✓ (FBiH & RS)	
Kosovo	✓	✓	✓		
Former Yugoslav Republic of Macedonia	✓		✓		
Montenegro	✓				
Serbia	✓		✓		✓

Note: FBiH – the Federation of Bosnia and Herzegovina; RS – the Republika Srpska.

Source: Submissions from authorities and independent consultants.

ACHIEVEMENTS

- **Financial disclosure and audit practices have improved in a number of jurisdictions.** Large and economically important SOEs are increasingly expected to file financial reports consistent with International Financial Reporting Standards (IFRS), as laid down in corporate laws or in specific SOE legislation.
- **The assessed SEE economies have raised their auditing standards.** Some of the economies in the region apply high standards of external audit to their SOEs, consistent with private-sector practices, whereas others continue to rely mostly on their state audit functions.
- **The economies have taken the first steps towards improving co-ordination of state ownership.** A couple of economies have taken steps to ensure that the ownership of at least part of their SOE portfolios is exercised on a whole-of-government basis rather than by individual ministers or political communities.
- **The economies have introduced measures to ensure a healthier competitive landscape between SOEs and other firms.** Partly as a consequence of their efforts to align themselves with European Union (EU) legislation, the economies have made changes likely to contribute to levelling the playing field. These include measures to ring fence, or unbundle, monopoly elements of SOEs' value chains.



CHALLENGES AND RECOMMENDATIONS

- **Professionalise the state ownership function as a priority in all six SEE economies.** Most SOEs continue to be run by individual line ministries as extensions of the political powers of these ministries, which arguably lead to inefficiencies and conflicts of interest. The ownership of SOEs should be entrusted to state units with specific knowledge of corporate economy and law, and shielded from conflicts of interest with other government functions.
- **Foster clarity in financial and non-financial objectives for individual SOEs.** State-owned enterprises' financial objectives are not fully outlined in the assessed economies; at best they are often basic (e.g. "not to lose any money") and they do not ensure that the state obtains a reasonable return on its invested capital. Non-financial objectives are in most cases opaque or weakly defined. This needs to be addressed if SOE managers and those exercising the state ownership function are to be held properly to account for SOE performance.
- **Ensure governments engage in aggregate reporting on their SOEs.** An essential first step will be a recurrent mapping exercise, making it clear to governments, parliamentarians and the public which enterprises are in public ownership and why and how they are performing. In the absence of such information, at best only an ad hoc and piecemeal approach to reform can be realised.
- **Strengthen protection of non-state investors further.** The protection of minority shareholders is also of concern in the private sector in a number of the assessed economies. The state needs to go beyond the requirements established by ordinary company law in this respect: there is a temptation to use the state's shares to vote in shareholder meetings in pursuit of public policy objectives rather than in the interest of all investors. Whether and under what circumstances this may occur should be made clear to non-state investors at the time of their investment.

EDUCATION & COMPETENCIES

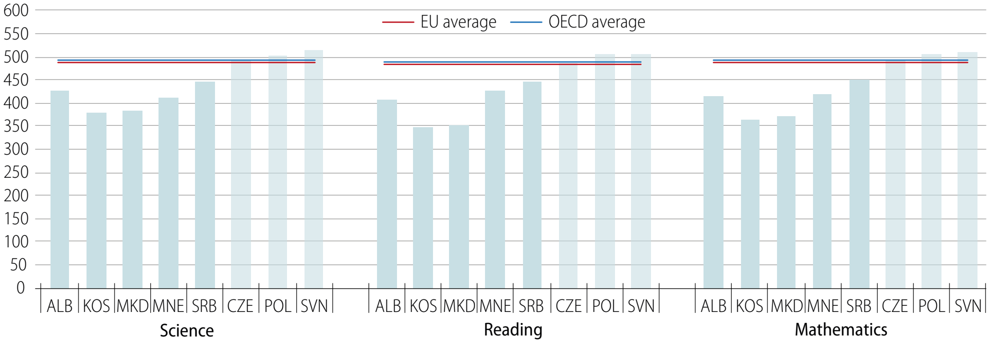
Ensuring inclusive and high-quality education is central to creating a competitive environment. Investing in education is necessary to increase human capital and further improve labour productivity. Across the region, the SEE economies have adopted national strategies to improve the overall standard of education and/or address specific aspects of education, such as equity, vocational education and training, and adult education.

However, the latest results from the Programme for International Student Assessment (PISA) for participating SEE economies are well below those for peers from Central and Eastern Europe and the OECD average. Encouraging participation in early childhood education and increasing spending on primary and secondary education could help to ensure that all students reach the PISA baseline level needed for full socio-economic participation.

KEY STATISTICS

2015 PISA performance in science, reading and mathematics

Mean scores



Note: Results for Serbia are from 2012. Data for Bosnia and Herzegovina are not available. CZE- Czech Republic; POL – Poland; SVN – Slovenia.

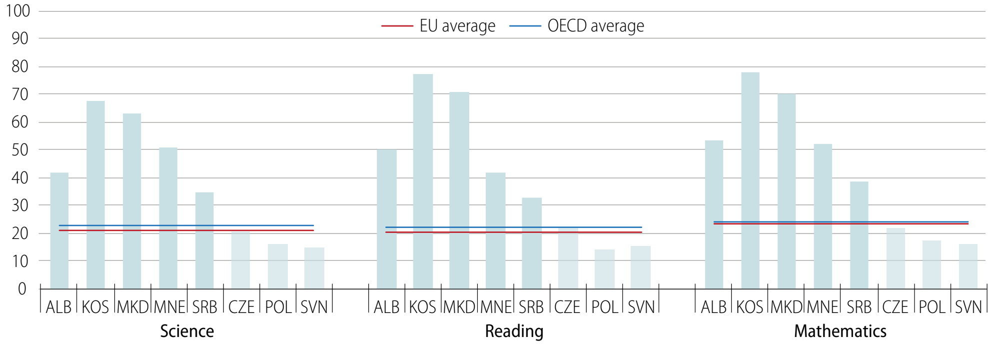
Source: OECD (2016), *PISA 2015 Results (Volume I): Excellence and Equity in Education*, http://dx.doi.org/10.1787/978926426649; OECD (2014), *PISA 2012 Results: What Students Know and Can Do* (Volume I, Revised edition, February 2014): *Student Performance in Mathematics, Reading and Science,* http://dx.doi.org/10.1787/9789264208780-en

The 2015 PISA results found that all the participating SEE economies have room to improve the quality of their science, reading and mathematics education. They scored well below the EU and OECD averages and those of selected OECD peers from Central and Eastern Europe.

The PISA assessment has established a scale of proficiency levels for the different domains. All students should be expected to attain Level 2 – the baseline level of skills required for full socio-economic participation – by the time they leave compulsory education. Among the participating SEE economies, in 2015 at least 40% of students were low achievers in science, ranging from 42% in Albania to 68% in Kosovo. Low achievers in reading range from 42% in Montenegro to 77% in Kosovo, and in mathematics from 52% in Montenegro to 78% in Kosovo. These figures are high, particularly in comparison to the OECD and EU averages of about 20%.

PISA low achievers in science, reading and mathematics (2015)

% of students scoring below Level 2



Note: Results for Serbia are from 2012. Data for Bosnia and Herzegovina are not available. CZE – Czech Republic; POL – Poland; SVN – Slovenia.

Source: OECD (2016), *PISA 2015 Results (Volume I): Excellence and Equity in Education*, http://dx.doi.org/10.1787/978926426649; OECD (2014), *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

ACHIEVEMENTS

- **All six reviewed SEE economies have recently adopted (or are about to adopt) updated national strategies to improve the quality of education and increase the competencies of the labour force.** These new strategies are based on an assessment of the impact of previous strategies. These updated national strategies seek to improve the overall standard of education and/or address specific aspects of education, such as equity, vocational education and training (VET), and adult education.
- **All the economies have made progress in implementing their national qualifications frameworks** and aligning them with the European Qualifications Framework (EQF). Over the period of this assessment, this is particularly the case for the Former Yugoslav Republic of Macedonia and Kosovo.
- **The economies have made efforts to draw up policy frameworks that support equity in education.** All six economies have recognised the importance of ensuring equitable access to, and participation in, education.

CHALLENGES AND RECOMMENDATIONS

- **Increase expenditure on primary and secondary education**; the latter is considerably lower than in economies such as the Czech Republic, Poland and Slovenia, as well as OECD and EU-22 averages. The latest 2015 Programme for International Student Assessment (PISA) results for the participating SEE economies are well below those for peers from Central and Eastern Europe and the OECD average. One factor that explains this is the high percentage of secondary students who do not reach the baseline level of skills required for full socio-economic participation (PISA proficiency Level 2). Prioritising spending on primary and secondary education could help to ensure that all students reach this level.
- **Stimulate participation in early childhood education (ECE), for example by improving ECE provision and affordability.** Only 36.8% of children were enrolled in ECE on average in 2015, 58 percentage points below the EU average.
- **Invest more in increasing the attractiveness of the teaching profession and the participation of teachers in professional development programmes.** Teacher quality is one of the in-school factors that most determines students' learning outcomes. Yet the best candidates are not choosing the teaching profession and teachers in the SEE economies participate less often in professional development programmes than their peers in OECD countries.
- **Promote and strengthen work-based learning schemes like apprenticeships or internships.** PISA data show that vocational education is attracting disadvantaged students who have fallen behind at school. Increasing the share of students in work-based (in-company) learning remains a challenge. Co-operation between VET providers and higher education institutions, as well as businesses and social partners, needs to be reinforced.
- **Make efforts to reduce skills mismatches**, for example by fostering career guidance to direct students towards science, technology, engineering and mathematics (STEM) subjects, which have greater prospects for stimulating innovation. The economies have an over-supply of graduates from the fields of business, administration and law, and an under-supply of STEM graduates.

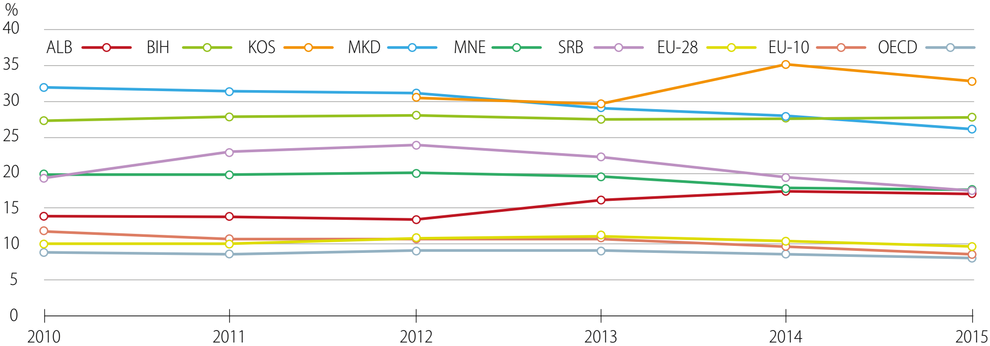
Employment policy can provide a framework of strategies, action plans, laws, measures and institutions that improves the functioning of labour markets, makes them more inclusive, and enhances their ability to address post-crisis and demographic challenges. The participating SEE economies have a number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

KEY STATISTICS

Unemployment rates in the six SEE economies, measured as the proportion of people in the labour force who do not have a job and are actively looking for work, are relatively high compared to the EU and OECD averages. Evidence suggests that labour market challenges in the SEE economies are structural and that growth alone will not be enough to create the number and types of jobs needed.

With the exception of Montenegro, the share of young people not in employment, education or training (NEET) in the SEE economies is almost double the EU and OECD averages. Young NEETs are considered “at risk”: being jobless, inactive and with no access to learning.

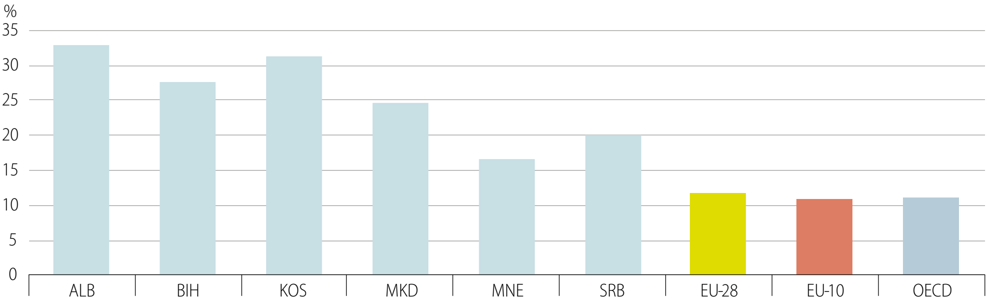
Unemployment rates at age 15 and above – % of labour force



Note: Data not available for Kosovo for 2010 and 2011. EU-28 – all 28 EU Member States; EU-10 – Cyprus[1], the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

Source: EC (2017), *Employment and Unemployment (Labour Force Survey)* (Eurostat database), **http://ec.europa.eu/eurostat/web/lfs/data/database**; World Bank/WIIW (2017), *SEE Jobs Gateway* (database), **www.seejobsgateway.net/charts**; OECD (2017), *OECD Data* (database), **https://data.oecd.org/.**

Not in employment, education or training at age 15-24 (2015) – % of total population aged 15-24



Note: EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. OECD average does not include Republic of Korea. The EU and OECD averages have been calculated as simple averages.

Source: ILO (2017), *Key Indicators of the Labour Market* (database), **www.ilo.org/global/statistics-and-databases/research-and-databases/kilm/lang--en/index.htm.**

ACHIEVEMENTS

- **Most of the assessed SEE economies have made efforts to design comprehensive employment frameworks through consultative processes.**
- **Most of the economies have relevant institutions, such as public employment services and labour inspectorates, in place,** aiming to address their specific labour market challenges.
- **All the SEE economies are attempting to address structural unemployment** through activation policies.
- **The SEE economies have started to consider developing social enterprises** as a way of strengthening the development of the social economy so as to stimulate innovation and encourage the inclusion of vulnerable groups in labour markets.

CHALLENGES AND RECOMMENDATIONS

- **Implement fully the measures set out in strategies and action plans.** Effective implementation is often hampered by a lack of funding and human resources, as well as weak co-ordination with other policies (e.g. education policies, tax policies).
- **Strengthen the capacities of social partners, in particular worker organisations**, which often lack the capacity to undertake analysis and to engage actively and constructively in a social dialogue with government.

- **Continue to tackle informal employment.** Although estimates put informal employment as high as 30% in some of the economies, measures to gradually coax informal workers into formal work are often lacking. Labour inspectorates do not have enough capacity, which further hampers detection and enforcement.

- **Improve activation policies** to increase the motivation and employability of the unemployed and to facilitate additional employment opportunities; and create an effective institutional setup able to co-ordinate delivery of a complex array of services. Activation policies are still insufficiently developed in most of the six economies and have limited impact. This is often due to poor targeting, disincentives for unemployed people to participate in activation measures, and ineffective policy design.

- **Strengthen the capacity and infrastructure of public employment services (PES), the key institutions implementing activation policies, to provide quality support.** Staff workloads are high (on average about 400 jobseekers for a single PES officer), which can seriously limit the implementation of active labour market policies.

- **Improve skills matching, and ensure that training measures are effective.** Current skills gaps analyses are limited in their coverage and data provided, and are seldom institutionalised or integrated into educational and employment systems.

- **Improve job quality by targeting the factors that affect earning, job security and the quality of the working environment.** Overall job quality is lower compared to the EU and OECD averages, reflected in low earnings, high labour market insecurity and poor working environments.

- **Further support social enterprise development.** Most of the assessed economies are currently either drafting legislation on social enterprises or have recently adopted it. Nevertheless, social enterprises generally do not play a role in their strategic frameworks, and in the implementation of support measures.

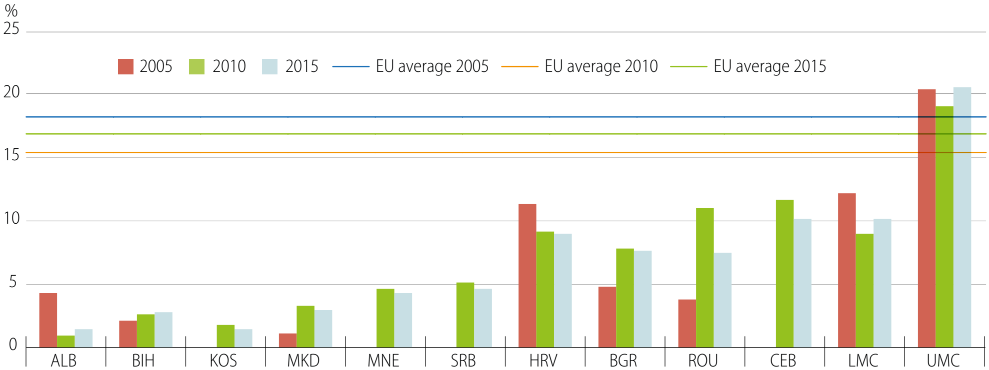
SCIENCE, TECHNOLOGY & INNOVATION

Science, technology and innovation (STI) provide the means for the transition to high value-added products and services. This dimension assesses the governance of STI policy, the performance of the public research system, the support to business innovation, as well as the linkages between the public and private sectors. Throughout the region STI outcomes remain modest.

A lack of funding for research and development (R&D) limits the potential for innovation, while the wider diffusion of technology does not receive sufficient policy attention. In the future, a more structured link between business and academia would help facilitate the spread of cutting-edge research, while an emphasis on individual innovation could help foster new creative sectors.

KEY STATISTICS

High-tech exports as a share of manufactured exports (2005-15)



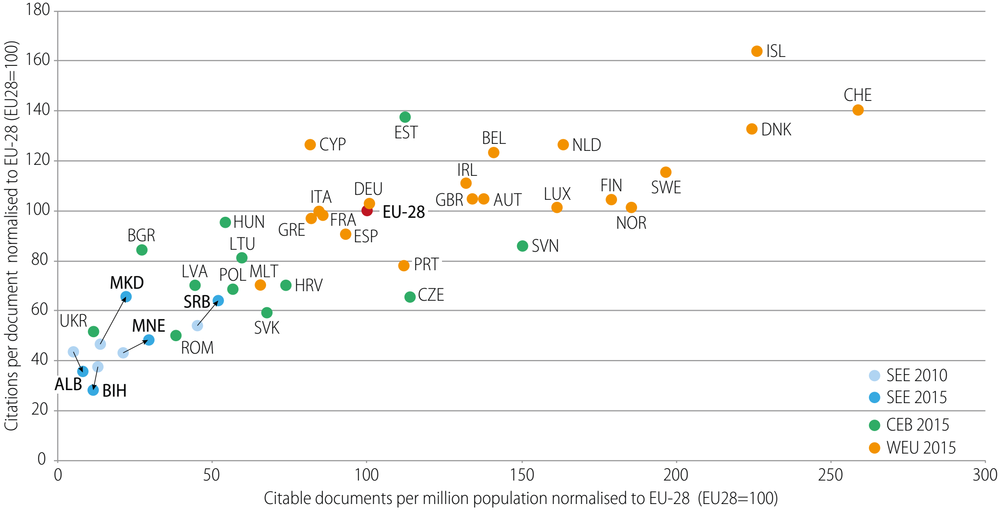
Note: HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); LMC – lower middle-income countries; UMC – upper middle-income countries.

Source: World Bank (2017), World Development Indicators (database), **http://data.worldbank.org/data-catalog/world-development-indicators**. For Kosovo and Montenegro, data from national statistical offices.

High technology exports as a percent of manufactured exports remain at extremely low levels compared to EU and Central Europe and Baltics averages.

The volume and quality of scientific production offers a measure of basic research outcomes, and research outcomes are improving. The number of scientific articles per million population is used as a measure of volume; quality measures use citations per article, normalised relative to the average for the 28 EU Member States (EU-28). The performance of the SEE economies is very low, both in volume and quality, but the trend between 2010 and 2015 is clearly positive for the Former Yugoslav Republic of Macedonia, Montenegro and Serbia.

Scientific production in SEE and comparator countries



Note: WEU – Western Europe; EU-28 – the 28 EU Member States.

Source: Scimago (2017), Country Rankings (dataset), www.scimagojr.com/countryrank.php; World Bank (2017), World Development Indicators (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

ACHIEVEMENTS

- **The six assessed SEE economies have taken positive steps towards establishing strategic approaches to STI policy.** The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have adopted holistic innovation strategies, while Albania, Bosnia and Herzegovina, and Kosovo have prepared drafts for adoption.
- **The Former Yugoslav Republic of Macedonia and Serbia have strengthened horizontal co-ordination** with ministerial-level councils to co-ordinate STI policy in both economies.
- **Independent and professional innovation funds have been established in Serbia and the Former Yugoslav Republic of Macedonia** to implement competitive innovation grant instruments.
- **Start-ups benefit from an infrastructure of incubators and accelerators, and the first venture capital funding.** All six economies have established incubator infrastructure offering events such as hackathons, start-up weekends, mentoring and training. The venture fund South Central Ventures has started operations in all six economies.
- **The first science and technology parks have been established** in Bosnia and Herzegovina, Montenegro and Serbia. However, these parks have yet to develop strong ties to academia.
- **Serbia has established rules governing the intellectual property split between individuals and institutions**; at least 50% of profits from an invention go to the researcher, which should encourage researchers to patent their discoveries.

CHALLENGES AND RECOMMENDATIONS

- **Increase and consolidate financial support for research and development.** Overall financial support is a small fraction of that offered in comparable transition countries, particularly for business innovation. Introducing performance-based contracts for institutions would increase the efficiency of government spending in this area. Financial support for business innovation (and in some cases, public-sector research) largely depends on donor financing or loans, threatening sustainable development of the innovation ecosystem over time. Funding instruments are fragmented across ministries for education, science and economy, and various agencies.

- **Place more emphasis on technology diffusion and absorption policies.** In the absence of government support for technology extension services, a donor programme has effectively enhanced SMEs' technological development. However, the SEE governments have not implemented such instruments, which are crucial for technology absorption in middle-income economies, enabling the SEE economies to catch up with more advanced ones. Cross-border technology transfer to SMEs is yet to be developed, for example, through collaboration with international networks such as Fraunhofer.

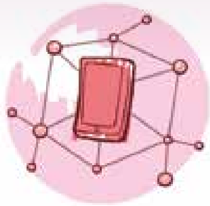
- **Use procurement to encourage innovation.** Existing procurement can be adapted to encourage innovative solutions by using functional requirements rather than technical specifications, as they can spur innovative solutions while enhancing competition and preventing bid rigging.

- **Develop a structured approach to creating links between business and academia.** In particular, they could consider: 1) introducing the "third mission" of co-operation with industry in higher education institutions (HEIs); 2) introduce private-sector representation on the governance boards of HEIs and public research organisations (PROs); 3) develop "triple helix" type events to create opportunities for business and academia to meet; 4) use innovation vouchers to initiate small-scale collaboration; and 5) develop collaborative grants for more mature projects.

- **Provide incentives for individuals to unleash their creative potential.** Except in Serbia, there are no clear rules on splitting intellectual property rights between an individual researcher and their institution. Researchers are not evaluated on their co-operation with business, and there are no schemes to promote mobility between the public and private sectors, such as industrial master's or PhDs, entrepreneurial leave of absence, or subsidies for employment transfer.

- **Make better use of the SEE economies' highly educated diaspora and tackle brain drain.** More than 30% of highly educated people have left the region. While bringing them back may be difficult in the short term, programmes could improve connections and knowledge flows.

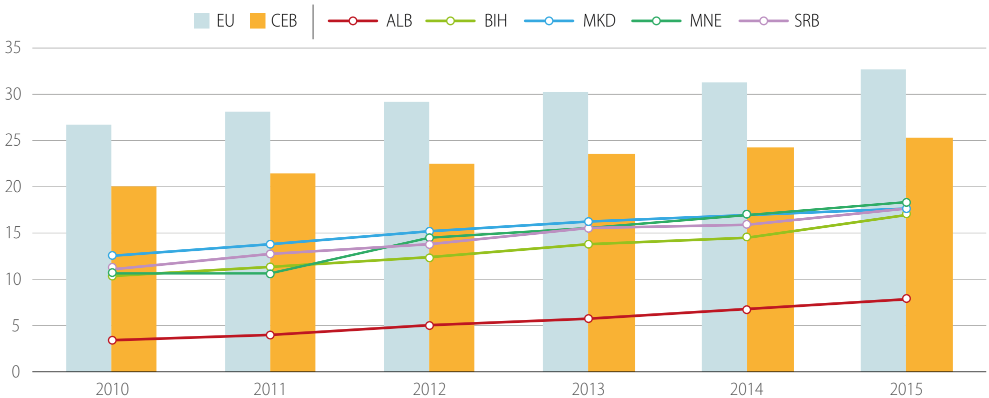
- **Improve the creation of STI-related statistics to enable the development of evidence-based policies.** The economies collect very few statistical indicators relevant to STI, and only Serbia and the Former Yugoslav Republic of Macedonia are covered by the European Innovation Scoreboard (EIS).



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

KEY STATISTICS

Fixed broadband subscriptions (2010-15) – per 100 inhabitants



Note: Data for Kosovo not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: ITU (2017), World Telecommunication/ICT Indicators Database, **www.itu.int/en/ITU-D/Statistics/Pages/publications/wtid.aspx**.

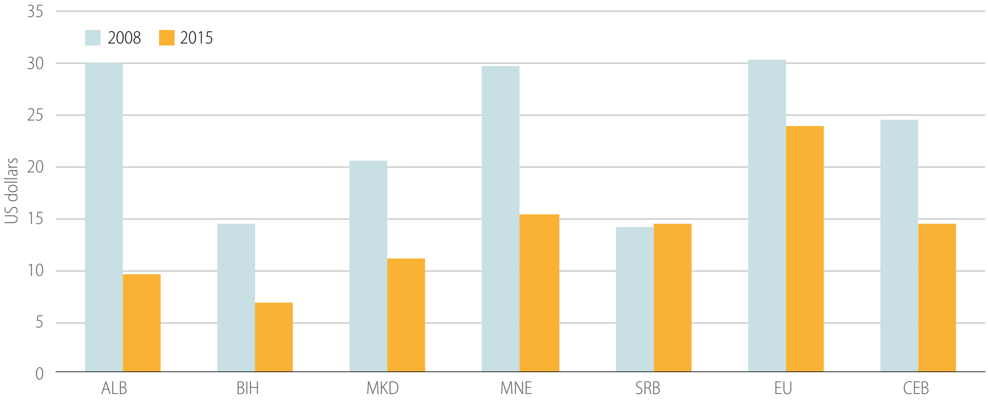
Fixed (wired) broadband subscriptions remain lower than the EU and CEB averages and the SEE economies are not catching up. However, they are gradually closing the gap to the EU average in active mobile subscriptions.

Charges for a standard fixed-broadband monthly subscription in the SEE economies are falling, but are still less affordable than in the EU or in the CEB, since the GDP per capita in purchasing power standards in the six economies is at 28% of the EU and about 30% lower than CEB.

The six SEE economies rank closely alongside the CEB in the Networked Readiness Index of the World Economic Forum, which measures how economies use information and communication technology (ICT) for increased competitiveness and well-being.

The SEE economies' share of ICT goods and services in total exports is lower than the EU and CEB averages with two exceptions: for ICT services exports, Serbia has reached the EU average and the Former Yugoslav Republic of Macedonia, the CEB average.

Trends in fixed-broadband monthly subscription charges (2008-15) – in USD



Note: Data for Kosovo not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: ITU (2017), World Telecommunication/ICT Indicators Database, www.itu.int/en/ITU-D/Statistics/Pages/publications/wtid.aspx.

ACHIEVEMENTS

- **The six SEE economies have taken positive steps to facilitate broadband development and to align their regulatory frameworks with the European Union (EU) *acquis*.** Most of the SEE economies have adopted European broadband policies and regulatory frameworks that allow for palpable improvements in the coverage and speed across communications infrastructures. Most have also set targets such as providing basic broadband to all citizens, using satellite broadband to extend coverage to 100% of the population and enabling investments in next generation networks to deliver 30 Mbps (megabits per second) by 2020.

- **Most of the SEE economies have adopted cross-cutting digital strategies to support the development of ICT across all sectors.** Most of the SEE economies have also recognised the important role of the ICT sector and have adopted strategies to support its development in co-operation with the information technology (IT) industry.

- **The six economies have taken steps to strengthen their e-business and e-commerce legal frameworks.** They have aligned their sectoral legislation and regulations with the European E-Commerce Directive (2000/31/EC) and have made efforts to address non-legal bottlenecks to e-business take-up, such as building awareness and capacity among small and medium-sized enterprises (SMEs).

- **Most of the SEE economies have established national Computer Emergency Response Teams (CERTs) and made progress in adopting cybercrime strategies and legislation.** Most of them have defined critical information infrastructure (CII), and CERTs or similar teams are in place in a variety of government institutions. The SEE economies, apart from Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia, have already adopted policies and legislation relating to digital security matters.

- **Most of the SEE economies have adopted e-authentication frameworks and improved their e-authentication schemes.** Most have adopted updated e-signature legislation, and in some cases they have revised their technology selection to promote the wider use of e-authentication. They are gradually aligning their e-government services with their national interoperability frameworks.

CHALLENGES AND RECOMMENDATIONS

- **Enhance the use of ICT for teaching and learning, as well as for developing e-skills for students and professionals.** All six economies have included relevant strategic objectives in their ICT or education sector policies, but none have managed to really transform education by using ICT to take learning to the student and worker, adapt teaching to the learner's needs or adopt multi-device and 24/7 learning approaches. Their competency frameworks are largely outdated, the ICT industry suffers from skills gaps, and schools often lack IT equipment, connectivity and e-curricula. The SEE economies should therefore co-ordinate their education and digital strategies and inject more resources to fund equipment purchases and connection upgrading.

- **Prioritise the inclusion of underprivileged groups in digital strategies.** Policies for e-inclusion are scarce and incomplete. While progress has been made in adopting e-accessibility regulations, there is little enforcement of them for public-sector websites and e-services, and in some cases they are optional. The SEE economies could make the implementation of e-accessibility mandatory and strengthen the relevant capacities in the public sector.

- **Take steps to systematically respect privacy and data protection, especially in social media.** While all six SEE economies have legal frameworks and authorities for personal data protection, online privacy and data abuse issues are still not clearly understood by data controllers in the public and private sector. The SEE economies should increase their public awareness campaigns and enforce mandatory training for professionals in the private and public sector, following OECD recommendations on privacy and personal data (OECD, 2013c).

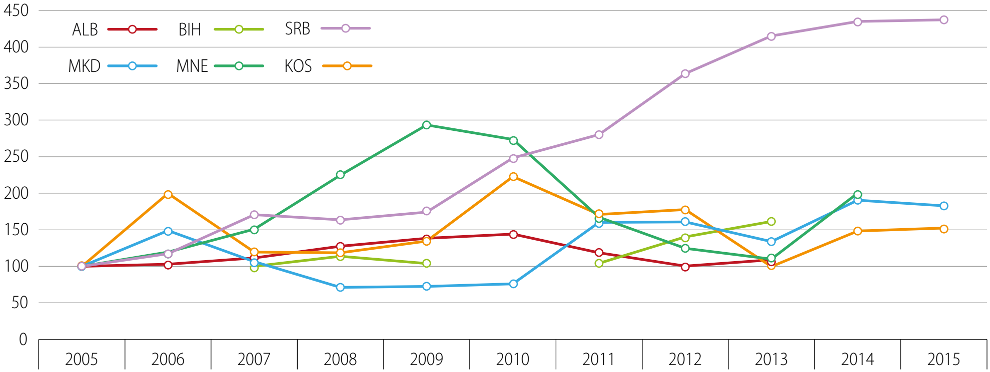
- **Promote the adoption of digital technology by SMEs.** Although all of the SEE economies have included some relevant measures in their digital strategies, their activities and programmes have not had any substantial impact on SMEs and should be revised and allocated specific resources. The SEE economies could consider wider campaigns to promote the adoption of e-business and e-commerce and look at the legal and non-legal barriers to increased take-up.

TRANSPORT POLICY & PERFORMANCE

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

KEY STATISTICS

Evolution of road freight transport volumes (2005-15)



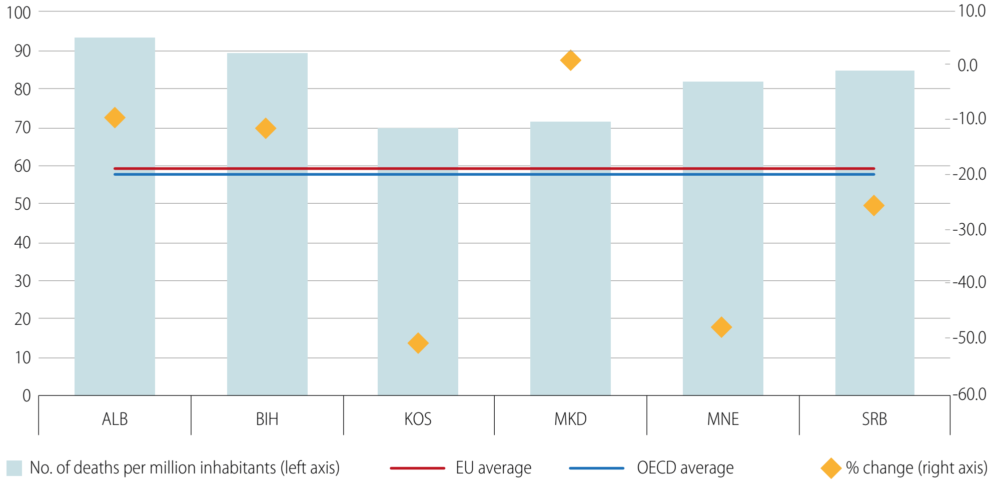
Note: Reference year for Bosnia and Herzegovina is 2007. SEE statistical offices and ministries provided economy-specific data as part of the Competitiveness Outlook assessment conducted in 2016-17.

Source: OECD (2017), "Transport measurement: Freight transport", Transport (database) http://stats.oecd.org/Index.aspx?DataSetCode=ITF_GOODS_TRANSPORT; Kosovo Ministry of Infrastructure.

In light of growing transport volumes, especially on roads, removing bottlenecks will be critical to enhancing competitiveness.

In 2015, the numbers of road fatalities per million inhabitants were higher in the SEE economies than the EU and OECD averages. Kosovo and the Former Yugoslav Republic of Macedonia performed better than the other economies, while Albania continues to have the highest fatality rate. However, all of the SEE economies except the Former Yugoslav Republic of Macedonia recorded improvements over the period 2005-15, with Kosovo and Montenegro achieving the largest reductions in fatalities.

Road fatalities (2015) and percentage change over 2005-15



Note: Data for Kosovo refer to the period 2005-14. SEE statistical offices and ministries provided economy-specific data as part of the Competitiveness Outlook assessment conducted in 2016-17.

Source: SEE statistical offices; Ministry of Infrastructure of Kosovo (2015), Sectorial Strategy and Multimodal Transport 2015-2025 and the Action Plan for 5 Years, www.kryeministri-ks.net/repository/docs/SECTORIAL_STRATEGY_AND_MULTIMODAL_TRANSPORT_2015-2025_AND_ACTION_PLAN_FOR_5_YEARS.pdf; OECD (2017c), "Transport safety: Road injury accidents", http://stats.oecd.org/Index.aspx?DataSetCode=ITF_ROAD_ACCIDENTS.

ACHIEVEMENTS

- **The six SEE economies have developed long-term transport strategies and established high-level project selection processes.** The latter apply mainly to investment funded by the European Union (EU), and enable decision makers to have an overview of the infrastructure projects pipeline over time.
- **Regulatory reforms of transport sectors have continued.** There has been substantial progress in introducing and updating legislation to improve the efficiency of the rail, aviation and road sectors, further promoting harmonisation with the EU *acquis*.
- **Growing interest from private investors is leading to more transport projects considering alternative procurement methods.** There are examples of successful public-private partnerships (PPPs) in the aviation and maritime sectors and international consortia are increasingly involved in road and rail projects.
- **Institutional mechanisms for road safety measures and their implementation have improved.** Co-ordinated efforts through national road safety councils and the implementation of stricter policies have led to road deaths falling across the SEE economies.

CHALLENGES AND RECOMMENDATIONS

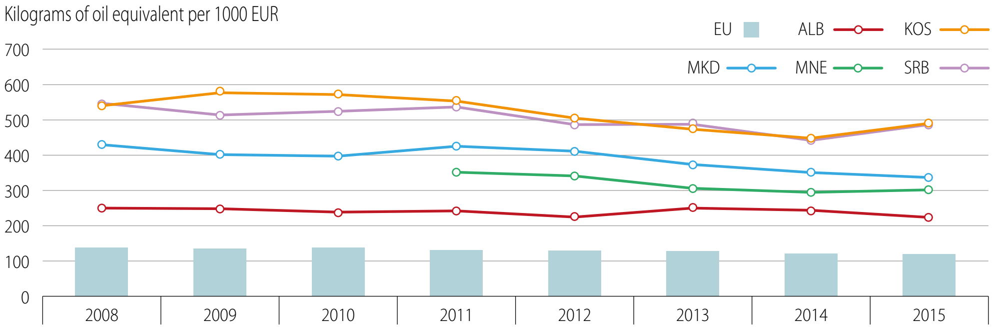
- **Strengthen the effectiveness of both the new transport strategies and the project selection processes.** Many of the economies' strategies currently lack monitoring and implementation plans. A number of large-scale projects fall outside the scrutiny of formal prioritisation processes and have gone ahead despite the lack of public evidence on costs and benefits.
- **Complete transport market reforms.** Although progress has been made, the assessed economies still need to make final yet important harmonisation efforts, such as reforms to open rail markets and airspace management plans. Implementing the large body of legislation and regulations will also be a significant challenge for newly formed and at times understaffed authorities and government departments.
- **Address the drivers of logistics performance, a key enabler of trade competitiveness, in a co-ordinated way.** The SEE economies need to enhance their public policy efforts to reduce logistics costs and makes freight movements faster and smoother across the region, at both national and international levels.
- **Make the resilience of key transport infrastructure assets a policy priority.** The lack of systematic asset management plans and related maintenance budgets could lead to key assets deteriorating over time. This risk is heightened by growing pressure on existing infrastructure from economic growth and from the impact of climate change.
- **Integrate key aspects of sustainability, such as environmental quality, into transport strategies.** Existing strategies often fail to encompass key aspects of sustainability. The lack of co-ordination between infrastructure investment, regulatory regimes and sustainability goals results in high environmental costs.

ENERGY POLICY

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

KEY STATISTICS

Energy intensity (2008-15) – Gross inland consumption of energy divided by GDP



Note: Data for Bosnia and Herzegovina not available. Data for Montenegro from 2011.

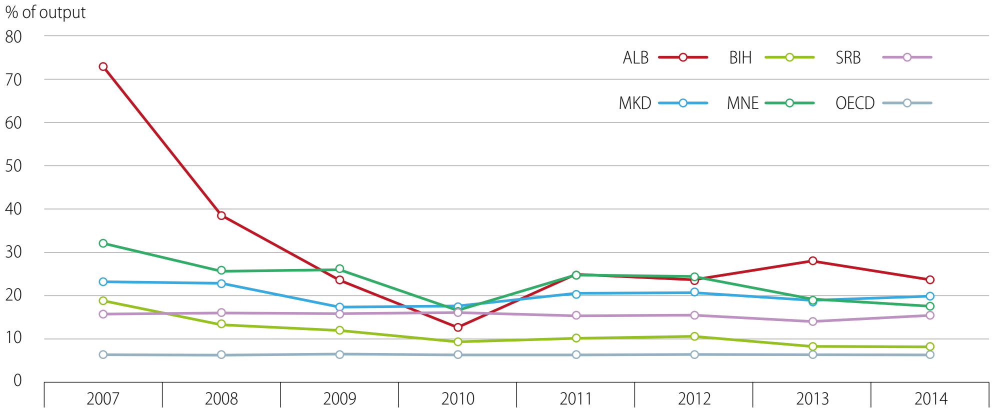
Source: Eurostat (2017), Energy Intensity of the Economy (database), http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsdec360.

The energy required to produce one unit of GDP, or the energy intensity, of the six SEE economies is higher than the EU average. The energy intensity of an economy is effected by various factors including their economic structure – the relative importance of different economic sectors and their level of energy use, e.g. the industry sector is more energy-intensive than the service sector. While industry contributes a greater share to most of the six SEE economies' GDPs than the EU average, their energy intensities are still substantially higher than the EU average.

This suggests that a growing service sector will reduce the energy intensity of the SEE economies, but greater impacts will come from energy efficiency programmes and technological progress.

While there are many factors which explain the prevalence of outages across the region, one important factor is the weak energy infrastructure, which is in dire need of investment. Data on electric power transmission and distribution losses in the assessed SEE economies are consistently well above the OECD average.

Transmission and distribution losses (2007-14) – % of output



Note: The figure shows the share of electric power transmission and distribution losses in electricity production. No data available for Kosovo.

Source: World Bank (2017), "Electric power transmission and distribution losses (% of output)", http://databank.worldbank.org/data/reports.aspx?source=2&series=EG.ELC.LOSS.ZS&country=ALB,BIH,KSV,MKD,MNE,SRB.

ACHIEVEMENTS

- **All six assessed SEE economies have taken steps to improve the competitiveness of their energy sectors.** They have either developed policy frameworks that set objectives across sub-dimensions, or are actively developing comprehensive policy frameworks. Kosovo and Serbia have the highest average scores across the entire energy policy dimension, due in large measure to their relatively strong performance in establishing Third Energy Package-compliant legislative and regulatory frameworks, and their progress in implementing their policy frameworks.

- **All six economies recognise the positive competitiveness effect of regional energy market formation**, and have committed to the Western Balkans Connectivity Agenda, which is a high-level driver of reform.

- **The six SEE economies have identified gaps in their energy infrastructure.** Working together and with the Energy Community Secretariat, they have established a priority list of ten Projects of Energy Community Interest (PECI): six projects on electricity transmission, three projects on gas transmission and one on oil transmission. The ten selected projects will benefit from the streamlined issuing of permits and the possibility of regulatory incentives, cross-border cost allocation, and funding under the European Union's (EU) Instrument for Pre-Accession Assistance and the Neighbourhood Investment Facility. In addition, two electricity and eight gas projects have been approved as Projects of Mutual Interest with the EU.

CHALLENGES AND RECOMMENDATIONS

- **Remain committed to reforming national and regional energy markets.** Energy sector reform is an ongoing and intense challenge. It will require sustained political and institutional will if the economies are to achieve both national and regionally shared objectives by implementing the adopted legislative and regulatory frameworks.

- **Adopt and implement urgently the EU Third Energy Package-compliant primary and secondary legislation.** At present compliance with the EU Third Energy Package is patchy at best, but remains an essential prerequisite for the interoperability of the SEE and EU energy systems, as well as for improving the productivity and competitiveness of the sector at regional and national levels.

- **Ensure that energy policy strategies and action plans set out measurable objectives and outcomes.** Current strategies and policies do not always include well-defined objectives and outcomes and therefore lack focus. As a consequence reform may be slow, and the evaluation and monitoring of progress is problematic.

- **Implement energy policy fully, including action plans and strategies.** Key aspects of several sub-dimensions have not been implemented. In particular, the strategies and action plans in the sustainable development sub-dimension have not been fully implemented, which is disappointing given the considerable potential for renewable energy sources (RES) and energy efficiency to give the SEE region and economies a significant competitiveness boost. The sustainability of the energy sector and the competitiveness of the region's economies are further threatened by plans for substantial new investments in coal-fired power plants.

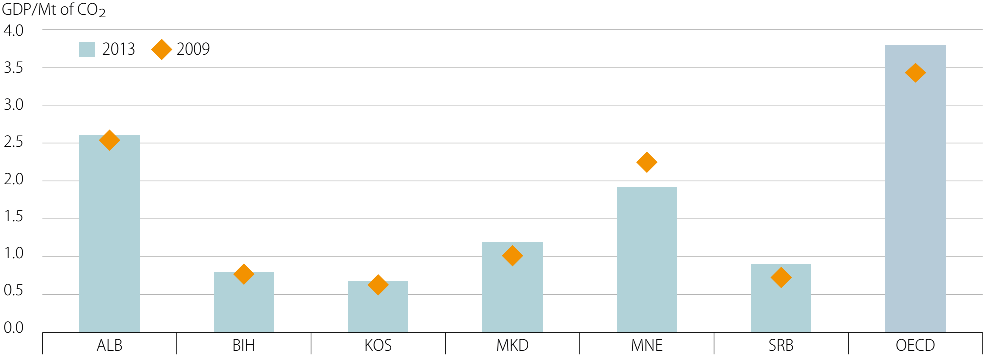
- **Strengthen administrative and institutional capacity and provide additional resources.** Adequate institutional and administrative capacity is a prerequisite for effective energy sector reform. However in assessing almost every sub-dimension concerns were raised about insufficient human and/or financial resources within some national and municipal administrative authorities and regulatory agencies. Pressure on skills and financial resources is likely to increase due to the dynamic nature of EU energy policy, and as administrative and regulatory institutions expand their competence across the whole range of energy sector functions.

ENVIRONMENTAL POLICY

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

KEY STATISTICS

Production-based CO_2 productivity



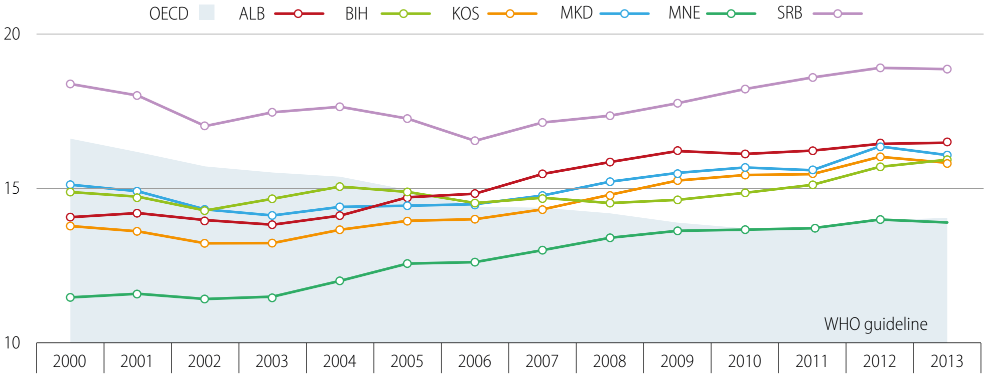
Note: Production-based CO_2 productivity reflects the economic value generated (in terms of real GDP) per unit of CO_2 emitted. Production-based emissions refer to gross direct CO_2 emissions from fossil-fuel combustion, emitted within the territory.

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

Carbon productivity (economic output per unit of CO_2 emitted) has not seen significant improvement in any of the six SEE economies over the last few years. It still falls short of the OECD average, even in the relatively more carbon productive economies of Albania and Montenegro thanks to their reliance on hydropower.

Outdoor air pollution remains high and is a **serious threat to public health**, especially in urban areas.

Mean population exposure to $PM_{2.5}$ air pollution



Note: µg/M^3 – micrograms per cubic metre; $PM_{2.5}$ – fine particulate matter. All data points are moving five-year averages. Kosovo data points are the population-weighted averages of macro-regional data for Kosovo, Kosovska Mitrovica, Kosovsko Pomoravlje, Peć and Prizren macro-regions. Serbia data are the population-weighted averages of macro-regional data concerning the remaining 25 macro-regions.

Source: OECD (2017), "Exposure to air pollution", OECD Environment Statistics (database), **http://dx.doi.org/10.1787/env-data-en**.

ACHIEVEMENTS

- **All six SEE economies are starting to enact environmental legal and policy frameworks.** Overarching environmental strategies and legislation on core environmental topics are in place. Strategies to adopt environmental legislation aligned with the EU *acquis* have also been developed.

- **Overall, the populations in the six SEE economies have good connections to improved water supply and sanitation facilities.** Albania and Montenegro have made considerable progress in expanding access to improved sanitation facilities in the last decade and Kosovo has increased access to water supply with support from donors and the EU. However, access to public wastewater treatment in urban areas remains below the OECD average.

- **The six SEE economies have adopted legislation and developed a general policy vision for land-use management**, but policies differ in their coverage of local and regional spatial plans, as well as the level of the capacity and financial resources secured to support policy implementation.

CHALLENGES AND RECOMMENDATIONS

- **Integrate environmental considerations and international commitments into the main economic and sectoral policies.** The implementation of the Sustainable Development Goals and selected multilateral environmental agreements (MEAs) should be enhanced by integrating them into the relevant sectoral policies and legal frameworks.

- **Accelerate the transition to a low-carbon and circular economy.** The current energy mix is highly dependent on fossil fuels, resulting in high carbon dioxide (CO_2) emissions and poor outdoor air quality. Hence, energy policy frameworks need to be fully aligned with climate change objectives, and policies supporting energy efficiency and renewable energy sources with high potential, such as wind and solar photovoltaics (PV), need to be implemented. Measures to reduce illegal dumping, minimise landfill waste, expand recycling programmes and execute extended producer responsibility schemes should be fully defined and implemented.

- **Increase the use of economic instruments to incorporate environmental costs and benefits into budgets.** The tax burden should be shifted away from labour towards environmentally harmful consumption and production patterns. Although the polluter pays principle is legislated, it is not effectively applied. User fees (e.g. for water and waste) should be fully collected and should be higher to promote efficient resource use or deter pollution. Widespread environmentally harmful subsidies, especially in the energy sector (e.g. subsidised coal and transport fuels), should be phased out.

- **Define clear roles and responsibilities in the institutional frameworks for environmentally sustainable development** to strengthen policy implementation, enforcement and compliance.

- **Improve framework conditions for green investment and innovation.** Measures which provide incentives for businesses to adopt greener technologies – e.g. to use materials and energy more efficiently – should be put in place and promoted effectively.

- **Strengthen natural asset management.** Although limited policy frameworks for the management of land, biodiversity, forestry and water (including some river basin management strategies) are generally in place, they are not implemented adequately due to a lack of capacity at local levels and insufficient budgets. Uncoordinated, uncontrolled use of water and land increases the risk of losing valuable river ecosystems.

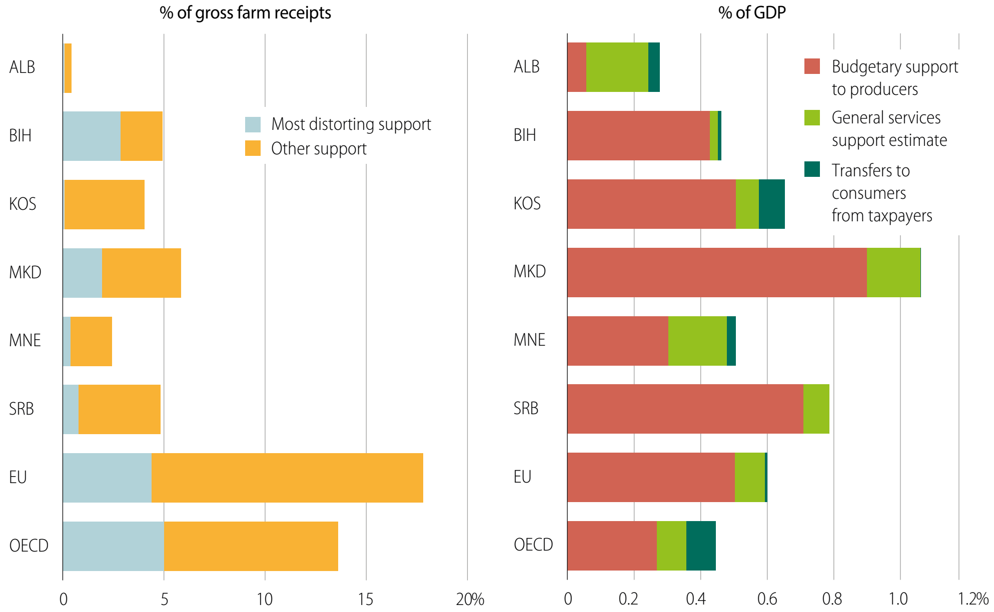
- **Institutionalise the collection of key environmental statistics and policy monitoring and evaluation activities.** Despite increasing numbers of environmental quality monitoring stations, data are not systematically collected or published. Accordingly, timely and accurate data should be collected to enable the government to design and monitor progress in implementing environmental policies and to better inform the public, decision makers and the authorities on environmental conditions and issues.

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

KEY STATISTICS

Budgetary support to agricultural producers in the six SEE economies ranged from less than 1% of gross farm receipts in Albania to 6% in the Former Yugoslav Republic of Macedonia in 2013-15. This level of support is substantially lower than the EU (18%) and OECD (14%) averages. Budgetary support to agricultural producers in all the assessed SEE economies except Bosnia and Herzegovina is mostly generated by measures that are less market distorting. Total budgetary support to agriculture is dominated by transfers to individual producers in all the assessed SEE economies except Albania where it focuses on general services.

Composition of budgetary support to producers and total budgetary support to agriculture (2013-15)



Note: Data on market price support in the six SEE economies are currently unavailable so support indicators only include budgetary support. As a result, assuming that market price support is positive in the six SEE economies, support values are probably lower than they otherwise would be. Data for agricultural output for Albania is 2009-11, for the Former Yugoslav Republic of Macedonia 2012-14 and for Montenegro 2012-13.

Source: Adapted from APM Database (2016), *Agricultural Policy Measures Database*, http://app.seerural.org/agricultural-statistics; ASK (2016), "Economic Accounts for Agriculture", **http://ask.rks-gov.net**; BHAS (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Agriculture Questionnaire", Responses to the OECD received from the Bosnia and Herzegovina Agency for Statistics; INSTAT (2012), "Statistical yearbooks through 2011", **www.instat.gov.al**; MAKSTAT (2015), "Economic Accounts for Agriculture", **www.stat.gov.mk**; MARD (2015), "Strategy for the Development of Agriculture and Rural Areas 2015-2020", **www.minpolj.gov.me/ResourceManager/FileDownload.aspx?rid=253749&rType=2&file=Strategija%20razvoja%20poljoprivrede%20i%20ruralnih%20podrucja%202015-2020.pdf**; OECD (2017), "Producer and consumer support estimates", *OECD Agriculture Statistics* (database), **http://dx.doi.org/10.1787/agr-pcse-data-en**; SORS (2016), "Economic accounts for agriculture in the Republic of Serbia 2007-2015", **www.stat.gov.rs**; World Bank (2017), World Development Indicators (database), **http://data.worldbank.org/data-catalog/world-development-indicators**.

ACHIEVEMENTS

- **The six SEE economies have agricultural strategies in place** with accompanying annual programmes and budgets. However, they are at varying levels of readiness for the EU's Instrument for Pre-Accession Assistance in Rural Development II (IPARD II); a few of them have already used IPARD I or similar programmes.
- **The assessed economies have reasonably well-developed rural infrastructure.** Most rural areas have functioning roads, electricity, and information and communications technology (ICT), which enables rural producers to connect to markets for inputs and their crops, and to access critical information including on weather and technology.
- **Agricultural education, research and extension systems are in place in all six SEE economies.** All the economies provide agricultural vocational education and training and university education, and have agricultural research institutes and functioning extension services.
- **The six SEE economies have regulations in place for key agricultural inputs.** Regulations for seeds, fertiliser and tractors protect public health and compliance is not overly burdensome.

CHALLENGES AND RECOMMENDATIONS

- **Strengthen inter-sectoral co-operation.** Low levels of co-operation, co-ordination and synergies between agriculture and other sectors hold back the performance of rural infrastructure for agriculture, irrigation systems and agricultural education and research.
- **Re-orient agricultural producer support towards better productivity and sustainability objectives.** The current composition of producer support has a large share of payments for commodity output and input use and is unlikely to facilitate long-term productivity gains and competitiveness. Income support does not facilitate structural adjustment. Public resources which provide general services for the sector are better positioned to support productivity and sustainability objectives.
- **Fully implement farmland consolidation plans.** Small, fragmented farms limit productivity by hindering economies of scale and do not optimise natural resource use. While land transfer regulations in general do not pose a barrier, some economies need to make significant efforts to reform cadastres and clarify property rights.
- **Enhance the quality and impacts of the agricultural innovation system.** Increase investment in research and development, both public and private. Enhance the resources and human capacities of extension services and encourage private consultants to supply them.
- **Enhance environmental objectives across agricultural policy frameworks.** The economies' current agricultural legislation, producer support, rural development measures, education, research and extension do not provide sufficient incentives for the efficient use of natural resources nor safeguard them from pollution. Economies should continue to transpose the EU Nitrates Directive and prepare to implement the associated agri-environmental measures associated with the IPARD programme.
- **Strengthen policy analysis to better inform policy development.** Build the necessary databases to inform policy analysis, including data on agricultural economic accounts, employment and output. Monitoring and evaluation practices for the EU and other donor-funded programmes such as IPARD are well established, but monitoring and evaluation activities should be expanded to cover government programmes. Use basic data and evaluation findings to inform new policies more consistently.


TOURISM

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

KEY STATISTICS

Key tourism statistics by economy

Economy	Tourism contribution to GDP, 2016	Tourism employment contribution, 2016	Tourism receipts as % of total exports, 2016
Albania	8.4% direct 26.0% total	7.7% direct 23.9% total	56.1%
Bosnia and Herzegovina	2.5% direct 9.2% total	3.0% direct 10.6% total	12.3%
Former Yugoslav Republic of Macedonia	1.8% direct 6.7% total	1.6% direct 6.1% total	5.4%
Montenegro	11.0% direct 22.1% total	6.5% direct 14.6% total	49.3%
Serbia	2.3% direct 6.7% total	1.9% direct 5.0% total	7.7%

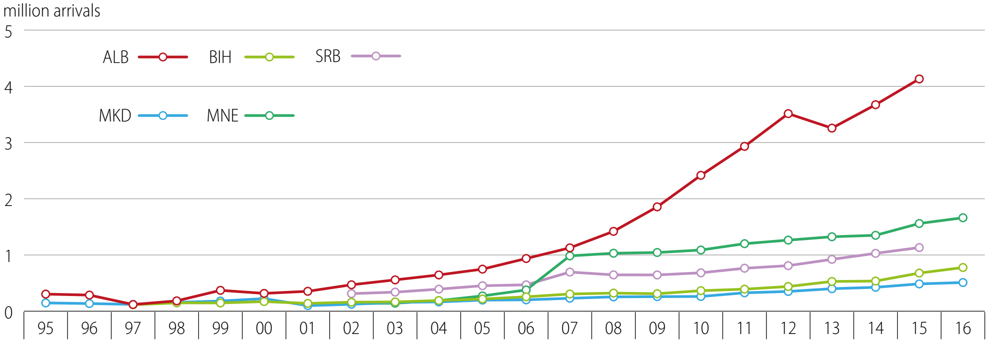
Note: No information available for Kosovo.

Source: Estimates of the WTTC (2017), *Travel & Tourism: Economic Impact Country Reports*, www.wttc.org/-/media/files/reports/economic-impact-research/regions-2017/world2017.pdf.

Tourism is an important economic sector for SEE. **Industries that deal directly with visitors (e.g. hotels, travel agents and airlines) in the region generated over 5% of regional GDP and 4% of total regional employment in 2016**. As travel and tourism continue to expand globally, the region can position itself to benefit further from tourists' increased interest in the new experiences and authentic history and culture it offers.

The six assessed SEE economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia – all have tourism frameworks and institutions in place. The qualitative assessment of tourism policies in the region found that tourism prioritisation and promotion is the strongest area for many of the economies, while providing a qualified workforce is the area with the most scope for improvement. The scores also suggest that there is significant room to strengthen policies across all the tourism sub-dimensions. Therefore, in time, their short-term advantages based on price competitiveness and novelties are likely to become less significant. It will take effective, whole-of-government policies, across all five tourism sub-dimensions, to bring lasting progress in improving competitiveness and supporting sustainable and inclusive tourism growth in the region.

The growth in international tourism (1995-2016)



Note: No information available for Kosovo.

Source: World Bank (2017) *World Development Indicators* (database), **https://data.worldbank.org/products/wdi.**

ACHIEVEMENTS

- **All six SEE economies have adopted strategies for tourism development and promotion** and have taken initial steps to support a more sustainable tourism industry. Strategic documents on the natural and cultural heritage do occasionally focus on tourism, as well as environmental protection. Some of the economies also aim to ensure that their new tourism strategies build on previous lessons, recent market research and capacity-building plans.

- **Destination branding and product development have improved the tourist offer**, targeting specific tourism market segments, including mountain and adventure tourism. The six economies have also taken specific measures to strengthen their offer in culture and adventure tourism. This reflects their aspiration to realise the full potential of the sector for job creation, growth and enhanced well-being of SEE citizens.

- **Private-sector involvement in policy design and implementation is slowly increasing** through dialogue on relevant legislative changes and strategy development. The six SEE economies are beginning to introduce targeted incentives to encourage investment and higher-quality standards for tourism-related services.

- **The economies have taken steps to attract more international visitors from emerging markets and neighbouring countries** by improving accessibility, branding and perceptions. This reflects a growing appreciation of the importance of marketing tourism in a highly competitive global environment with over 200 countries as destinations. Each economy has taken steps to liberalise visa arrangements among many countries, including those in the European Union (EU), the People's Republic of China and India. They are also establishing regional hub airports attracting low-cost as well as some domestic carriers.

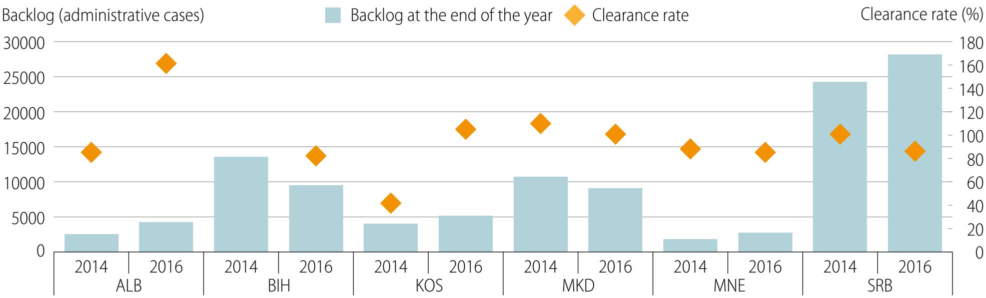
CHALLENGES AND RECOMMENDATIONS

- **Systematically implement a whole-of-government approach to tourism**, engaging relevant public-sector institutions, with support from the industry. Most economies need to increase the financial and human resources allocated to tourism development.
- **Forge stronger links between natural and cultural resource strategies and tourism** and increase transparency on the respective budget allocations. This would be key for implementation and sustainability.
- **Bring tourism infrastructure into line with internationally recognised standards.** The accessibility of the region by air, land and sea needs significant improvement to attract greater numbers of tourists.
- **Further professionalise the tourism workforce and address the significant skills gaps in the sector.** All six economies need to review their existing frameworks for vocational education and training, higher education, and lifelong learning to strengthen their links to tourism. They also need to make tourism a more attractive career choice and strengthen the links with businesses and academia to address skills gaps.
- **Develop tourism data and statistics in line with international standards and good practice, address gaps in the evidence base and the lack of satellite accounts.** Existing data need to be more comprehensive to inform strategic planning and decision making, and to facilitate monitoring of implementation.
- **Improve co-ordination among institutions promoting tourism at central, regional and local levels.** The six SEE economies need to foster regular interaction among bodies and services at all levels. This interaction should also track progress of reforms.
- **Put in place independent monitoring and evaluation of tourism-related action plans and strategies** to learn from experience and support policy adjustments. Particular emphasis is needed on synergies between sectors, i.e. transport, environment, investment promotion and education.

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

KEY STATISTICS

Backlog of administrative cases and clearance rates of administrative courts



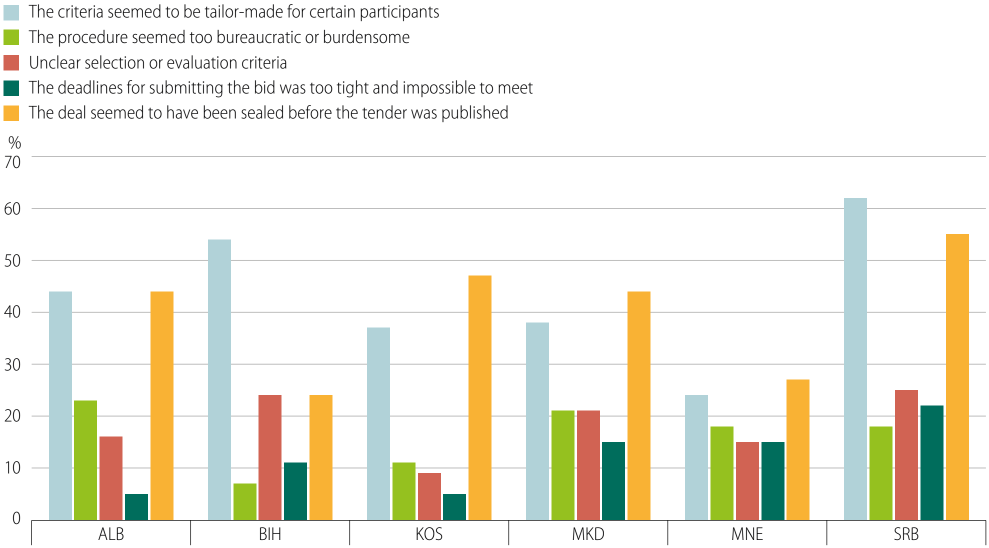
Note: Data for Bosnia and Herzegovina are for the court at the state level. The 2014 clearance rate for Bosnia and Herzegovina is unavailable. The clearance rate is defined as the number of resolved cases divided by number of incoming cases.

Source: OECD (2017), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017), *Monitoring Report: Bosnia and Herzegovina,* www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017), *Monitoring Report: Kosovo,* www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

Clearing the backlogs of administrative cases in Albania, Bosnia and Herzegovina, Kosovo, and Serbia is unlikely in the foreseeable future unless extraordinary measures are taken. While the clearance rates in Albania and Kosovo are over 100%, the number of new cases is even greater resulting in a growing backlog. In Bosnia and Herzegovina, the efficiency of courts dealing with administrative cases varies across the economy. In Serbia, the clearance rate dropped below 90% resulting in a growing backlog.

Across all six SEE economies, businesses reported that their reasons for not taking part in public procurement related to the quality of the tender and fairness of the procedure.

Reasons businesses did not take part in public procurement (2017)



Note: Full question: In the past three years, has your company decided not to take part in a public tender or a public procurement procedure? If yes, why?

Source: Regional Cooperation Council (2017), *Balkan Barometer 2017: Business Opinion Survey,* www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

ACHIEVEMENTS

- **The six SEE economies are showing an increased commitment to improving their standards of economic governance.** In recent years, the SEE economies have strengthened their efforts to improve their economic governance, supported by initiatives such as Economic Reform Programmes (ERPs) and the *Competitiveness Outlook* assessment.
- **The SEE economies have well-developed legislative frameworks for public procurement, including systems to handle complaints.** The frameworks are largely aligned with the European Union *acquis*, though some inconsistencies remain. The scope of their review and remedy systems are also to a large extent in line with the requirements of the *acquis*. However, one challenge to their implementation is the focus on procedural compliance rather than good outcomes.
- **Most of the SEE economies have established legislative frameworks for merit-based recruitment of civil servants.** Key elements in place include the principle of merit, defined professional categories for civil service staff and legislated competition for positions. However, they are not fully reflected in practice.
- **The six SEE economies have legal frameworks to guide procedures for government sessions** – i.e. formal, regular meetings of ministers. The legal frameworks set out procedures to prepare for, follow-up and communicate on government sessions. They also define the roles and responsibilities of the centre-of-government institutions which ensure legal compliance and conformity with procedures, and policy coherence.

CHALLENGES AND RECOMMENDATIONS

- **Strengthen the use of evidence in policy making.** Regulatory impact assessments (RIAs) should be conducted for all draft legislation and policies which require them, and should include basic elements such as a problem analysis and a comparison of the options, grounded in evidence. Furthermore, the RIA process and the financial impact assessment should be linked. Additional capacity building for line ministries should support this.

- **Further develop the public consultation legal framework and its implementation.** Requirements for public consultation should be more systematically enforced. Central portals for public consultation should be used more systematically.
- **Strengthen recruitment procedures for the civil service.** Objective selection methods should be reinforced by developing and using common standards to design written exams and structured interviews. The SEE economies should also enhance the capacity and professionalism of selection panels.
- **Reduce the backlogs in administrative courts of appeals.** Albania, Bosnia and Herzegovina, Kosovo and Serbia should develop and implement a corresponding action plan, including measures to increase the number of judges and legal assistants in the administrative courts and to establish a mechanism to regularly monitor the courts' workload. Albania and Kosovo should establish case-management systems, and Serbia should enhance its existing one.
- **Continue to modernise and digitalise public services.** The SEE economies should continue to implement their strategies and build political support for these reforms. They should provide digital skills training and awareness rising for the general public.
- **Further develop laws and implementing regulations on public procurement** by harmonising them with recent EU procurement directives. This includes abolishing preferences for domestic bidders and goods of domestic origin, and reducing the use of the lowest price as the only criterion for awarding contracts. Secondary legislation should be reoriented away from formal procedures to focus on transparency and value for money.
- **Enhance e-procurement systems and expand their use.** Montenegro should start implementing e-procurement, while the remaining economies should increase its use. Their e-procurement systems should be expanded to include monitoring functions and modern purchasing tools such as e-auctions, e-catalogues and dynamic purchasing systems.
- **Improve the procedures of public procurement review bodies.** Review procedures should be clarified and simplified to improve the quality of complaint processing. Electronic case-management systems should be made fully operational and mechanisms put in place to ensure the consistency of review bodies' decisions, especially by making past decisions fully searchable.

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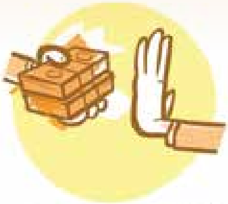


ANTI-CORRUPTION POLICY

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

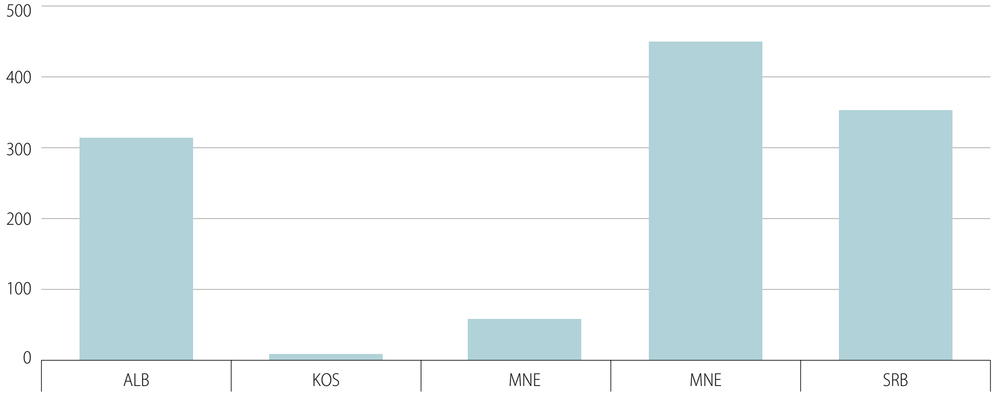
KEY STATISTICS

All six SEE economies are making efforts to tackle conflicts of interest and have adopted laws to regulate them. However, the public officials that are covered by dedicated conflict-of-interest laws vary. In several of the economies (for example, Bosnia and Herzegovina at the state and entity level, Kosovo, Montenegro, and Serbia), civil service laws govern the conflicts of interest of civil servants. Generally, the conflict-of-interest frameworks cover public-sector office holders comprehensively.

The SEE economies all provide guidance to officials on how to manage conflicts of interest. This guidance includes publications and/or opportunities to ask questions. For example, Albania has published the Explanatory and Training Manual for Preventing Conflict of Interest; the Guideline on the Declaration of Assets and Prevention of Conflict of Interest, which covers all public servants; as well as guides on preventing conflict of interest in particular sectors such as tax administration, customs administration, public procurement and local governments. The Former Yugoslav Republic of Macedonia has also published a variety of guidance notes on managing conflicts of interest. Serbia has published guidance notes which look more broadly at integrity, and Montenegro has published rulebooks.

Preventing and managing conflicts of interest

Number of sanctions (including warnings) applied for conflict-of-interest related violations (2016)



Note: Data for the Former Yugoslav Republic of Macedonia from 2015. Data for Bosnia and Herzegovina were not available. In Kosovo, the seemingly low number of sanctions (just 9) is mostly explained by the large number of cases where no sanctions were applied: of 210 cases of reported conflicts of interest, in 90 of them the conflict of interest was averted and in 54 opinions (advice) were issued.

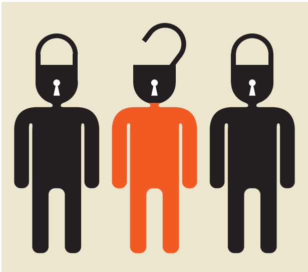
Source: Data provided by the governments. Kosovo: ACA (2017), *Annual Report January – December 2016*, http://akk-ks.org/repository/docs/ANG-9._Raporti_Vjetor_2016_versioni_final_shqip_477475.pdf; Serbia: Anti-corruption Agency (2017), "Izveštaj o Radu za 2016. Godinu" [Work report 2016], www.acas.rs/wp-content/uploads/2017/03/Izvestaj-o-radu-2016-za-net.pdf?pismo=lat.

ACHIEVEMENTS

- **Most economies have adopted comprehensive anti-corruption policy documents and taken steps to involve civil society in their preparation and monitoring.** These documents typically contain clear objectives, concrete tasks and deadlines. They assign responsibilities to implementing bodies and define follow-up mechanisms.
- **All six SEE economies have made efforts to raise public awareness of anti-corruption issues and to train public officials.** Several economies have run extensive campaigns targeting the general public.
- **All of the economies have assigned clear responsibilities for co-ordinating the implementation of anti-corruption policy documents.** They often have sophisticated procedures for appointing the leadership of their corruption prevention and co-ordination institutions in order to ensure transparency and limit the risk of undue political interference.
- **The economies generally have comprehensive legal frameworks for managing conflicts of interest.** All relevant public officials and civil servants are generally covered by conflict-of-interest rules.

CHALLENGES AND RECOMMENDATIONS

- **Improve the involvement of civil society in policy development and the preparation of draft legislation by outlining the terms of co-operation more clearly**, for example for how participating organisations will be selected and for providing feedback on their responses.
- **Ensure more systematic and comprehensive corruption proofing of legislation.** The six SEE economies are still not widely corruption proofing new legislative proposals.
- **Make public awareness-raising activities more sustainable** in those economies where there is insufficient funding from government budgets.
- **Some multi-stakeholder co-ordination institutions should do more to demonstrate their effectiveness.** In several of the economies, stakeholders have indicated that the relevant councils or similar bodies are not proactive and stakeholders generally feel insufficiently involved.
- **Implement the whistleblower protection laws enacted by all of the SEE economies.** The particular challenges vary from economy to economy, but include a lack of public awareness about the options for protection, as well as the need to improve the effectiveness of protective measures.
- **Provide better safeguards to protect anti-corruption investigation units from undue interference.** For instance, they are usually not separated from the regular police hierarchy and several of the anti-corruption investigation or prosecution bodies suffer from staff shortages.


Endnote from page 45:

1. Endnote by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus. Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus" issue; 2. Endnote by all the European Union Member States of the OECD and the European Union: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

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OECD
BETTER POLICIES FOR BETTER LIVES

The Organisation for Economic Co-operation and Development (OECD) is a unique forum where 35 member governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and help governments address emerging policy issues such as finding new sources of growth, building skills, and restoring public trust in government and business. The OECD provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies. It increasingly engages with a number of non-members who have become important actors in today's global economy.

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Competitiveness and Private Sector Development

Competitiveness in South East Europe

A POLICY OUTLOOK 2018

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. Against the backdrop of enhanced European Union (EU) accession prospects and a drive towards deeper regional co-operation, SEE governments have demonstrated a renewed commitment to enacting policy reforms.

The second 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 good practices. The 17 policy dimensions addressed in this report encompass a wide range of areas key to economic competitiveness including the business environment, skills and capacity, the region's economic structure and its governance. The report leveraged a highly participatory assessment process which brought together more than 1,500 individual stakeholders including OECD experts, SEE policy makers, private sector representatives and regional policy networks and organisations to create a balanced view of performance.

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

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