



SERBIA: EU for Better Business Environment

1st Thematic Forum:

Supply Chains Relocations – Post COVID Opportunities

SERBIA AS THE STRONGEST LINK¹

Background

The first Thematic Forum of the EU for Better Business Environment project was held online on November 23rd, 2021 on the topic of relocation of supply chains, with the participation of key business environment stakeholders from the Government, private sector, International Financial Institutions and donors. Thematic Forums are a platform for informal public private dialogue with the goal to enhance the business environment conditions in Serbia. This note presents a summary of the discussion from the first Forum, including conclusions and recommendations, prepared by the keynote speaker, Prof. Branko Radulović.

Summary of Key Trends and Issues

For small economies linking up with GVCs that account for nearly 80 percent of global trade could be greatly beneficial. Linking with GVCs promotes exports and integration into global trade without having to build expertise in all aspects of producing a good. In the long-run, participation in GVCs has a positive impact on income per capita, investment, and productivity. However, the gains from linking up with GVCs are neither given nor equally distributed. They may be one-off as countries do not consistently achieve more dynamic industrial development in the long term. Empirical studies show that countries need to improve human and physical capital, institutional quality, and trade logistics/connectivity to enhance integration. Hence, besides gravity factors that predominantly determine the distribution of economic activity (GVCs linkages), policies that improve absorption capacity,

¹ This document has been prepared by the keynote speaker Prof. Branko Radulović. It does not necessarily represent the views and opinions of the EU, the World Bank, or the Government of Serbia.



including dealing with the skills shortage, improvement of institutional quality, and logistic issues, play an essential role.

The COVID-19 pandemic exposed the fragility of a model distinguished by high fragmentation and interdependences between lead chain companies and suppliers located across several continents. The current pandemic affects production and transportation costs, making it challenging to resume sustainable business globally (e.g., South Asia – North Europe freight rates are 560% higher than October 2020). Trade fell more steeply in sectors characterized by complex value-chain linkages (e.g., electronics and automotive products). The effect is widespread as most companies report supply chain disruptions, downsize production capacities, or even temporary or permanent shut down of their production activities. However, even before pandemic trade and VGC growth have slowed due to the decline in overall economic growth, especially investment.

Serbia is a typical small emerging economy that relies on export-led growth. Concerning integration into GVCs, Serbia is currently economy with intensive “backward” linkages (substantial foreign value-added) and some “forward linkages” (the domestic value-added is embodied in intermediate exports that are further re-exported to third countries). It took almost two decades for Serbia to move from an economy mostly in commodities to limited manufacturing GVCs alongside commodities (WB WDR 2020). Thanks to FDI, the structure of exports is changing toward medium and high technology.

Serbia can strengthen its GVCs linkages by facilitating domestic firms’ entry through local suppliers’ integration or attracting foreign investors via greenfield or brownfield FDI. So far, Serbia has mainly focused on the second option via subsidies. FDI and VGC links in Serbia had a substantial positive effect on suppliers or firms located in the same industry. These firms enjoy higher productivity from technology transfer, higher quality standards, or higher competition. However, adverse effects on productivity of domestic firms sourcing from industries with a large share of FDI firms may have their productivity levels reduced, presumably due to mark-ups. These results suggest that Serbia may rethink enhancing absorptive capacity and VGC linkages.

Despite a robust economic recovery in 2021 supported by the authorities’ substantial policy response, pandemic substantially changed the landscape for Serbian companies - prices of critical inputs, including electricity, are increasing, companies in several sectors are faced with supply chain disruptions and delays or lack of qualified workers especially in smaller cities and local-self-governments. Namely, the labour market is getting increasingly tight, making the issue of required skills essential.

There is a lack of awareness of Serbian companies to become suppliers to GVCs. Several successful initiatives, such as supplier development program to establish linkages with foreign companies implemented by the World Bank project in cooperation with the Regional Development Agency, or initiatives by German and Italian Chamber of Commerce including training programs. Still, companies generally lack knowledge and interest of becoming a supplier.

The clearance process (i.e., speed, simplicity, and predictability of formalities) by border control agencies, including customs and competence and quality of logistics services (e.g., transport operators, customs brokers), is not adequate. While Serbia has substantially improved the quality of trade and transport-related infrastructure, it is still ranked 65th among countries based on the World Bank Logistic Performance Index.

Nevertheless, due to nearshoring trends, the current and especially the future post-COVID environment represents an opportunity for Serbian companies to link with GVCs. Companies from major trade partners are looking to nearshore with competitive prices, lower transportation costs,



and shortened delivery to make their supply chains more resilient, simultaneously meeting quality requirements. The nearshoring potential is mainly present in areas where Serbia has revealed comparative advantage (manufactured goods, especially metal, wood and plastic processing, textiles, food processing, IT sector, and business services).

Summary of conclusions and recommendations

Serbia can address issues in several diverse policy areas that affect the successful integration into GVCs. They include, among others, logistics and trade facilitation, improved awareness and conformity to international standards, labour market integration, and the broader business environment policy measures.

The following feasible short- and medium-term actions are recommended for support:

- Several policy measures could address Serbian companies' lack of awareness and capacities. Measures such as export readiness and coaching programs and supply-side capacity building (certification, standardisation, procurement requirements) could improve the absorption capacity of Serbian companies. For example, the state may provide additional financial assistance or incentives, as high prices of such services weaken companies' incentives to obtain certificates required to participate in GVCs.
- Serbia may benefit from increased labour mobility, becoming a regional hub for GVCs. Following the Open Balkan Initiative, procedures related to the work permits should be streamlined, resulting in the free movement of labour. Easier access to labour would enable employment opportunities across the region and help resolve the lack of adequate workforce attracting the regional talents.
- Improved databases or regional platforms could help match foreign companies with domestic suppliers. Measures that would improve data availability on potential products/suppliers available on the market could help some of these companies integrate into GVCs. One potential exercise is to match the needs of companies interested in nearshoring with the offering of Serbian companies by pairing Serbian suppliers or companies with potential foreign counterparts who are either buyers of products and services or potential acquirers.
- Well-run communities that invest in crisis prevention and response and pursue evidence-based public policy will be better able to weather crises and mitigate negative economic impacts. In that respect, Serbia should continue pursuing reforms that enable evidence-based policies and improve transparency in policymaking. Review of transport, logistics, and customs clearance regulations should remove existing impediments. Further simplifying these procedures should reduce time spent at customs, reduce transportation, loading, and unloading costs, reduce delays, and make nearshoring in Serbia a more attractive option.
- Lawmakers, regulators, and corporate stakeholders demand increased corporate responsibility across supply chains. Calls for "sovereign" or "national" supply chains and rethinking domestic companies' approaches to international outsourcing of production are becoming louder. For example, the German Supply Chain Due Diligence Act imposed several conditionalities related to sustainable production, human rights, etc. Hence, Serbian companies (both existing and potential GVC suppliers) should start thinking and adjusting to the new environment and implementing required standards to secure continued cooperation with their business partners.