

**South East Europe Investment Committee
Seventh Meeting**

Paris, 23 November 2010

- Conclusions -

Executive Summary

- The 7th SEE IC meeting took stock of the low level of private sector innovation and poor skill base in the region, particularly the Western Balkans.
- The OECD Secretariat presented the results of its work on international best practices related to innovation and human capital development. This included a review of the benefits of strengthening the so-called “triple helix” relationship, between government, industry and academia and the use skills gap analysis in policy development.
- The OECD Secretariat’s work was complemented by contributions from two speakers: Mr. Ugo Poli and Dr. William Bartlett. Mr Poli identified key challenges and priorities for the innovation system in the Western Balkans while Dr. Bartlett gave an overview of the use of skills gap analysis in the Western Balkans.
- Mr. Peter Polajnar, European Commission, presented “Europe 2020,” a new 10-year European strategy that was proposed by the European Commission on 3 March 2010 for reviving the economy of the European Union. It puts forward the ideas of smart, sustainable and inclusive growth, with greater co-ordination of national and European policy. The strategy places high importance on innovation and skills.
- Following Mr. Polajnar’s presentation, the OECD Secretariat reviewed the results of its preparatory work related to the EU-funded Western Balkans Regional Competitiveness Initiative (RCI). The Secretariat presented the results of its mapping exercise reviewing domestic actions by governments in the Western Balkans to support innovation and human capital development and projects supported by the international donor community.
- The OECD Secretariat also provided an update on the results of several roundtable meetings in the Western Balkans to identify four pilot projects to be launched in 2011. They will include: 1) development of an innovation strategy in the former Yugoslav Republic of Macedonia; 2) implementation of an innovation voucher in Montenegro; 3) actions to strengthen the triple helix relationship in Bosnia and Herzegovina; and 4) support with the establishment of a competence technology centre in Serbia.
- To demonstrate how the *Investment Reform Index* 2010 is contributing to setting policy priorities in SEE, country economic team leaders were requested to identify four to five policy priorities resulting from the latest assessment. The OECD Secretariat will formally contact each Country Economic Team Leader requesting these priorities in early 2011.
- The SEE IC discussed a draft agenda for a ministerial-level meeting in 2011. The Committee agreed that an agenda should include visionary elements alongside an emphasis on regional co-operation, the position of SEE economies in Europe and the world, and lessons learnt from ten years of development aid and sustained support in building regional ownership. The Committee agreed that private sector participation should be significant at the meeting and that at least two preparatory meetings should be organised.
- The SEE IC gave a mandate to the OECD Secretariat and its co-chairs to revise and finalise the ministerial meeting agenda and communicate the revised version including a workplan and schedule
- to the SEE IC by the end of the 2010,

Detailed report

1. The seventh meeting of the South East Europe Investment Committee (SEEIC) was held on November 23, 2010, at OECD headquarters in Paris. The meeting was chaired by Ms. Vesna Arsic, State Secretary, Ministry of Economy and Regional Development, Serbia and Mr. Manfred Schekulin, Director, Export and Investment Policy, Federal Ministry of Economy, Family and Youth, Austria.
2. The meeting involved representatives from SEE economies, the OECD Secretariat, senior education and innovation policy specialists, representatives from the European Commission (EC), the Regional Cooperation Council (RCC), the European Training Foundation (ETF), the South East Europe Centre for Entrepreneurial Learning (SEECCEL), representatives from the Support to IFI Coordination in the Western Balkans and Turkey office, the CEFTA Secretariat as well as bilateral donors to the Investment Compact. Participants actively took the floor during the various discussion sessions¹.
3. The morning portion of the meeting focused on international best practices to boost innovation and skills in South East Europe. In the afternoon participants discussed the 'Europe 2020' strategy which is closely linked to supporting innovation and skills development. In addition, the SEE IC examined the progress made on the Regional Competitiveness Initiative (RCI), the implementation of the Central European Free Trade Agreement (CEFTA) and SME policy reform in the region. The last topic for discussion was the date and agenda for a SEE ministerial-level meeting in 2011.
4. The OECD Secretariat opened the meeting by highlighting the importance of medium and long-term competitiveness and the need to link innovation and skills policies to broader economic development strategies.
5. Ms. Arsic focused her opening remarks on innovation and identified 'sustainable competitiveness' as the main challenge for SEE economies. She noted that the region's technological performance is weak compared to OECD members. For example, OECD countries export on average 20% of goods with high technology content while SEE countries average only 5% high technology exports, ranging from 1% for FYR of Macedonia to 9% for Croatia.
6. Ms. Arsic noted that while governments in the region have already introduced a number of institutions and frameworks for innovation, countries continue to rank poorly in international rankings measuring competitiveness. For example in the most recent World Economic Forum rankings SEE economies are underperforming and barely reach the top 50: the highest is Montenegro at rank 49 and the lowest is Bosnia-Herzegovina at 102.
7. Ms. Arsic stressed the necessity to reorient economies towards knowledge creation as drivers of economic development. She concluded her remarks by noting that obstacles to cooperation between the actors in national innovation systems still exist, cluster policies are often underdeveloped, access to finance remains difficult for innovative businesses, and gaps persist in implementation and policy coordination. While donor programmes have attempted to respond to these challenges greater coordination between initiatives should be improved and efforts should be made to enhance their long-term sustainability.

¹ All presentations are available on the Investment Compact website at www.investmentcompact.org

8. Mr. Schekulin began his remarks by noting the skills potential of the SEE region. However, skills shortages appear to be holding back the development of specific sectors and are an obstacle to increased value added in manufacturing. The problem is made worse due to the “brain drain.” The private sector frequently noted the need for more employees with practical and technical skills.
9. Despite the adverse net effects of migration, the region's potential volume of skilled labour remains one of its competitive opportunities. In order to unleash this potential, more attention will have to be paid to raising the awareness on the need for reform as some economies still have an overly high opinion of their education systems. The OECD’s Programme for International Student Assessment (PISA), which reflects performance of 15-year old high school students, shows a low level of performance for most SEE economies relative to OECD averages. An exception is Croatia, whose level of performance is close to the OECD average, similar to the level found in the United Kingdom or in Belgium
10. Mr. Schekulin concluded by noting that the crucial issue governments need to tackle is the persistence of large skills gaps. The mismatch between labour supply and demand is still significant. An area where policy can make a difference in this regard is adult education and re-training. Lastly, to better understand skills gaps and monitor them, data development and analysis should be improved.

Boosting Innovation in South East Europe

11. The first session reviewed best practices and key challenges to fostering innovation in South East Europe. Prior to the meeting, participants were sent a paper on ‘Linkages within the Innovation System – OECD best practice and application to the Western Balkans’. The first session began with an interactive quiz, led by Mr. Alan Paic, Principal Administrator, OECD Investment Compact. The questions revolved around recent innovation policy developments detailed in the OECD paper and covered the themes of clusters, inter-firm networks, access to finance for innovation, and triple helix partnerships. The quiz generated broad participation from Committee members. Most of the questions were answered correctly.
12. Some of the key points highlighted by Mr. Paic included:
 - a) Innovation is not just about pure scientific research, but rather involves extensive investment by the business community. The increasing complexity of products means that private companies have to invest increasing amounts in R&D. In 2008, business expenditures in R&D amounted to 1.7% of GDP in the OECD (compared to 1.5% in 1998). In the EU 27, the enterprise sector represented 55% of Gross domestic expenditure on R&D compared to 34% for the Government (67% and 27% respectively in the US).
 - b) The so-called Triple Helix model is gaining prominence. Instead of focusing simply on bilateral public/private interactions, it encompasses trilateral relationships among industry, government and universities in the process of knowledge capitalisation. In this model, universities, industries and government constitute interdependent and relatively equal institutional spheres. The Triple Helix model departs from the traditional distribution of roles in which each actor in the innovation process performs its own tasks, for example, universities become firm founders through incubator facilities, industries play the role of an educator through company universities and the government becomes a venture capitalist.

13. Mr. Paic's presentation was followed up by Mr. Ugo Poli, International Expert for Innovation Policy (Anteja ECG doo), on the 'Main challenges and priorities for the innovation system in the Western Balkans'.

14. The presentation highlighted a number of crucial points:

- a) Concerning innovation, progress has been observed in legal frameworks and financial support for innovative companies. Yet, the innovation process is still hampered by a number of gaps including a high degree of discontinuity in policy setting, rushed preparation of policy documents, and a lack of foresight activity.
- b) One way to overcome fragmentation in the innovation process is through the Triple Helix. Mr. Poli particularly emphasised the need for bottom-up integrated approaches strengthening linkages among university research, industry and funding schemes through the evaluation of research results and active matching with market potential.
- c) The other step in strengthening innovation is to set up the critical mass, essentially through adequate cluster policy. While all Western Balkan economies have adopted cluster policies in recent years, cluster value chains remain characterised by a very low degree of specialisation. Additionally, visibility and exchange of experiences among clusters are limited. A few platforms are being established to bridge this gap.
- d) Mr. Poli concluded with a two-fold strategy combining a bottom-up operational approach with a clear top-down concept. Top-down guidelines should seek to clarify ranking criteria for the funding of innovation projects, build on the endogenous resources and skills of existing and emerging clusters, and decentralise the implementation of integrated innovation frameworks. Bottom-up operations should focus on local actors including municipalities, chambers of commerce and free no-profit associations.

15. The presentation gave rise to a dynamic discussion in which a number of Committee members took part:

- a) The EC wished to clarify that the instrument for pre-accession (IPA) does support economic development as well as cross-border cooperation through multi-beneficiary funds.
- b) A number of participants underlined that clusters generally stem from private initiative and that they are not inherently beneficial, as suggested by cases of unsuccessful clusters. Thus, governments cannot and should not seek to set up clusters from scratch. Government intervention should primarily consist in removing the barriers that hinder cluster development.
- c) A question was raised about the current relevance of proximity. Indeed, physical proximity and clusters may be less relevant than inter-firm networks in a globalised economy where communication technologies allow people in different parts of the world to be connected instantaneously.
- d) Serbia pointed out that government authorities are aware of the need for reforms. For instance, earlier this year the National Competitiveness Council of Serbia issued 38 recommendations to stimulate competitiveness. Also, since 2007, cluster development support at the national and regional levels has been renewed annually.

Boosting Human Capital in South East Europe

16. The second session focused on human capital development, which was identified as the other competitiveness priority for South East Europe. Indeed, the skills developed within the existing education systems do not meet labour market needs. The presentations in this session reviewed best practices and key challenges to skills gaps analyses. Prior to the meeting, participants received a paper entitled ‘Skills Gap Analysis – OECD best practice and application to the Western Balkans’.
17. This session was initiated with an interactive quiz on human capital and skills gap analysis, led by Mr. Alan Paic. Most questions were answered correctly but the quiz proved very helpful in stimulating interest and participation. Some of the key points highlighted by Mr. Paic included:
 - a) Investing in human capital is about trying to achieve more with an economy’s limited labour resources. However, investing in more human capital in terms of education, skills, and know-how will not necessarily result in more output or value. During the past several decades, economies in the OECD area have tried to invest more in higher levels of education, but labour productivity and output have not always increased as expected. There is likely to be a mismatch between the kinds of jobs people prepare for, and those that are actually in demand.
 - b) A gap between the skills workers have and those they need to perform tasks is a critical issue for competitiveness. Persistent skills gaps across many sectors and occupations means that employers will produce less than they could if there were no gaps. This also means that the economy will likely have higher levels of unemployment and underemployment with its labour supply in addition to producing less income. Removing or reducing these gaps can be an important way to increase both output and productivity.
18. The interactive quiz was followed by a presentation by Dr. William Bartlett, Senior Research Fellow for the LSEE – Research on South Eastern Europe, Europe Institute (London School of Economics). The presentation provided an overview of the challenges and priorities for skills gap analysis in the Western Balkans.
19. The following points were highlighted in Dr. Bartlett’s presentation:
 - a) Globalization has led to continuous changes in the labour market. A process of skill-biased technological change has been occurring, resulting in diminished demand for less skilled elements of the labour force. For the so-called ‘transition’ economies, the notion of change and the need for new skills are even more pronounced.
 - b) Education systems in the region are dysfunctional. Vocational secondary schools have curricula which have not significantly evolved since the 1960s. In addition, the skills taught are generally of little practical use. With regard to gymnasia education, learning relies on memorisation rather than problem-solving skills. Returns from secondary education reforms are therefore likely to be high.
 - c) Dr. Bartlett also presented an overview of the different approaches to skills gap analysis. Supply-led approaches, based on macro or sector analysis, consist in adjusting the education supply to the demand of skills. Yet, because skills gaps emerge faster than planners can change the education system, supply-led approaches tend to be ineffective in the short-run. Thus, competitive ‘quasi market’ solutions such as training subsidies and training vouchers may be useful in replacing central planning in the short-run.

- d) While a number of skills surveys are carried out in Western Balkan economies, there are still significant challenges to skills gaps analyses including weak capacities and under-funding, gaps in certification and accreditation, and low-levels of in-house training by employers.
20. The presentation was followed by a lively discussion. The key points that emerged were the following:
- a) Questions were raised about the measurement of unemployment rates. Dr. Bartlett responded that calculations were based on official numbers and quarterly reports from the EC labour force survey.
 - b) Some participants also raised the question of gender differences in the labour market. According to Dr. Bartlett, although it is true that women's participation in the labour force differs across the region, the question should go beyond gender and include other population groups that tend to be excluded from the formal labour market (i.e. the Roma).
 - c) Private universities could play an interesting role, especially in a demand-led and market-oriented approach.
 - d) A few participants highlighted that efforts have been made in secondary and VET education. According to Dr. Bartlett, while these reforms have had a positive impact, they have focused on numbers more than on the nature of skills acquired.
 - e) Participants largely agreed that the content of curricula is crucial but that more attention should be paid to the teaching/transmission of skills.
 - f) Migration and regional labour market considerations have become increasingly relevant. There is significant potential at the regional level, as few language and cultural barriers separate economies. Efforts should be made to understand which skill sets are needed at the regional level.
 - g) Finally, the importance of soft and flexible skills was again emphasised for businesses to adapt to global economic challenges.

Europe 2020 Strategy and Regional Competitiveness

21. The afternoon session began with a presentation by European Commission representative Mr. Peter Polanjar. The presentation focused on the European Commission's Europe 2020 Strategy.
- a) Europe 2020 is a 10-year strategy that was proposed by the European Commission on 3 March 2010 for reviving the economy of the European Union.
 - b) It puts forward the ideas of smart, sustainable and inclusive growth, with greater co-ordination of national and European policy. These concepts are intimately linked to innovation and skills.
 - c) The Strategy is structured around a set of macro- and micro economic, as well as employment-related guidelines for national reform programmes. These include, for instance, the sustainability of public finances, optimising support for R&D, and developing a skilled workforce responding to labour market needs.
 - d) The Strategy is linked to the EU's enlargement policy and therefore is of relevance to SEE economies: EU external policies are extending the internal market and enhancing cooperation

in areas where cross border cooperation is key (e.g. transport and energy and seven flagship initiatives enable cooperation with Member States). The Commission will associate, to the extent possible, the enlargement countries with these initiatives.

- e) Furthermore, Europe 2020 offers the enlargement economies an anchor for reforms: these economies are invited to adapt and adopt relevant headline targets and to organise their work on the Europe 2020 related issues in regional groups.
- f) With regards to innovation, Europe 2020 envisages the formation of an Innovation Union, ensuring more consistency in innovation policies and creating a single market for innovation. With regards to human capital development, Europe 2020 includes the Agenda for Skills and Jobs, which aims at further developing the “flexicurity” principle, fighting unemployment, raising the activity rate, and promoting intra EU labour migration as well as cooperation of social partners and labour market institutions across the EU.

22. The presentation was followed by a discussion:

- a) Ms. Arsic noted that Europe 2020 could provide useful guidance for the implementation of the Regional Competitiveness Initiative. Mr. Anthony O’Sullivan, Head of the Private Sector Development Division, OECD, agreed and added that most targets of Europe 2020 are relevant for South-East Europe and that these targets could form the basis for a regional strategy on innovation and human capital development in the region.
- b) A question was raised by the Business Advisory Council about the applicability of policy tools of Europe 2020 to South East Europe. Mr. Polanjar responded that cooperation between the EU and accession economies on issues related to innovation and human capital is already part of the Thessaloniki Agenda. Pre-accession economies are invited to fully engage in this process, which brings benefits but also obligations, such as adopting and implementing life-long learning programmes.

23. Mr. Milan Konopek from the OECD Investment Compact provided an update on the implementation of the EU-funded Western Balkans Regional Competitiveness Initiative (RCI).

- a) The project is nearing the end of its preparatory phase. The OECD Secretariat has completed a review of domestic policy actions in the fields of human capital development and innovation along with mapping of international donor projects in the Western Balkans. As a result of this work the Secretariat has identified key policy gaps related to innovation and human capital development.
- b) Based on the noted analytic work, the OECD Secretariat produced a list of potential pilot projects which could be used by Western Balkans governments to close some of these gaps.
- c) The OECD Secretariat subsequently organised five roundtable meetings in the region over the autumn period. The purpose of the roundtable meetings is to assist the beneficiary governments and key stakeholders in industry and academia to identify the most relevant pilot projects for implementation.
- d) The RCI Steering Committee, which met on 22 November, endorsed four pilot projects in the former Yugoslav Republic of Macedonia, Montenegro, Bosnia and Herzegovina and Serbia. These pilot projects will be implemented in 2011 and are noted below. The remaining three economies will launch their pilot projects in 2012.

- e) The RCI Steering Committee also reviewed its terms of reference, discussed the OECD mapping of domestic actions and international donor initiatives and agreed for the OECD Secretariat to proceed with organising an RCI Advisory Group.
24. Ms. Arsic praised the work of the OECD and pointed to the complexity of the project. She also highlighted the importance for Western Balkan economies to receive assistance from the OECD in prioritising their work on innovation and human capital development.
25. Presentations by the former Yugoslav Republic of Macedonia, Montenegro, Bosnia and Herzegovina, and Serbia followed with each outlining their RCI pilot project.
- a) The former Yugoslav Republic of Macedonia will work on drafting an innovation strategy for the years 2012-2020.
- b) Montenegro would like OECD support to implement an innovation voucher scheme to stimulate cooperation between small and medium-sized enterprises and universities and/or research institutions and/or business consultancies.
- c) Bosnia and Herzegovina proposed that its pilot project support the national innovation system by strengthening the “Triple Helix” relationship between government, industry and academia.
- d) Serbia requested OECD support with the establishment of a Competence Technology Centre.
26. The presentations were followed by a short intervention by Ms. Jelica Minic, Deputy Secretary General, Regional Co-operation Council (RCC) on the RCC’s recent and upcoming investment-related activities.
27. The South East Europe Centre for Entrepreneurial Learning (SEECCEL) commented on the importance of training needs analysis for human capital development in South-East Europe. SEECCEL noted its plans to extend training needs analysis (TNA) to specific areas of women’s entrepreneurship.
28. Mr. O’Sullivan pointed out that there was scope for further strengthening of links between the Investment Compact for South-East Europe and the RCC.

An Update on CEFTA 2006 and Related Work

29. Mr. Antonio Fanelli, Deputy Head, Private Sector Development Division, OECD, provided an update on the Investment Compact’s work supporting the implementation of CEFTA 2006.
30. Within the project ‘Implementation of the CEFTA 2006 investment related clauses’, three reference reports were completed on: intellectual property rights, national treatment and bilateral investment treaties, and a paper on “The impact of European and Regional integration on industry concentration and FDI inflows.” The reports were presented at the CEFTA 2009 and 2010 weeks.
31. As part of the Hungarian funded project on the ‘The Reduction and Elimination of Non-Tariff Barriers’, a roundtable was recently held in Budapest which yielded the following results: identification of common priority sectors for NTB reductions, based on an analysis of intra-CEFTA trade flows on intermediary goods; and, elaboration of a monitoring framework for evaluating progress on NTB reduction on a multilateral basis;

32. The CEFTA Secretariat praised the South-East Europe Investment Committee as an effective platform for cross contamination. The CEFTA Secretariat will start the implementation of a project on trade logistics as well as negotiations on the liberalisation of services.
33. Mr. O’Sullivan announced that the OECD plans to publish another Investment Reform Index (IRI) in 2012. In the meantime it would be important to demonstrate how the IRI 2010 is contributing to policy priority setting. He therefore suggested that each South-East European economy choose four to five policy priorities resulting from the IRI 2010 assessment. This idea was formally endorsed by the Committee. The OECD will formally contact each Country Economic Team Leader requesting these priorities in early 2011.
34. Ms. O’Mahony from the IFI Co-ordination office stated that her office’s activities are complementary to those of the Committee and suggested to enhance co-operation in 2011. Strong synergies could, for example, be established between a project on identifying the range of credit lines in the region and the OECD SME Policy Index. A new website will be launched in December 2010 serving as a portal for all EC IFI activity in the region. The portal will include links to the RCI, OECD Investment Compact, and RCC.

Adoption of the Agenda for the 2011 Ministerial-Level Meeting

35. This session began with a brief presentation by Mr. Paic from the OECD, which summarised the proceedings thus far to adopt an agenda for a 2011 ministerial-level meeting.
36. A concept note, outlining the key substantive ideas for the ministerial-level meeting agenda, was circulated to the members of the SEEIC. As a general topic, “strengthening regional competitiveness in South-East Europe” was suggested with a focus on: i) fostering a transfer to the knowledge economy, by facilitating the creation of regional centres of excellence in areas such as biotechnology or nanotechnology; and ii) promoting intra-regional value chains.
37. In terms of the structure of the meeting, the concept note suggested a two-day meeting, with day one taking the shape of a working level meeting with ministerial rapporteurs and day two focussing on developing a ministerial agreement on the items discussed on day one.
38. Key points emerging from discussion included the following:
 - a) Several delegations, including the RCC, the EC, Serbia, the former Yugoslav Republic of Macedonia, and Bosnia and Herzegovina, supported the idea of holding a ministerial-level meeting in 2011 and the topics suggested in the concept note.
 - b) Broad support was also expressed for the two-day structure outlined in the concept note and the necessity for a concrete ministerial declaration as the main outcome of the meeting.
 - c) In addition, Bosnia and Herzegovina suggested holding the meeting back-to-back with the official celebrations of the OECD’s 50th anniversary in May 2011.
 - d) The EC stated that the Commissioner for Enlargement would be present at the Ministerial meeting.
 - e) Mr. Schekulin remarked that the ministerial meeting agenda would benefit from a more visionary approach towards the year 2020. In addition to the topics suggested, the agenda

should include: elements of regional co-operation, the position of SEE economies in Europe and the world, lessons learnt from ten years of development aid and sustained support in building regional ownership, the role of SEE's growth model, and the role of intra-regional co-operation.

- f) He also made the point that the profile of the private sector should be raised, with high-level representation, and that, in addition to the normal SEEIC meetings, at least one preparatory meeting would be necessary.
- g) Mr. Schekulin concluded by suggesting that the SEEIC give a mandate to the OECD Secretariat and its co-chairs to revise the Ministerial meeting agenda and communicate the revised version, including a workplan and schedule, to the SEEIC members by the end of the year.
- h) The Committee agreed with this proposal. It was noted that due to the challenging agenda, the ministerial meeting might have to be postponed to autumn 2011.