Summary of the Expert Conference:

SMART STRATEGIES TO INCREASE PROSPERITY AND LIMIT BRAIN DRAIN IN CENTRAL EUROPE[1]

6 November 2018

STATE OF PLAY AND CHALLENGES

Citizens of new EU member states are increasingly leaving their countries to pursue better opportunities and reap the benefits of intra-EU mobility. In the immediate aftermath of accession to the European Union, *economic reasons were the main drivers of mobility*. Today, governments in *new member states need to develop a clear vision* about the reforms necessary to improve economic and social conditions and create incentives for their citizens to return and to stay. The danger is that, in the long-run, the benefits of intra-EU mobility for these countries will not be enough to compensate for a permanent 'brain drain'.

There is a common understanding that *limiting freedom of mobility is not a viable solution to the brain drain*, nor would it be optimal given the gains at both macroeconomic and individual levels generated by freedom of movement. Therefore, the focus should be on reversing the negative effects of the brain drain by strategically strengthening these countries' overall prosperity.

Another challenge that Central Eastern European (CEE) countries will have to face arises from economic development itself and economic convergence towards the EU average. Differences in *GDP and wages relative to the EU* were *main push factors*

[1] This summary draws extensively on the discussion of the prosperity index report: The Central and Eastern Europe Prosperity Report: Smart strategies to further improve economic and social wellbeing.

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for national reforms after accession. Many nations rapidly and successfully integrated their industries into the wider industrial hinterlands of Germany, Austria and the rest of the European Union. However, with wage and GDP differentials shrinking, the production model based on low labour cost – which underpinned economic convergence in the first place – is now coming to an end. Questions arise about how the region can reinvent and diversify its production model and where the financing needed to build this future will come from.

To foster further prosperity, CEE countries must look beyond existing partners and technologies to either integrate or invent, or best of all, both. As CEE countries enter a new phase, with challenges that are very different from before, they need to start thinking of themselves differently: as players on a bigger, global stage who compete for higher value added businesses, skilled talent and smart capital.

Based on the successful experience of the Baltic countries, there is little doubt that any significant change in this direction not only requires entrepreneurship and openness to innovation but also qualified human capital.

Unfortunately*, ongoing mistrust in governments, poor education* and the *lack of an enticing working and institutional environment* appear to be behind the ongoing desire of highly-skilled nationals from new member states to seek opportunities in other countries. Such dynamics tend to be self-reinforcing and can have a detrimental effect on long-term prosperity, which ultimately determines the attractiveness of a country to workers. Meeting expectations and creating new opportunities for young generations are key challenges if these countries wish to retain and welcome back highly-skilled citizens to build a prosperous future.

Furthermore, *long lasting structural issues* in these economies contribute to slowing down the pace of structural transformation. Small and micro enterprises – in both industry and agriculture – account for the largest share of employment across CEE countries. However, they tend to be inefficient in their modes of production and generate low-paid jobs; as a result, they account for a very small share of value in overall economic production. What is *lacking* is the *medium size segment of higher value added firms*, which would help provide well-paid jobs and offer professional careers.

RECOMMENDATIONS

What are the main priorities national policy makers should be focusing on? What can EU institutions do? What role can the private sector play? And to what extent is the mobility of people a challenge rather than an opportunity?

Development of human and social capital is critical for ensuring a successful structural transition from production- to innovation-driven economies. Another key factor is the increasing role of technology in the production process and the changes this brings to economies and labour market dynamics. Workers of tomorrow are likely to have to change job, and even career, several times in their lifetime and *must be able to periodically re-skill themselves*. Therefore, *education* should focus on *flexibility to respond to change*, to enhance citizens' readiness and capability to adapt to new situations. This applies not only to students, but also to people already in the workforce. Businesses in the region are realising that hiring the right talents may become increasingly costly and difficult. A shortage of people meeting the knowledge demands for the new ways of working and possessing the skills required can have a severe effect on future economic development and prosperity. It is therefore important to enforce the *culture of life-long training/education* and *re-skilling of the labour force*.

Quality education should *target key skills for the future*, such as *digital and soft skills* (e.g. teamwork, communication, time management). The priority should be access to quality education, where quality refers not only to content and facilities, but also to the way *teachers are trained*. Education programmes (both at primary and secondary level) should cover the role and functioning of the EU and its institutions, an aspect that is currently missing in all countries of the region. But

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above all, education should have an element of *entrepreneurial training*. It is important to enhance people's understanding of business and how it adds value. If education remains confined to traditional theoretical courses, it will become progressively harder to keep pace with technological progress. Moreover, by including entrepreneurial education, *businesses* will have the chance to be active and *take responsibility for carrying out the structural transformation* necessary to improve working conditions and generate broader work satisfaction. Ideally, improved working conditions and more plentiful opportunities will help to reverse the brain drain by attracting workers to return home, particularly those who have acquired new skills whilst living in other countries. Entrepreneurial education would also have a key role in facilitating a cultural change necessary for the business environment, helping to establish the more vibrant medium-size business segment that is missing from these economies.

Digitalisation is becoming a pervasive feature of the economy and our lives. It is leading to dramatic changes in the way we work, produce and interact in the business environment and in private. Across the continent, entrepreneurs are starting up and rapidly growing businesses and these businesses are going to be the basis of Europe's future prosperity. These opportunities stretch well beyond pure technology, to encompass new ways of applying technology to existing challenges. Efforts in the digitalisation field should also be directed at *enhancing access to and use of the internet in rural areas*. Improved access to the internet can open new doors to people who live in remote areas and face prohibitive transportation costs. For instance, it could *unlock several education opportunities or facilitate remote working*. In many cases, such new business opportunities require little infrastructure beyond digitalisation and thus could provide a much wider range of opportunities for young people, potentially curtailing emigration or creating the right incentives to return home.

Digitalisation can also transform the way governments interact with citizens in the provision of public services and tax collection. The example of Estonia and how

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its *e-government developed* is instructive. Such evolutions can help to support long-term prosperity by: *facilitating bureaucratic procedures*, thus lowering cost and uncertainty, and increasing *trust between citizens and institutions.* Both aspects currently hamper the establishment of new businesses as well as how citizens perceive future living conditions in several of the CEE countries.

Functioning capital markets in the EU, and in CEE in particular, are not yet a reality. The exit of Britain from the EU will make this picture even worse. Developing capital markets would offer entrepreneurs another way to finance their projects, especially the riskiest, and create prosperity through more innovation and greater dynamism. It would also provide citizens with opportunities to participate in the success of local economies at a time of zero interest on deposits. The main challenge will be to create a capital market environment such that corporates and SMEs truly consider market financing as an alternative to bank credit.

Financial markets in CEE countries are completely bank-centric and dominated by foreign banks from EU-15 member states. Debt financing is not adapted to the needs of start-ups and fast growing enterprises, which need vibrant capital markets as they are more prone to risk-taking. In this respect, tangible measures could consist of designing programmes to prepare firms for IPO/bond issuances and providing incentives for transparency enhancing measures. These could help to develop a stronger capital market orientation and promote a culture of transparency. Higher levels of financial literacy will be key. Governments and EU institutions should foster financial literacy to support retail investors in acquiring the knowledge and the skills to manage their investments. Finally, more tailored solutions and a wider range of financing tools should be available to meet the market financing needs of both large and smaller companies.

The key question, however, is **who should take the next steps?** Neither EU policymakers nor entrepreneurs can address the major issues at stake alone, nor

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would simply raising the quality of education be a solution. *All three pillars*, the business community, educational systems and policymakers, *must work together*.

There needs to be a greater appreciation of the impediments to starting a business and of the need to foster risk-taking, both through policies (which can include curtailment of bureaucracy) as well as encouraging a culture of entrepreneurism. EU policy makers can only recommend policies related to education, as this is a national competence. However, on the one hand, EU institutions can design initiatives that encourage individuals to participate in education and training programmes, by, for instance, *widening the scope of Erasmus programmes*.[2] And, on the other hand, the business sector can foster the transformation process by *complementing traditional education with entrepreneurial education*, thereby equipping students with the set of new skills relevant for the future of labour: *digital, soft and flexible*. Finally, simply training teachers, or introducing new courses, would not address the issue if they are not thought through in a wider framework of institutional change.

In the framework of this **three-legged approach**, it would become easier for the relevant stakeholders to take responsibility for change, which is hard to achieve otherwise. What is required is a collective effort from **national** and **EU policymakers** as well as from **entrepreneurs** focusing on the **development of human and social capital**, **education and digitalisation.**

[2] A valuable example is the ErasmusPro program, which started as a pilot project targeting high-school students rather than undergraduates.

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