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Innovation and Competitiveness Policies

## Results and Policy Recommendations of the Subregional Innovation Policy Outlook

### Note by the secretariat

#### I. Context for and objectives of the Subregional Innovation Policy Outlook

1. Countries in the Eastern Europe and the South Caucasus (EESC) sub-region have considerable potential for sustainable growth and development. The post-independence transition process has been rocky: it took decades to regain the output levels of 1990 and to set up the fundamental elements of a functioning market economy. With many of these elements now in place, high levels of educational attainment, in some countries a relatively diversified production structure, a tradition of public research, a strong commitment to innovation, and a range of opportunities for trade and investment should hold substantial potential for sustainable development.

2. At the same time, this will not happen automatically on current trends: several growth drivers are reaching diminishing returns and look increasingly unlikely to underpin progress towards the SDGs in the medium term. The boom many countries saw in the first decade of the century was driven mainly by market- and resource-seeking investment and credit- and remittance-fuelled consumer spending. Most countries have seen total factor productivity slow or even decline, in part due to negative reallocation of factors of production from more to less capital-intensive activities, such as from manufacturing to domestic services. Manufacturing has declined substantially, both in terms of output, employment, and diversification, and most countries rely on low value-added commodity exports and remittances for foreign revenue. The COVID-19 pandemic is the latest, and potentially the most severe, of a long series of external shocks that have hit the region.

3. Against this background, making the most of this potential requires systematic and continuous experimentation with new ideas that could make more out of human and natural resources – in other words, innovation. Such experimentation is underway in the EESC region, with the rise of export-oriented information technology (IT) and business process outsourcing (BPO) services being a prominent example. But to drive sustainable development, build a circular economy and shape a resilient post-COVID response, experimentation needs to become systematic across the economy and society. This requires entrepreneurship, or specifically a small sub-group of innovative, potentially high-growth



entrepreneurs, who systematically look for opportunities and try out solutions – supported by a good business climate, a solid research system, competitive markets, and targeted, effective support policies that defray risks and help overcome market failures.

4. This, or making sure that more experimentation with ideas takes place, is the central challenge of innovation policy in the EESC region, especially in the context of uncertainty around globalisation, rapid technological change, and the increasingly untenable nature of the development trajectory that worked well for the success stories of East Asia.

5. Innovation in public policy is equally crucial for policy to play an effective role in enabling and promoting this dynamic: the nature and complexity of the challenge requires effective, flexible institutions and processes for designing, co-ordinating, driving, and evaluating policies and instruments. This is especially true in a broader context of reduced fiscal room for manoeuvre and the imperative to increase impact of scarce public resources

6. The United Nations Economic Commission for Europe's Subregional Innovation Policy Outlook (IPO) guides EESC countries in responding to this challenge through a concerted, systematic and comprehensive assessment and comparison of innovation-related policies, institutions and processes across countries and across a set of good practices and with a clear sustainable development perspective. The IPO complements international composite indices, such as the World Intellectual Property Organisation's Global Innovation Index and the World Economic Forum's Global Competitiveness Index, by looking more closely at the role that policies and institutions play in enabling and promoting innovation and by focusing on a group of countries with shared economic, structural, legacy and institutional features, challenges, and opportunities. The results can inform policy dialogue, reform processes, joint initiatives, donor-funded programming and investment.

## **II. Structure of the Innovation Policy Outlook**

7. The IPO has three pillars. The first, innovation governance, assesses the overarching strategic, institutional and legal framework for innovation policy, as well as the nature, capacity, incentive structure, quality and effectiveness of the corresponding agencies, coordination bodies and processes. The second pillar, innovation policy tools, covers the nature, scale, scope, quality, impact and implementation status of key policy areas related to innovation. The third pillar, innovation policy processes, uses a specific project or programme underway or completed in each country to examine the scope, nature and effectiveness of rules, procedures and mechanisms. It also examines the role of evidence and data during policy design, implementation and post-implementation.

8. The IPO publication was launched globally on 25 November 2020 during a high-level webinar, which was opened by the ECE Executive Secretary, the Director General of the World Intellectual Property Organisation, and the Ambassador of Sweden to the United Nations in Geneva. High-level country-specific launch events for all six EESC countries were held from December 2020 through February 2021. Printed copies of the English version of the IPO publication will be available in April 2021, Russian printed copies will be available by Q3 2021.

9. ECE stands ready to support the implementation of the IPO's recommendations with the support of donors and the aim of building back better after COVID-19.

## **III. Main findings and recommendations of the Innovation Policy Outlook**

10. Although many of the fundamental elements are in place, there is limited progress towards innovation-driven sustainable development. EESC countries perform well compared with their income-group peers on central innovation input indicators such as educational attainment, political commitment, and a waning but still critical mass of public research institutions. Yet these factors do not systematically lead to corresponding innovation outputs, such as diversification towards knowledge-intensive, tradeable products and services and, ultimately, sustainable economic growth.

11. A central reason for this is limited, vibrant linkages and systematic interaction among the actors of the broader national innovation system, including science-industry collaboration, and the nascent stage of development of some of the most important elements, such markets for risk capital investment. The strong role of less efficient state-owned enterprises (SOEs) and concerns around corruption and rule of law limit domestic and foreign investment and entrepreneurship to the least innovative and risky activities. Laws and regulations contain both significant gaps and a legacy of rules that protect entrenched interests and constrain experimentation.

12. The complexity of innovation systems and the scope of the challenge, especially in the broader context of the SDGs, require a significantly higher degree of co-ordination and alignment than is currently taking place. At the policy level, long-term innovation strategies do not systematically align with SDG priorities and those of central, related policy areas such as industrial development, SME promotion, and public research. At the level of design and implementation, there are few systematic mechanisms for inter-ministerial co-ordination and multi-stakeholder consultations to explore needs and complementarities, align and consolidate efforts, and monitoring and evaluating impact.

13. Recognising the importance of innovation, EESC countries engage in a range of targeted support measures to support experimentation in the private sector – albeit with limited impact. Countries offer a wide array of business development services, infrastructure such as technology parks and incubators, and concessional finance schemes. Several factors constrain their effectiveness. There is a strong emphasis on technology start-ups, and less attention to gradual, adaptive innovation in the economy overall – where most of the potential lies. A clear life-cycle perspective is missing, with many gaps in support at different stages. Countries would benefit from a concerted approach to cater to the needs of the small subgroup of innovative, potentially high-growth entrepreneurs that could consolidate and complement existing measures. Finally, funding and institutional capacities are at times not sufficient to put ambitious plans into practice.

14. As innovation is, by definition, uncertain, its very nature conflicts with the traditional, planning-oriented approach to policy and public support – making a solid, transparent yet flexible approach to the different steps in the innovation policy cycle essential in all EESC countries. Solid policy foresight exercises, broad stakeholder consultations, in-depth analysis of and clarity around market failures and the rationale for intervention, clear and detailed performance indicator, and continuous monitoring of impact and regular reviews that inform reforms and further interventions – all are essential to maximise the positive impact of interventions.

15. Some of the central areas for reform and related recommendations are:

### **Pillar I: Innovation governance**

16. Legal and institutional frameworks are not sufficiently robust to support innovation policy effectively. Specific recommendations include the following: Improve the enforcement of laws and regulations. Simplify rules where possible, aiming to enable rather than constrain innovation. Remove regulatory gaps and constraints on risk capital investment, insolvency, start-ups and spin-offs. Harmonise national legal frameworks with international standards and best practices.

17. Insufficient co-ordination across policy areas relevant to innovation. Specific recommendations include the following: Integrate different elements of innovation policy into a coherent strategic document covering, in particular, research, technology, and private sector development. Align the strategy carefully with overarching strategies for socio-economic and sustainable development. Set up and empower mechanisms for supervision and co-ordination, both at the ministerial and working levels.

18. Funding of strategic initiatives in innovation is low. Specific recommendations include the following: Move from suboptimal financing mechanisms to new arrangements for allocating funding. Improve the quality of governance, accountability and transparency

of public institutions. Explore alternative funding by taking advantage of private and international sources.

## **Pillar II: Innovation policy tools**

19. Broad, systematic, and effective policy support for knowledge absorption is still underdeveloped. Specific recommendations include the following: Design, monitor and evaluate business support mechanisms and infrastructure to align services more clearly with existing and potential needs and opportunities. Promote good public and private sector organizational and managerial practices. Introduce co-financing mechanisms for technical and business services. Review the complex systems of fiscal incentives and exemptions to ensure measures clearly target and catalyse experimentation with new ideas, rather than activities that are established or would take place without support.

20. The lack of systematic support throughout the different phases of firm development, compounded by low access to finance for innovation, limits efforts to promote innovation. Specific recommendations include the following: Engage in regular consultations to scout needs and opportunities to inform policy design. Develop a framework for regular monitoring and evaluation of support schemes for the different stages in the firm life cycle, as well as post-evaluation of beneficiary projects. Enable and catalyse risk finance, such as venture capital, to address the gap between seed funding and early-stage development of innovative start-ups and to systematically finance innovation across the economy.

21. Relationships and linkages among actors in the innovation system are limited, especially among science, academia, and the private sector. Specific recommendations include the following: Extend the policy mix of innovation voucher schemes and cooperative R&D grants to target more clearly pilot initiatives to align applied research with private sector needs and to explore the commercial potential of research results across the sub-region. Develop a comprehensive framework for monitoring and evaluating the innovation support infrastructure, assess market needs and integrate business and technical services in the portfolio of relevant structures. Expand the incentives for mobility between academia and industry.

22. Existing policy tools do not sufficiently support the systematic diffusion of knowledge through industrial technology assistance and brokerage schemes for technology upgrading, and the potential of public procurement policy is not fully explored. Specific recommendations include the following: Stimulate innovative development through demand-based policies and contribute to the diffusion of innovation for broad public use by innovation-enhancing procurement. Extend policy support for industrial technology assistance to stimulate technological advancement of production processes. Develop further the digital infrastructure to enhance connectivity in the sub-region.

23. The mismatch between education and research system outputs and the needs of innovative entrepreneurs obstructs further enhancement of research and education across the sub-region. Specific recommendations include the following: Stimulate R&D activity in the public sector by increasing the levels of R&D funding and ensure its efficient use. Conduct a comprehensive impact assessment of research initiatives and grant programmes to identify potential inefficiencies and drivers of innovative development. Consider expanding schemes for commercializing research. Build a science, technology, engineering and mathematics (STEM) community by engaging educators and individuals within and outside formal educational settings to popularize STEM education and make technical careers more accessible.

## **Pillar III: Innovation policy processes**

24. The underlying analysis that should inform effective innovation policy design is limited and not sufficiently based on evidence. Specific recommendations include the following: Integrate innovation foresight practices into the policymaking processes of relevant ministries to capture future trends in and perspectives on research activities for incorporation in the long-term strategic direction of innovation development. Review the

legal frameworks for preparing policy to ensure that they are clear, flexible, appropriate for the purpose and consistently used. Build on regulatory impact analysis efforts to enhance the quality of policy preparation and its evidence base, ensuring that efforts add value, not administrative burden, and become sustainable.

25. Multi-stakeholder scrutiny of government work and participation in innovation policy design is not systematically ensured. Specific recommendations include the following: Develop or enhance approaches to public-private consultations by relevant line ministries on policy design and implementation, as part of the regular policy cycle and decision-making processes. Strengthen inter-ministerial consultation processes, ensuring that all relevant government bodies take part in the policy design process and have enough time to comment.

26. Policy evaluation and impact assessments are of poor quality or not implemented at all. Specific recommendations include the following: Establish a culture of evaluating policies and promote the quality of policies, for instance through guidelines, capacity-building and ex-post review and control mechanisms. Adopt a more systemic linkage of monitoring and evaluation practices with policy design, including in government bodies responsible for science, technology and innovation policy.

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