

Challenges for smart specialisation in the South-East Europe

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Romanian EU Presidency Conference

Bucharest "Supporting Smart Specialization strategies and technology transfer in South-East Europe", 18. June 2019

S3 approach to technology upgrading of SEE: key argument

- If designed and implemented in an **imitative way by blind copying of the best practice** developed for other contexts it can fail miserably.
- The key is **to adapt it to the nature of innovation processes and to the institutional context in the SEE**
- It should address country and region **specific obstacles** to improved productivity and technology upgrading

Outline

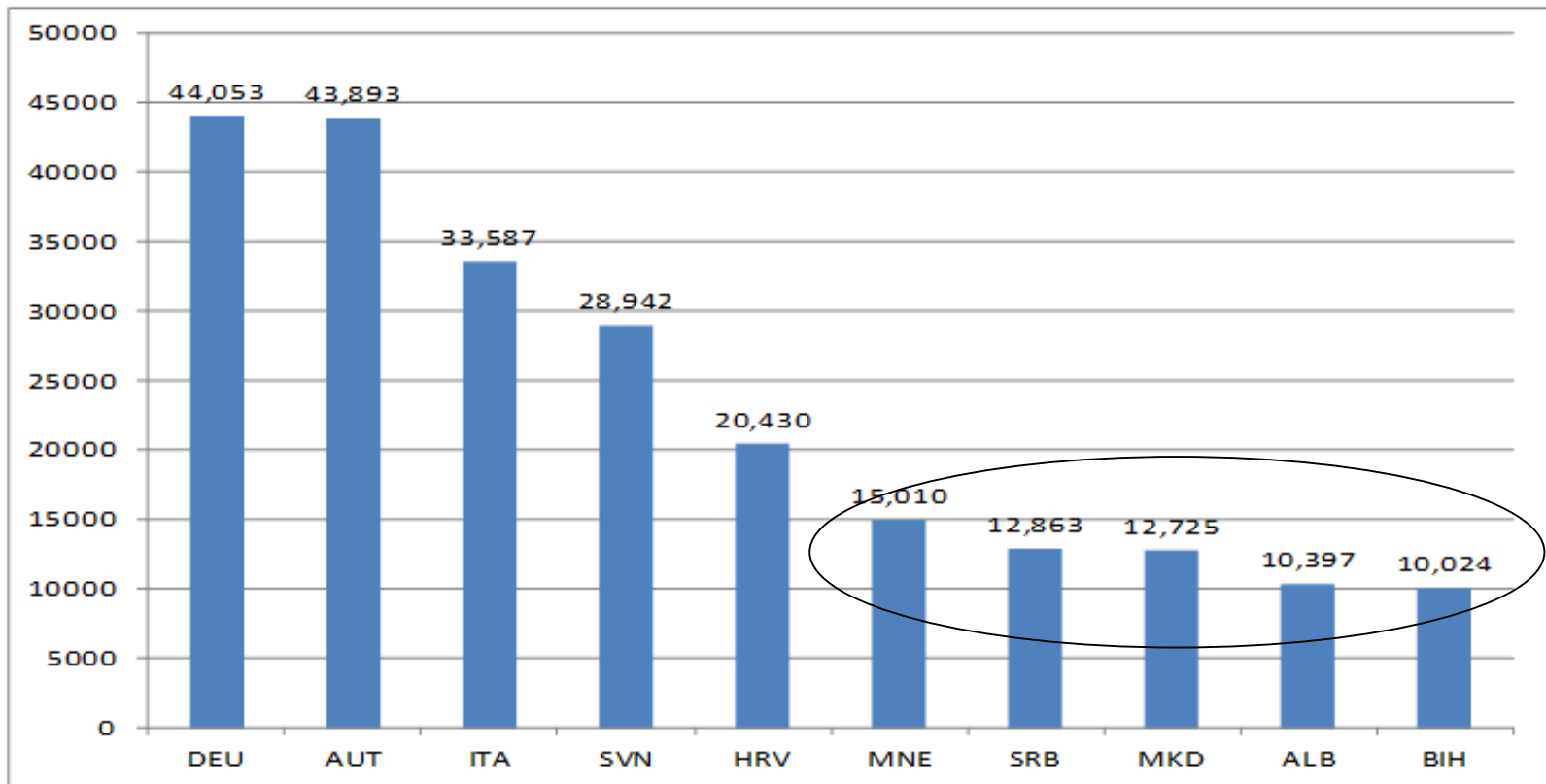
1. Specificities of the SEE economies
2. S3 requirements
3. Gap between 1 and 2
4. S3 approach to technology upgrading of SEE
5. Conclusions

Specificities of the SEE economies

- Technological - structural
 - Different nature of innovation process
 - De-industrialisation
 - Outside of global value chains
- Institutional – policy
 - Transition > horizontal ('agencification') – 'vertical' (S3)
 - Structural reforms fatigue
 - Low institutional capacities for S3 policies

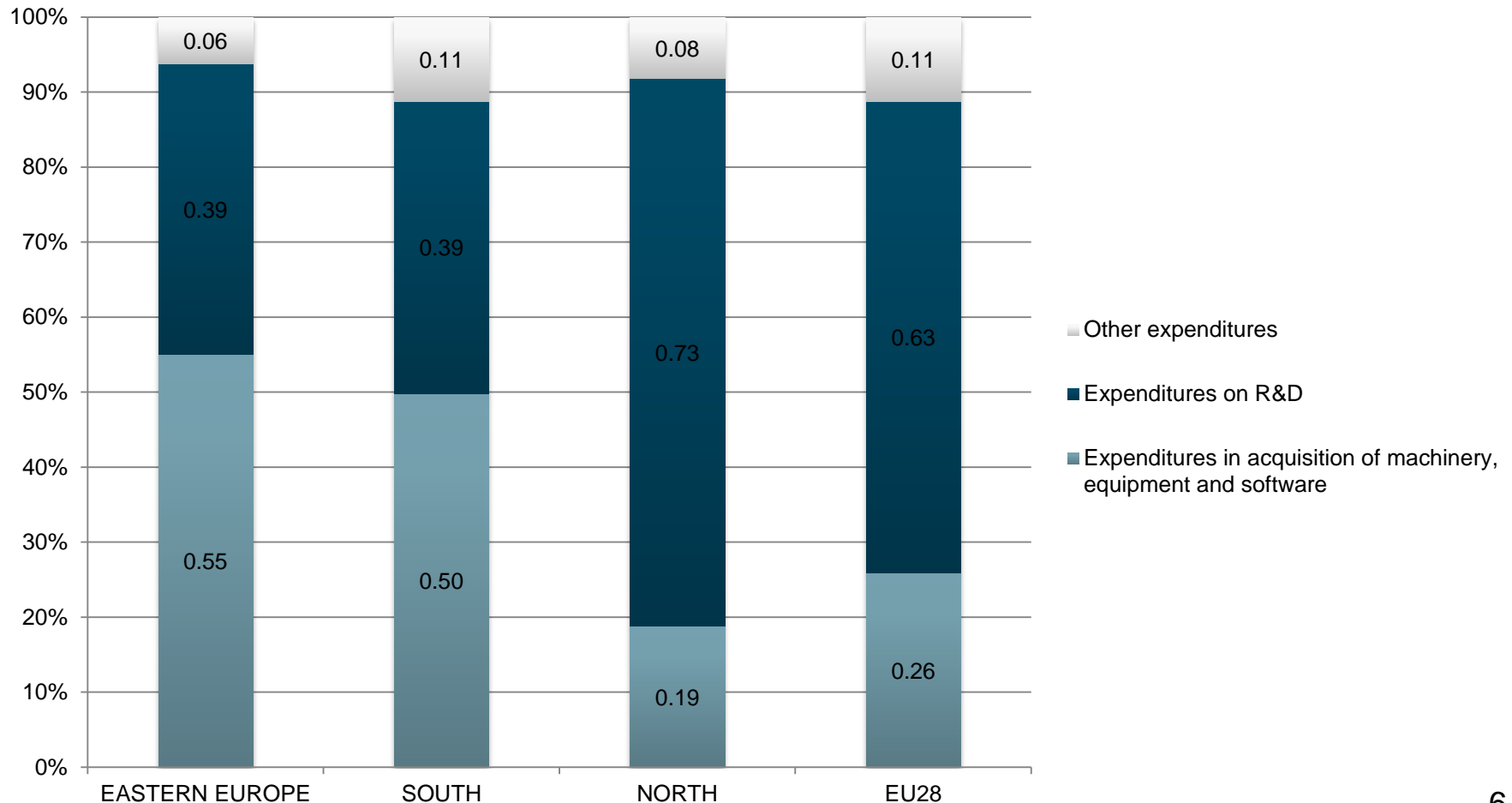
Homogenous group at the low income level
SEE5 - 22- 34% of German GDPpc

GDP per capita 2015, PPP (constant 2011 international \$)



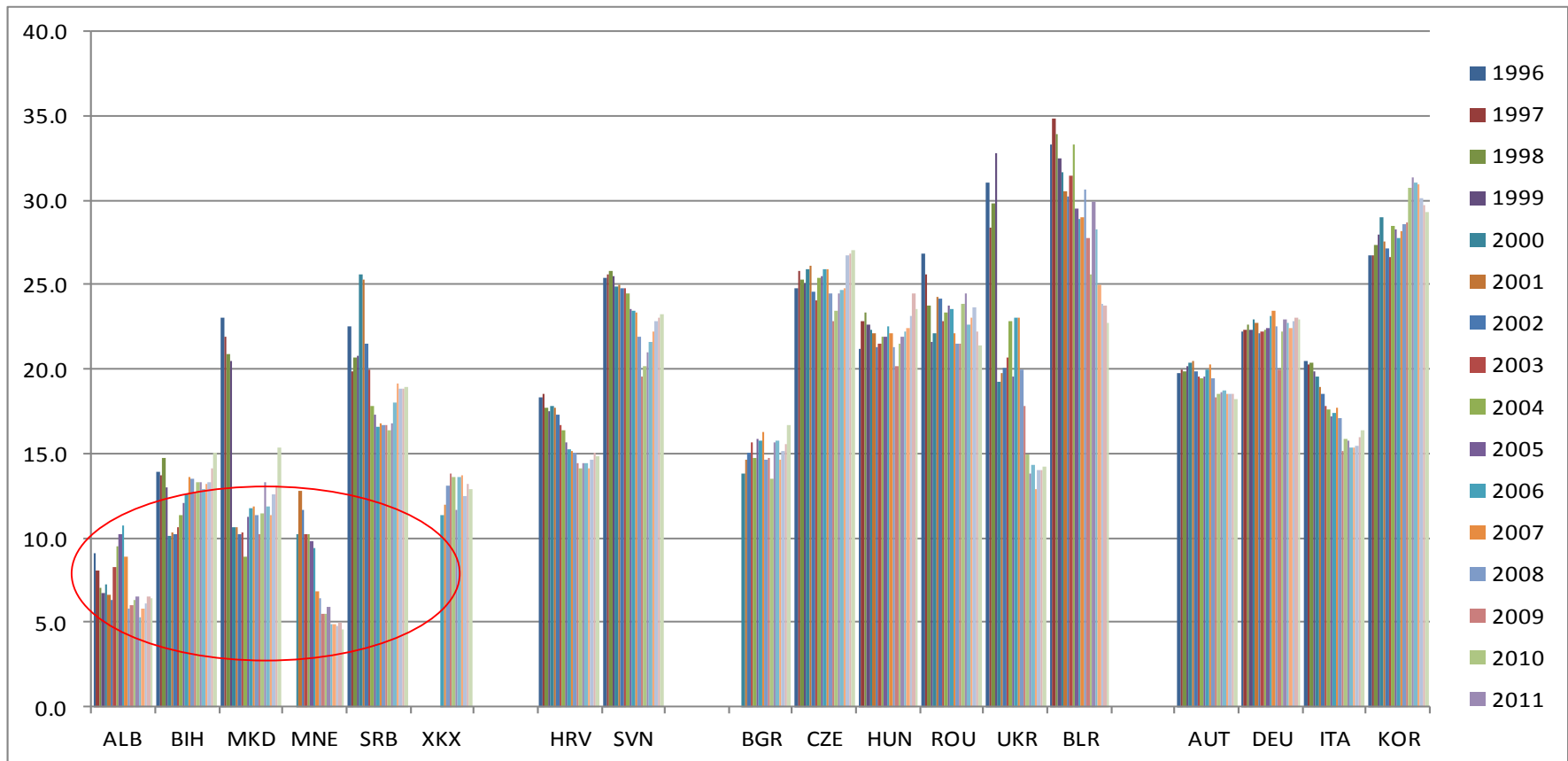
Different nature of innovation activities between the EU core and periphery ... (SEE as the low end of the EE scale)

Structure of innovation expenditures 2010-2012 in EU28 regions



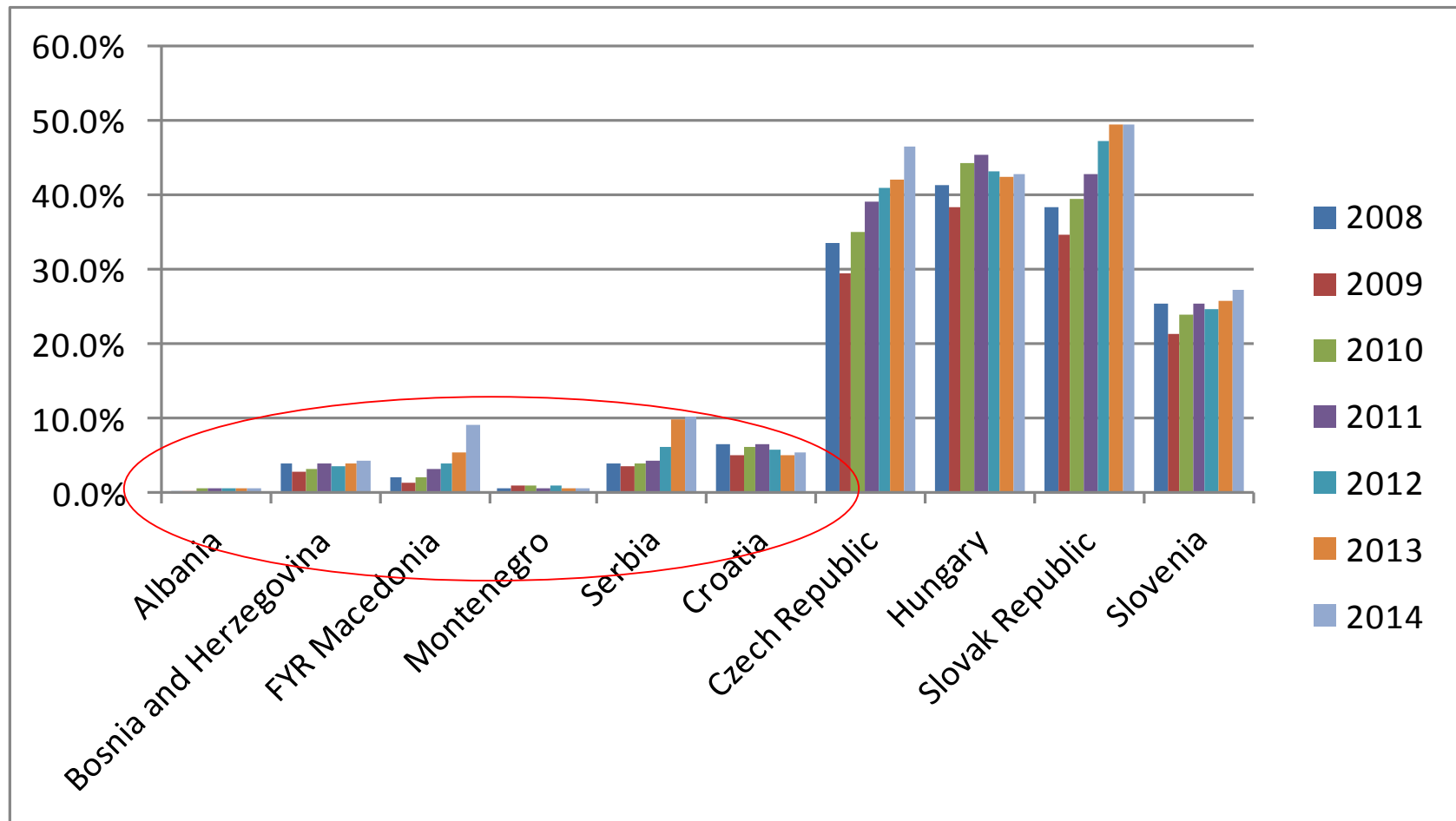
A protracted 'deindustrialisation' of SEE5 and some recovery

Share of manufacturing value added in GDP



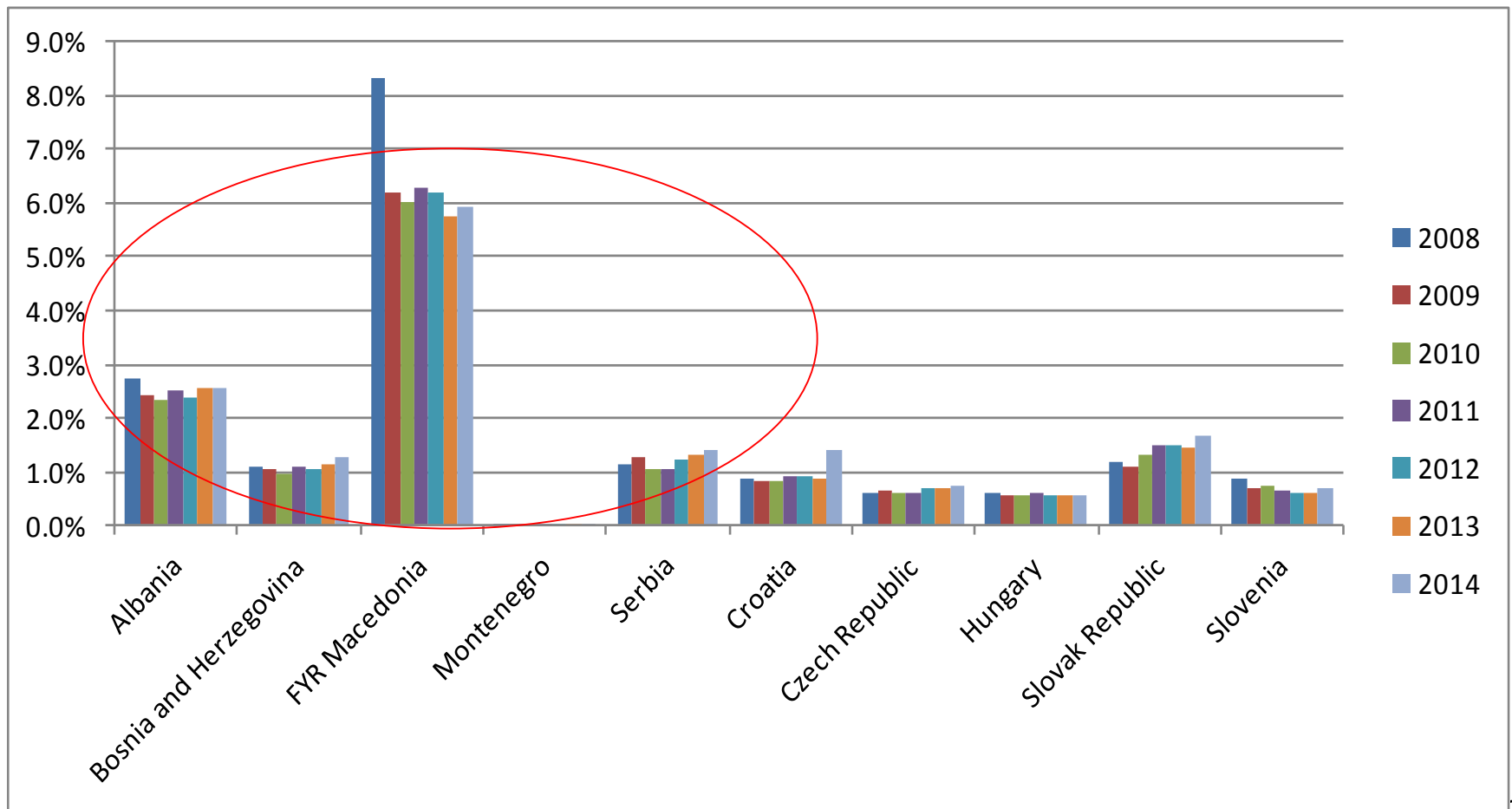
Exports of machinery and transport equipment (in % GDP)(current prices), 2008-2014

A huge gap in the degree to which Central Europe is involved in technology-intensive industries when compared to the SEE-5 group which is outside these networks



Exports of clothing (in % GDP)(current prices), 2008-2014

SEE-5 shows some advantages in labour-intensive industries like clothing esp. North Macedonia and Albania



The essential pre-condition for initiating robust and sustainable S3 process

Effective, consensus-building political leadership in three domains (universities, the private sector, and political authorities) willing to embark on the process of technological upgrading and modernisation and perceives S3 as viable and necessary approach

The institutional capacity for S3 seriously lacks in SEE countries

- S3 requires developed public – private and mezzo (sector) level **coordination mechanisms**.
- A reminder: 1990s (transition); 2000s (horizontal/'agencification'); 2014 ('vertical'/S3)
- S3 assumes that there is **sector and technology-specific policy expertise** and that there are institutional and financial conditions for experimentation.
- As these preconditions are absent the EU SEE policy should strongly support **capacity- building measures** in research and innovation policy **including monitoring and evaluation (M&E) capacity**

Current factors of SEE competitive advantage ...

- **Proximity to EU markets**

12-14 hours from WE; apparel- 22% cheaper than Chinese; 'nearshoring' (language capability and cultural understanding)

- **Costs of labour**

15-50% of Hungarian wages; except HR
Flexible labour force as the (only) region-wide advantage

... can they **alone** reignite growth ? **unlikely...**

Focus of current R&D, innovation and industrial policies in the SEE

- **Upstream (R&D)**
 - Increased scientific quality
 - Commercialization of public R&D sector results
- **Downstream (innovation)**
 - SMEs and start-up support
 - FDI support/ investment incentives
 - But very specific country approaches and levels of development of ind/innov policy
- **Missing focus** on **production capability** (quality, skills, productivity, export requirements) and **technology upgrading** (by linking FDI and innovation policy) > FDI employment subsidies that are not necessary contributing to technology upgrading

Current R&D and innovation policies reflect the needs of neither business nor scientific sector

- The lack of transparency, lack of evaluation procedures, and are not appropriate given financial and political constraints.
- **The main weaknesses of R&D policy instruments:**
 - limited funding,
 - the lack of feedback,
 - poor management (implementation),
 - poor design of instruments, and
 - poor local relevance of instruments

Source:

Zoran Aralica, Slavo Radosevic, Josip Raos (2017) Assessing research and policy support needs for innovation in the South East Europe. Key findings based on SmartEIZ Questionnaire report

http://www.smarteliz.eu/system/wp-content/uploads/2017/09/SmartEIZ_online-survey.pdf

The most important priority areas for R&D and innovation spending in SEE.... reflects deindustrialized economies

- **ICT**
- **energy**
- **digital services**
- **healthcare**
- **food**
- **environment and**
- **biosciences and biotechnology**

Enhance modernisation in SEE by **integrating region into EU-wide supply (subcontracting) chains**

- Integrating SEE into EU industrial networks!
- Enhance linkages with CEE industry networks !
 - > leveraging pan-European networks > multi-tiering > ‘tandem growth’
 - (cf. Automotive components : SEE - only 4% customers in CEE)

Patterns of industrial upgrading in SEE in selected industries ... **do not require technology frontier R&D**

- **Apparel:** from only **CTM** (42%) services to gradual introduction of **Value Added services (OEM/OBM)** + beyond imitation (design schools)
- **Automotive suppliers:** to move out of **subcontracting 'cost trap'** towards improved **quality standards, design and supply chain management skills**
- **Business Process IT Outsourcing:** from **fragmented, diversified and local market-oriented firms** towards focus on core competencies (**specialisation**) and **creation of BPITO champions**

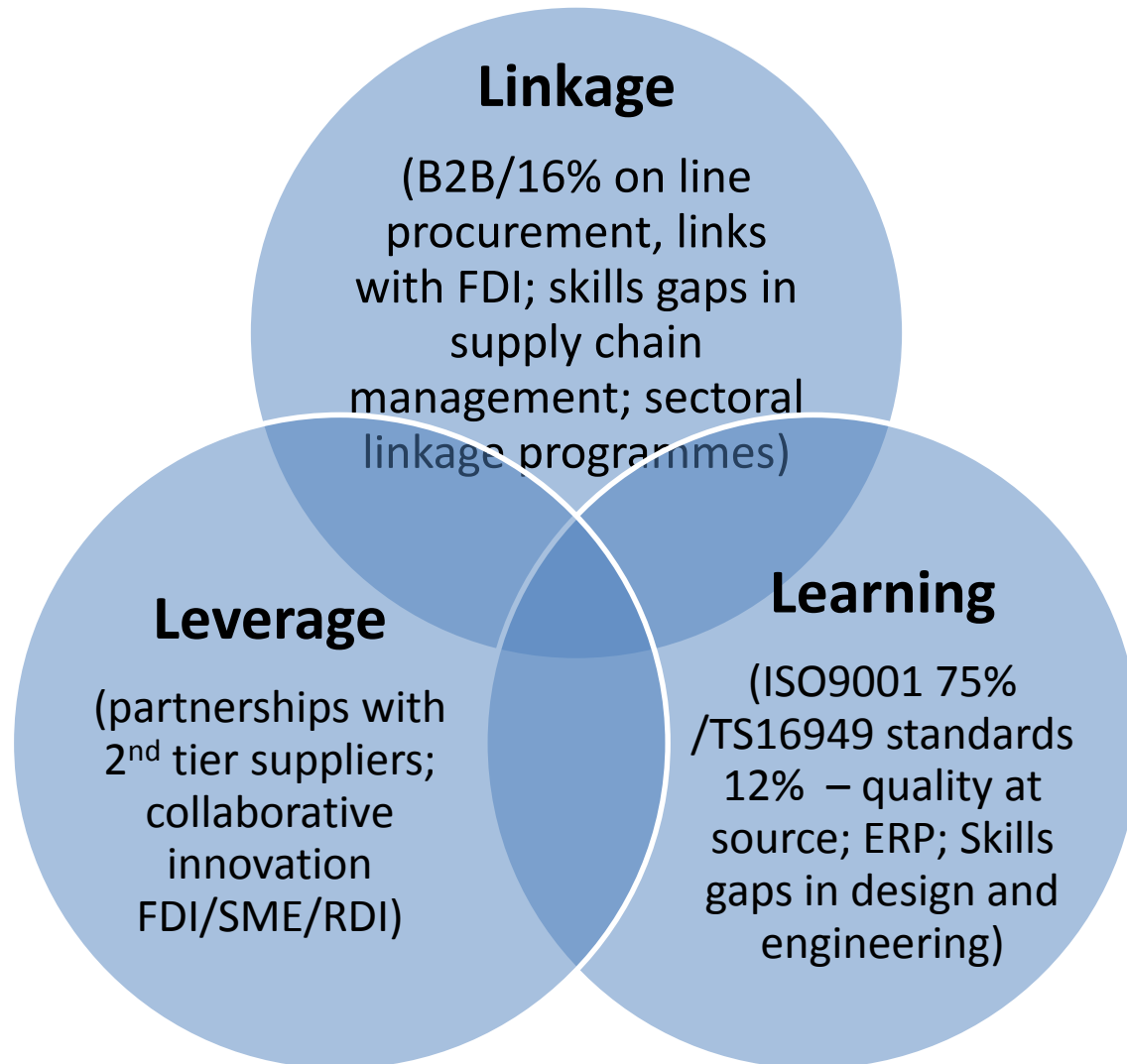
Based on OECD (2009) Sector Specific Sources of Competitiveness in the Western Balkans, OECD, Paris

CTM: Cut – trim – make

OEM/OBM: original equipment manufacturer/own brand manufacturer

LLL weaknesses in SEE-5 automotive components sector

- **example** -



Making S3 relevant:
Beyond policy silos mentality

- Industrial upgrading and sector specific regulatory reforms should go together > **regional cooperation** (cf. competition policy)
- International value chains and S3 should be integrated – **intra-and inter-regional supply chains**
- ‘Big push’ inter- and intra-regional projects should be **linked to 3S priorities**

Concluding point

- SEE countries need to support **integration** in **downstream areas** of the innovation value chain (subcontracting, supply agreements,...) by promoting **access to international supply chains** of local firms as well as their **upgrading** within these networks > **twinning and linkages initiatives with the EU partners**
- **Only R&D or upstream focus will not suffice**
- It is essential that countries **gradually develop local policy capability** (start from M&E)

- South-East Europe between the urgent need for economic transformation and the requirements for innovation paradigm shift

Sceptics view on RDI policy support to SEE

- WIIW study on Western Balkans (see Gabrisch et al., 2016) explicitly states:
- ‘Thus, for the time being, a country like Serbia, where only a few research institutions or larger companies implementing those research results exist, *should refrain from costly public investments in research and development for now*. These include *support for start-up companies aimed at financing innovations or the establishment of support funds for outstanding research*’.
- Instead, authors give much higher priority to *investments in transport infrastructure, investments in a dual system of vocational training, improve absorption capacity of EU funds, reduced share of non-performing loans, and fiscal devaluation*.

Seeking for viable approach to RDI support policy in SEE

- RDI policies are conventionally not seen as an immediate priority in the SEE-5 context.
- Indeed if conventionally designed and implemented RDI policy makers will have a difficult time to put RDI policy on the top of government's policy agenda.
- However, if conceived in a way that they go **beyond a sole focus on R&D** and address the issue of **sectoral technology upgrading, demand-led innovation, non-RD drivers of growth** related to quality, productivity, engineering and software they have much better chances to generate medium-term results.
- Moreover, in comparative terms, they can be **less expensive than alternatives**.

Prioritising structural reforms or industrial policy?

Industrial upgrading and regulatory reforms should go together

- To increase their impact, **regulatory reforms should be inextricably linked to potential areas and sources of growth**
- Areas of potential medium and long term growth should be exactly **those areas where regulatory reforms should be prioritized.**
- Regulatory reforms are not only about the removal of **general obstacles for doing business** but equally very **sector-specific obstacles** which are most often the major barriers.
- This would require addressing **failures in inadequate training and investment in human capital** in these areas as well as designing **technology-, sector- or area-specific investment promotion** packages

So far, **the policy focus has been on quadrants 1 and 2** i.e. on market enhancing governance reforms and on horizontal or generic innovation policy measures

Policy choices for industrial upgrading

	Structural reforms	Innovation policy measures
Horizontal (generic)	<p><u><i>Market enhancing governance reforms (1)</i></u> (Property Rights; Rule of Law and Effective Contract Enforcement; Minimizing Rent Seeking and Corruption, and Transparent and Accountable Provision of Public Goods)</p>	<p><u><i>Horizontal (generic) innovation policy measures (2)</i></u> (Generic innovation infrastructure; Innovation vouchers; Cooperative R&D programs; RTD tax measures)</p>
Vertical (sector/technology specific)	<p><u><i>Sector specific regulatory regimes (sectoral governance) (3)</i></u> (Sector-specific privatisation rules; Sector-specific price subsidies; Sector-specific regimes of licences; Sector-specific local content requirements; Sector-specific FDI promotion programs)</p>	<p><u><i>Sector or technology specific innovation policy measures (4)</i></u> (Sector or technology specific infrastructure; Thematic R&D programs; Technology platforms Technology or sector specific vocational training programs)</p>