Economic Development and Innovation Environment in the Balkan Region

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Introduction

This paper gives an overview of the economic paradigms, innovations, co-operating systems and clusters that make regions successful in our post-industrial society. As an example I have mainly selected the experiences of small and medium size enterprises (SMEs) gained in the development of the post-industrial economies, as we assume that their experiences are largely relevant in the Balkan region.

The modern state should not simply subsidize the *competitiveness* of its own *national economy*, as its competitiveness mainly *depends on the underlying innovative environment*, the so-called 'innovation milieu' (Camagni, P.R. 1992) and the *national innovation system*, which binds the system together. Therefore at a national level it is indispensable for the development of innovation that theeconomic policy makers create a coherent national innovation system.

I firmly believe that there are other tools for the development of innovation beyond financial sponsoring and these government measures can also be realized in the Balkans with relatively low cost.

Relationship with International Organizations

The international relations of Balkan countries are heterogeneous and complex due to the following reasons:

- The EU is the main foreign trade partner of all countries in the region but economic and political partnerships are at very different stages with the various countries in the region:
    - Bulgaria and Romania: member states of the European Union (EU);
    - Croatia and Macedonia: stabilization and accession treaties with the EU;
    - Albania: Enter into negotiation phase with the EU;
    - Serbia-Montenegro: feasibility study;

  - Albania, Croatia and Macedonia: members of the WTO;
  - Serbia-Montenegro as well as Bosnia and Herzegovina: entering into negotiation phase with the WTO;
- Negotiations about free-trade agreements have been accelerated in recent years. These agreements have been concluded but they have not been implemented everywhere.
- Success of free-trade agreements is reduced as Serbia-Montenegro as well as Bosnia and Herzegovina have not integrated their domestic markets yet;
- Revenues of privatization have to balance foreign trades because the countries of this area can hardly raise funds from the international capital markets;
- Nevertheless the intensity of privatization has fluctuated in recent years. Frequently internal resistance against privatization makes it more difficult. Generally revenues take a great leap after privatising one of the most significant infrastructures.
- Entering of foreign trade is made more difficult both for privatization and green-field investments by:
  - Corruption;
  - Untrustworthiness of legal background;
  - High level of bureaucracy;
  - Anti-investment attitudes.

ECONOMIC REVIEW

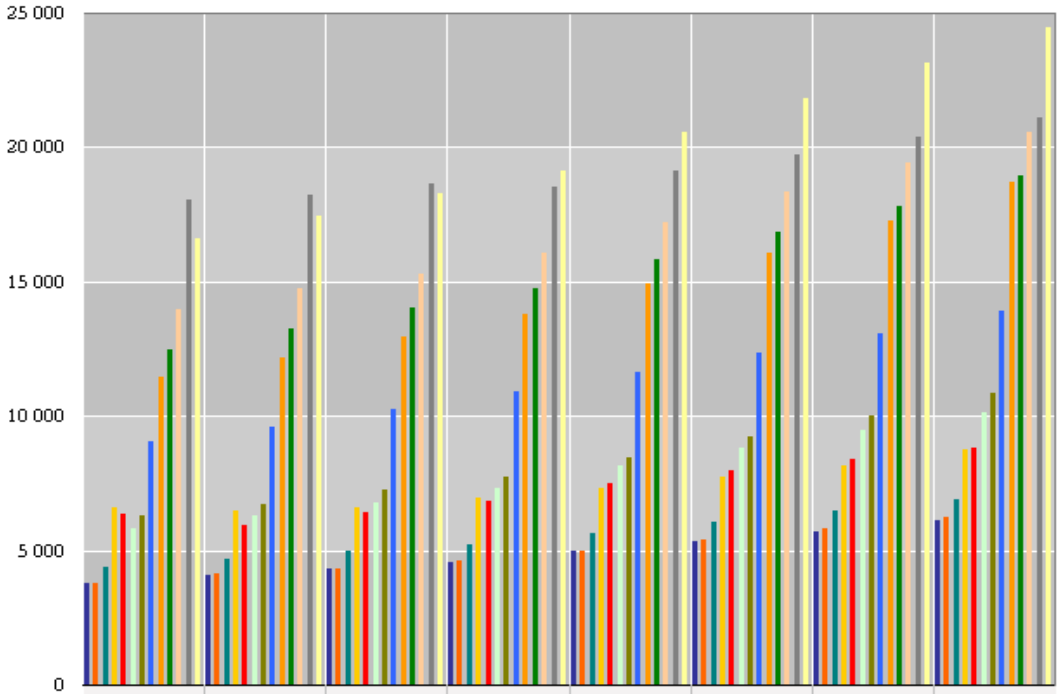
The chart below (Figure 1) shows the recent and predicted GDP per capita figures of the countries in the region (based on Purchasing Power Parity (PPP) which largely adjusts for the weight of the sometimes significant weight of the informal economy in these countries).

According to these statistics we can distinguish three groups in the region:

1. The five most advanced states[1]: above USD 16 000;
2. Croatia midway between the two groups: about USD 12 500;

[1]In an increasing order: Slovakia, Hungary, Czech Rep., Malta and Slovenia [the highest with USD 21,808(!) GDP per Capita in 2005]

3. Seven countries[2]: All under USD 10 000.



	2000	2001	2002	2003	2004	2005*	2006*	2007*
Serbia	3 795	4 105	4 341	4 543	4 992	5 348	5 713	6 112
Albania	3 754	4 115	4 300	4 622	4 997	5 405	5 818	6 259
Bosnia&H	4 394	4 673	4 969	5 232	5 631	6 035	6 456	6 884
Macedonia	6 623	6 454	6 608	6 962	7 302	7 748	8 175	8 738
Turkey	6 364	5 928	6 407	6 807	7 494	7 950	8 385	8 839
Romania	5 799	6 306	6 769	7 291	8 132	8 785	9 446	10 152
Bulgaria	6 278	6 736	7 238	7 756	8 464	9 223	10 003	10 844
Croatia	9 079	9 587	10 249	10 907	11 626	12 325	13 062	13 923
Slovakia	11 453	12 161	12 934	13 775	14 904	16 041	17 239	18 705
Hungary	12 460	13 277	14 016	14 769	15 838	16 823	17 821	18 922
Czech Rep.	13 968	14 750	15 266	16 074	17 220	18 341	19 428	20 539
Malta	18 017	18 253	18 667	18 555	19 100	19 739	20 365	21 081
Slovenia	16 604	17 423	18 307	19 137	20 537	21 808	23 159	24 459

Figure 1: GDP per capita (Power Purchase Parity, PPP)(Construct.: SITÁNYI L. (2006)) (Source: International Monetary Found (2006)), *calculations and forecasts

[2]In an increasing order: Serbia, Albania, Bosnia-Herzegovina, Macedonia, Turkey, Romania and Bulgaria.

Economic growth

Economic growth has been accelerating in seven Southeast European countries[3] in the last five years (Figure 2). Real GDP growth rate will continue to reach or exceed 5% in all these economies[4].

It is important to emphasise that the key drivers of economic growth in the Southeast Europe are different from those in the EU countries.

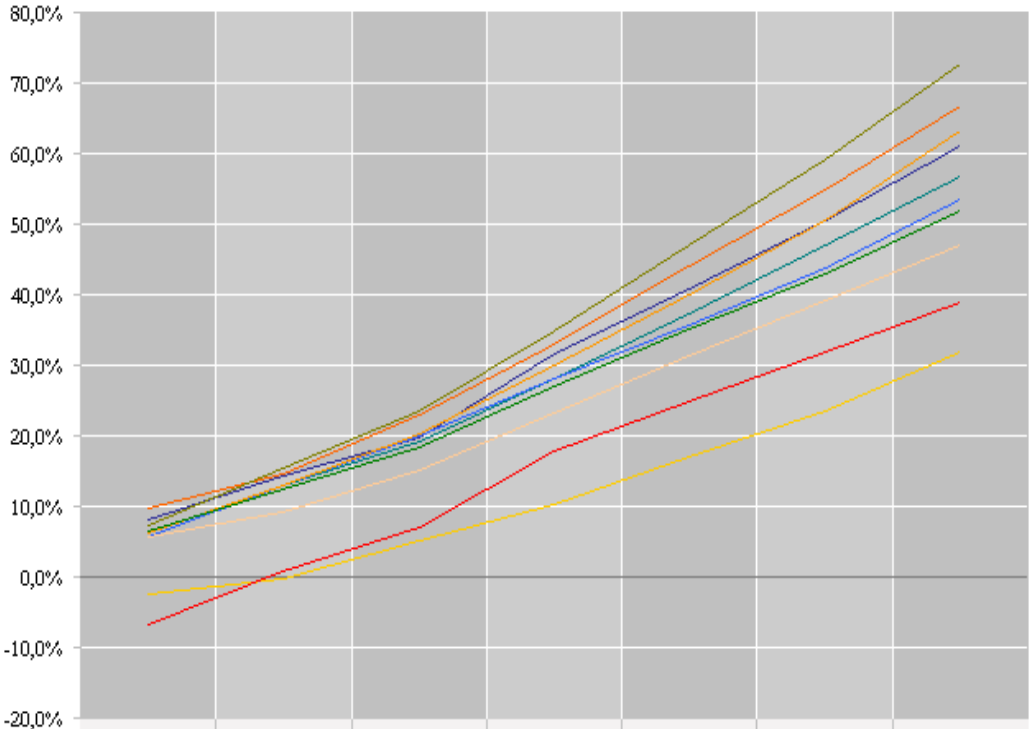
There are two main reasons for that:

1. Domestic demand is the main engine of growth in these countries;
2. However economic growth is not only consumption-driven but also investment-led, i. e. foreign and domestic investments play an important role in regional GDP growth.

As a result of strong domestic demand net export contributes negatively to GDP growth in these economies. Since the strong domestic demand boosts the import of consumer and capital goods, the foreign trade deficit increased significantly in the last few years (Figure 3). In some countries of the region it is now more than 20 per cent of GDP. Nevertheless this is not unusual for emerging economies as they are catching up with the more developed part of Europe and normally manageable as long as the investment environment remains attractive. If that is the case capital inflows normally compensate for the temporary shortfall in trade balances.

In 2007 these tendencies are likely to continue and economic growth will remain strong, while growth rate of the region will exceed 5% again. (ICEG EC – CORVINUS, 2006)

[3]In alphabetical order: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, FYROM (Former Yugoslav Republic of Macedonia), Romania, Serbia and Montenegro.
[4]Except for the FYROM where a significant drop is expected in the GDP growth rate.

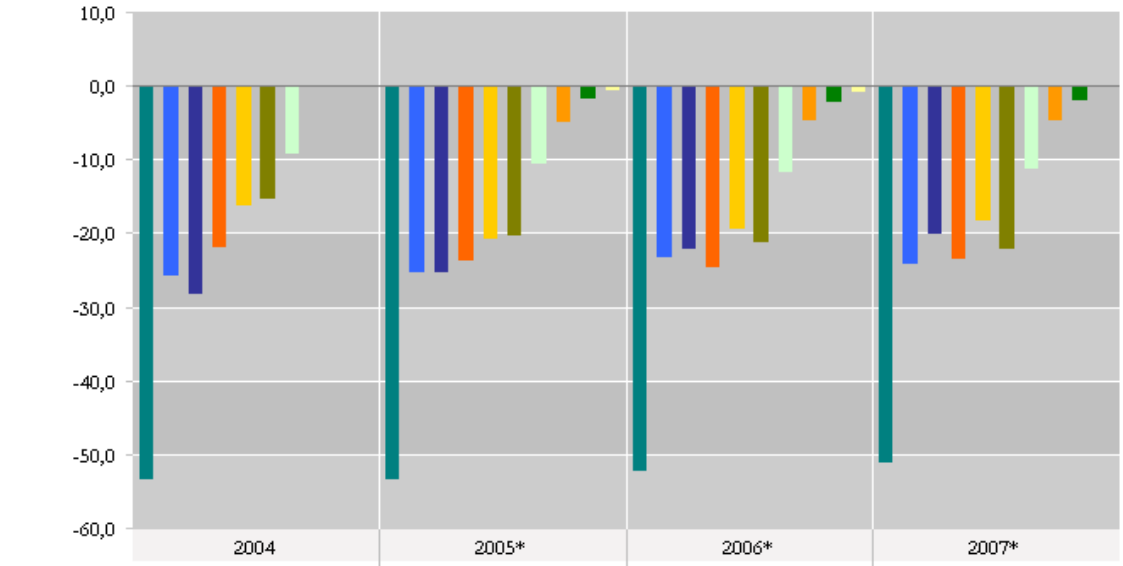


	2001	2002	2003	2004	2005*	2006*	2007*
Serbia	8,2%	14,4%	19,7%	31,5%	40,9%	50,5%	61,0%
Albania	9,6%	14,5%	23,1%	33,1%	44,0%	55,0%	66,7%
Bosnia&H	6,3%	13,1%	19,1%	28,1%	37,3%	46,9%	56,7%
Macedonia	-2,5%	-0,2%	5,1%	10,3%	17,0%	23,4%	31,9%
Turkey	-6,8%	0,7%	7,0%	17,8%	24,9%	31,8%	38,9%
Romania	7,3%	15,3%	23,5%	34,8%	46,9%	59,3%	72,7%
Bulgaria	7,3%	15,3%	23,5%	34,8%	46,9%	59,3%	72,7%
Croatia	5,6%	12,9%	20,1%	28,1%	35,8%	43,9%	53,4%
Slovakia	6,2%	12,9%	20,3%	30,1%	40,1%	50,5%	63,3%
Hungary	6,6%	12,5%	18,5%	27,1%	35,0%	43,0%	51,9%
Czech Rep.	5,6%	9,3%	15,1%	23,3%	31,3%	39,1%	47,0%

Figure 2: Changes of GDP per capita values in seven Southeast European countries (%) (Construct.: SITÁNYI L. (2006)) (Source: International Monetary Found (2006)), *calculations and forecasts, **Changes of GDP per Capita are compared to the level of year 2000.**

Balance of payments

"*External imbalances remained one of the key problems in the region. However, the development of current accounts in the region shows a mixed picture. The deterioration was mainly the result of the widening foreign trade deficit owing to high domestic demand in these countries. In Albania and Croatia, the deterioration of foreign trade balance also had a negative impact on the evolution of the current account balance, however, the improvement of other elements of the current account balance – current transfers in Albania, and services balance in Croatia – was able to counterbalance partly the deterioration of the current account balance in these economies.*" (BILEK P. et al. 2006)



	2004	2005*	2006*	2007*
Bosnia&H	-53,3	-53,1	-52,0	-51,0
Croatia	-25,5	-25,0	-23,0	-24,0
Serbia&M	-28,0	-25,0	-22,0	-20,0
Albania	-21,7	-23,5	-24,5	-23,2
Macedonia	-16,1	-20,6	-19,3	-18,0
Bulgaria	-15,1	-20,2	-21,0	-22,0
Romania	-9,0	-10,4	-11,6	-11,0
Slovakia		-4,8	-4,6	-4,4
Hungary		-1,6	-2,0	-1,8
Slovenia		-0,5	-0,7	0,1

Figure 3: Balance of foreign trade (2004, 2005, 2006*, 2007*) related to GDP [%] (Construct.: SITÁNYI L. (2006)) (Sources: National statistics as well as Bilek P. (2006) and Pellényi G. (2006)) *calculations and forecasts

Although the average real GDP growth rate of countries in the region will reach or exceed the double of the average of the EU countries, South-Eastern Europe suffers from the following basic problems:

- Lack of capital and liquid debt markets,
- The presence of 'grey' and 'black' economy,
- Weak infrastructure (transportation, telecommunication, finance),
- Lack of business and political confidence, social tensions,
- Underdeveloped human resources, lack of consumer confidence.

As a result of these issues and the relatively small size of the region in economic terms the multinational companies have now less incentive to consider South-Eastern Europe not least due to the emergence of South East Asia as a source of cheap labour and large internal markets. This trend however, may not be such an enormous problem since in both of these competitive locations (Latin-America and South-East-Asia) the economic development is focusing on industrial mass production, which in the long run often proved to be a dead end in smaller size semi-peripheral countries. Already in recent history it was found that this type of development can only be maintained artificially by 'strong state' (LIPIETZ, A. 1985) and protectionist interventions; not to mention the almost inevitable side-effect of potentially irreversible environmental damage, as it can be seen through the example of India and China. On the other hand if we truly want to exploit the potential for economic development, a system is necessary which is locally strong, independent and based on a sub-regional approach and endogenous sources, and which also encourages entrepreneurship and considers the cultural, linguistic and size differences. Thus, if we want to catch up and improve the attractiveness of our region, an innovative development based on endogenous sources is necessary. In order to achieve this goal, a supportive economic environment is needed, which is able to accommodate a fast growing SME sector and stimulates its development. This notion is also supported by the seemingly paradoxical fact that the development of the local economies was often actually strengthened by globalisation, as each successful country and company which has managed to give an adequate answer to global challenges, was actually building on endogenous sources and was successfully using local infrastructure (MATOLCSY Gy. et al. 1998). The key elements of sustainable economic development are reviewed in the following section.

Fact-Based Innovation and Development

The elements of strategic planning *need to be based* on facts and *reality*, ideally resulting from proper surveys. It is always necessary to carefully analyse the innovative environment. Innovation and R&D should not be an overly politicised, but firmly embedded in economic reality and based on the country's real competitive advantage.

Availability of local capital is important; but contrary to general perception the main issue is not only the home-grown capital available for innovation or the even government grants. According to recent research, success does not mainly depend on government support, but on the broader *economic environment, particularly on the milieu of innovation*. (Camagni, P.R. 1992)

This paradigm shift in the innovation approach has laid greater emphasis on a wide and decentralised set of institutions that promotes transfer of knowledge and technologies beyond pure emphasis on Research and Development. Research and technology parks, innovation and technology development centres, which suit these requirements, will build wider relations and network among the economic actors, therefore providing a better fit with the local economic and social environment.

Innovation and Government Support

The post-modern innovation is a complex system (Dőry T. 2005), where the research and market potentials interact in a multi-feedback model in a much more complex way than the earlier linear and chain-type models – as they develop almost in parallel due to the fast feedback of information. (Sitányi L. 2005)

The entrepreneur as the 'carrier' of innovation

In developed economies, the potential for innovation is a determining factor of business competitiveness. Research and Development is important, but contrary to the general approach, the main question is not the role of the government support, but the way how the companies recognise their opportunities and answer the challenges. The success of a country or region is primarily dependent on how the local actors can build efficient connections between the different phases of the innovative processes, how effective their regional networking ability is; because *these regional*

networks provide the basis of the interactions that integrate the geographically separated economies in the global network of trade and industry (FRITSCH et al. 1998). Thus, primarily the SMEs benefit most from the regional and indirectly global networks.

DEVELOPMENT OF CLUSTERS

The definitions for innovative groups, or clusters became well-known in the last decade. Such clusters could be observed distinctly in the pharmaceutical, automotive and IT industries in South-Eastern Europe. Even nowadays, the term 'cluster' is used many times as the synonym for inter-company and supply relations. As often happens, if we look behind new or fashionable terminologies, old and already known phenomena will be found. Let's take for example a few well known, old and still successful 'clusters', such as the French perfume and fashion industry, the Dutch flower production, the Finnish wood industry or the "chair-triangle" in Northern-Italy. We believe that studying such 'clusterising' processes leads to a crucial message which is quite relevant to the current situation in South-East Europe:

- Development of a cluster or a wide cooperation between groups does not necessarily belong to any fashionable new sector; in addition, those that have been functioning for a long time are normally built on traditional industry or products;
- The majority of such clusters use local resources, tradition, local culture or the reputation of a given area. Where preconditions cannot be found and are artificially created, the development of the cluster is slow, complicated or too expensive, and the cluster will only very slowly (if at all) become part of the local economy;
- Such well structured cooperation is able to compete with the low-cost countries of the global economy – even in the case of traditional agricultural or industrial products that are said to be downsized.

Innovative companies rarely act separately in their innovative work. In order to improve their knowledge and know-how, they increase their interaction with suppliers, consumers, competitors, universities and research institutions. Cooperation of companies is the most important channel to share and exchange knowledge. One of the biggest challenges of the modern economic policy is to stimulate this process.

In successful regions, a network of companies, universities, research institutions, technology-suppliers, bridging organisations and corporate clients is created, which forms a value-added production-service chain. As these groups develop further, after a period of time they grow over the corporate networks and involve all forms of the distribution and exchange of financial services and knowledge necessary for the operation. This is called cluster.

In a series of countries, such innovative clusters of economic activities act as a magnet attracting new technologies, qualified labour and research investments.

Unfortunately, according to both international and Hungarian surveys, clusterising cannot be created artificially; even the Grosz principle says: "*Development of clusters cannot be forced, only support of existing or potential regional clusters or at least those in their beginning, embryonic phase is possible.*" (GROSZ A. 2004)

As practising regional developers we must do something against the sinking of our narrower or wider regions; we need to induce this process in areas that have not developed clusters, yet.

CONCLUSIONS AND RECOMMENDATIONS FOR THE SCIENTIFIC AND TECHNOLOGY-POLICIES

A few conclusions and recommendations can be given for the scientific and technology-policies in South-Eastern Europe:

- It would lead to serious consequences if the support of small and medium sized enterprises were to be reduced and only the existing institutions of knowledge-centres were financed by the government, blaming the limited financial resources.
- Tax allowances should be considered in order to encourage innovation.
- Often economic development, regional development, technological development and the current institutional background of innovation are fragmented at the governmental, regional and local level; therefore, often even well-meaning sub-policies cannot function together as a system.
- Joining the regional policy of the EU can only be efficient in medium or long term if innovation is also in the focus of regional development.
- Ensuring the conditions for a knowledge-based economy necessitates the support and development of intermediary institutions.

- It is especially important to support technology-based, start-up, small and medium sized enterprises (SMEs), to reduce the risks of innovation and to encourage the development of corporate networks.
- Stimulation of establishment of innovative groups, networks.

SUMMARY: THE ROLE OF THE GOVERNMENT IN THE DEVELOPMENT

The task of the government's policy is to promote corporate innovation and to ensure the appropriate economic background. This is a big challenge especially in the case of new, technology-based small enterprises. In general, the following measures in scientific and technology policy can stimulate the development of innovative groups:

- Encouragement of knowledge-exchange: e.g. starting technological forecasting programs, setting up discussion groups.
- Promoting the cooperation of science and industry, building and maintaining innovation networks.
- Direct government intervention: financing R&D projects and supporting technological transfer programmes.
- The government playing a role as a consumer and procurer in education, health and defence developments.

There are other tools helping innovation beyond financial sponsoring and these government measures can also be realized in South-Eastern Europe with relatively low cost.

- *Effectiveness of the state and the adaptation of the 'value for our money' principle*. We have to increase the effectiveness of the state through implementing various measures, including: the promotion of small and medium size enterprises (SMEs) in the economy.
- *Improving of the business confidence* through the enforcement of transparency as well as the implementation of the computerized services of the governmental and municipal sector.

- *Adequate legal background, controlling, monitoring and survey of effectiveness*. When we establish and develop the relevant legal background, we have to consider innovation, competitiveness and the protection of intellectual property rights. It is important that the state subsidy of project-based research and development (R&D) has to be transparent and its financing has to be efficient, controlled and regularly monitored.

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