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Outlook on Serbia 2018

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Serbia's growing potential as an FDI destination • Serbian Manufacturing: Steady, solid growth
Serbian Automotive: A most attractive industry for investors • Serbian talent to the fore

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Everything you always wanted to know about Serbia is in our outlook

Serbia's growing potential as an FDI destination

Overlooked for some time in favour of its neighbours who can already boast EU membership, Serbia's star as an FDI location is rising. Yoan Stanev looks at the factors driving foreign investment.

Yoan Stanev

Serbia is establishing itself as a market attracting an increasing number of foreign direct investments (FDI). According to data from the National Bank of Serbia, the gross inflow of FDI has been rising since 2014, and 2017 has seen a peak of 2.5 billion euros in FDI – an increase from just under 2.1 billion euros in 2016. The Minister of Economy Goran Knežević stated that the increase in investment is the result of the country's improved business climate. Despite not being a member of the EU and being on the receiving end of external political pressure to resolve its dispute with the authorities over the border in Priština, as well as additional pressure to orientate its foreign policy interests towards either the EU or the Kremlin, Serbia experienced a GDP growth rate of 1.87 per cent in 2017, according to World Bank data.

The German-Serbian Chamber of Commerce (AHK Serbia) belongs to the network of German foreign trade and industrial chambers with 130 offices in 90 countries. *Emerging Europe* spoke to Martin Knapp, Executive Member of the Board of Directors of AHK Serbia. He praised the Serbian leadership, stating it "made a clear commitment to the country's accession to the EU and is working consistently towards this goal," therefore supporting the mission of AHK in maintaining strong business relations between Germany and Serbia. Serbia's willingness to convergence with EU norms was echoed by Rastko Petaković, a senior partner specialising in M&A, competition law and business regulation at the Karanović & Nikolić law firm that advises investors. Mr. Petaković stated: "On its path towards the EU, [Serbia] is implementing policies and regulations aimed at closer aligning its framework to that of the EU. With low inflation rates, stable GDP growth, and low business costs, it is full of opportunities for foreign investors considering market entry."

Corruption

It is no surprise that corruption is an issue that affects the entire Balkan peninsula and is a factor that hinders further FDI in the region. The EU's Western Balkan Strategy published in February 2018 recognises corruption as a problem that continues to hinder the strengthening of the rule of law, and the region's path towards EU accession. The problem of corruption is not unique to Serbia, as echoed by the organisations *Emerging Europe* spoke to. Mr. Petaković emphasised that there are no "Serbia-specific legal or bureaucratic hurdles and corruption." He added that the state seeks to make the climate more competitive for investment by reducing regulatory barriers and pointed towards the World Bank's *Doing business* survey as evidence of this. The survey places Serbia 43rd out of 190 countries for Ease of Doing Business. Nonetheless, more corruption-related barriers still need to be overcome: the EU strategy states that "the negotiating frameworks for Montenegro and for Serbia [for their EU accession] place particular emphasis on the need for rule of law reforms to be addressed early in the negotiations" and that the EU ought to make greater use of the leverage it has in the accession process.

A general presumption of corruption

Martin Knapp points out that, although corruption is often mentioned in relation to South-eastern Europe, concrete examples are hardly ever given, making it much harder to understand the problem. He, too, emphasises that the problem of corruption is not unique to the Balkans: "There is also something like a 'general presumption of corruption'. Many people in south eastern Europe imagine that almost everyone but themselves is corrupt," he adds. This has undoubtedly hindered the effectives of the state administration and bureaucracy, as "civil servants frequently don't have the courage to openly support an investment proposal, even if they believe that it would be good for the country."

TMF Services, an Amsterdam-based multinational professional services firm that provides accounting, tax, HR and payroll services to businesses operating on an international scale, has stated that Serbia has made the process of starting a business significantly easier. Thanks to government reforms, it takes less than 12 days to form a new corporate entity. However, bureaucracy remains an issue: TMF state that "trading across borders is both a costly and bureaucratic process, taking almost two weeks to both import and export goods. It costs 1,455 US dollars to export containers and requires seven documents to be prepared, in contrast to 1,660 US dollars to import and seven documents."

At a conference in Perth, Australia, earlier this year, Andrew Latham, head of Rio Tinto Ventures - an Anglo-Australian multinational metals and mining corporation - praised the Serbian investment climate.

He stated that Serbia offers "a strong combination of attractive investment characteristics", due to the established democratic process supportive of foreign investment. Regarding the mining industry, "Serbia is a very favourable place to be," he adds. "The country offers a skilled and productive labour force and costs remain competitive." Road and rail infrastructure is widespread, but will need upgrading to meet the needs of Rio Tinto's mining project in Jadar – a unique deposit near the town of Loznica. It contains jadarite – a new lithium sodium borosilicate mineral and Jadar is the only place in the world where this mineral can be found.

EU prospects

Serbia's EU prospects are undoubtedly a factor contributing to foreign business interests in the country. EU membership will offer Serbia the world's largest market and is already the destination for two thirds of Serbian exports. Andrew Latham adds that the EU is also expected to be "the second largest market worldwide for electric vehicles and we are seeing increasing interest from European auto makers to gain a secure feed of battery materials." Mr. Petaković of Karanović & Nikolić recognises Serbia's candidate status as an advantage over EU members in the region, namely Slovenia and Croatia. He states that Serbia is exempted "from what investors see as the strictness of EU laws, yet it affords them a sufficient measure of legal security to invest in this market."

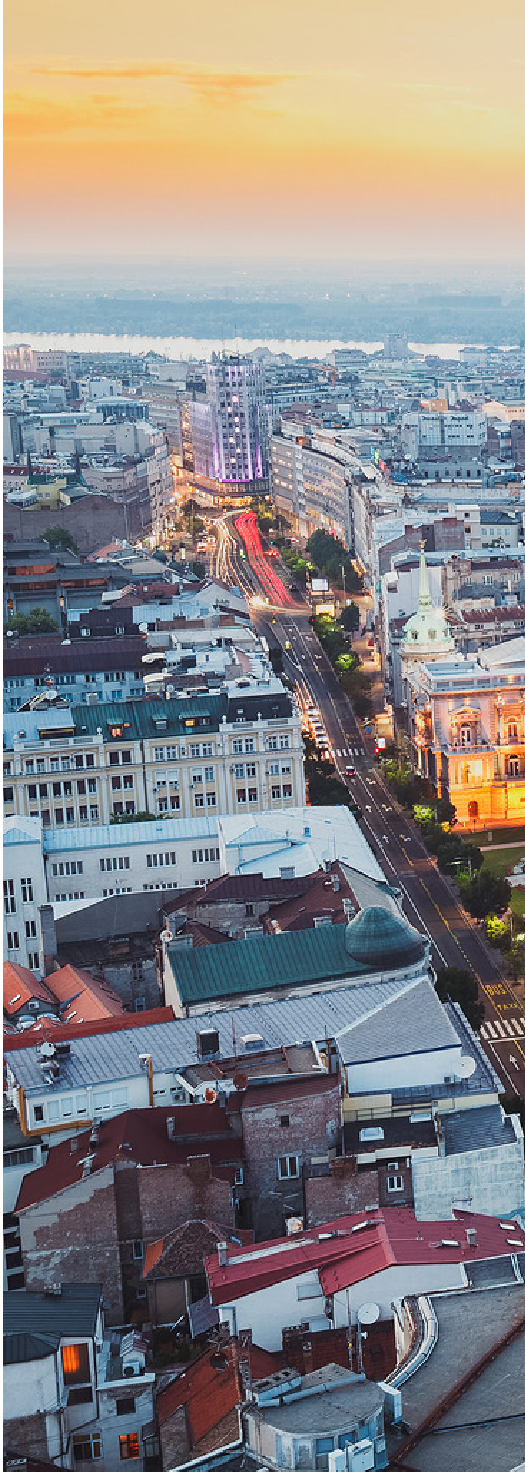
However, brain drain is an ongoing problem affecting all of emerging Europe, and Serbia is no exception. EU membership may affect foreign businesses' access to talent in Serbia, as an increasing number of young and qualified professionals will seek employment in EU member states with a higher standard of living. When asked about the issues surrounding businesses' access to talent, Mr. Knapp of AKH Serbia emphasised their commitment to dual vocational training – a system used in Europe's German-speaking countries which combines apprenticeships in a company and vocational education at a vocational school in one course. "The Serbian Government has understood how important this issue is. Since November, we have a law introducing dual vocational training", adds Mr. Knapp. "Such things as the Vocational Training Act show in particular, how consistently the government is working to improve the environment for local and foreign investors." And it seems this law will contribute to the already promising situation of Serbian talent: "There is an abundance of talent in Serbia, and this is evidenced in the recent investments in R&D facilities by some of the largest multinationals, such as Microsoft and Continental," says Mr. Petaković. The investments in staff training that companies in Serbia have made, especially tech-heaving businesses, has delivered high returns in terms of innovation and productivity.

Despite positive trends in FDI in Serbia, the country still has undoubtedly a lot to do. There are concerns regarding the rule of law and state bureaucracy affecting the potential of Serbia's economic growth. The issue of Kosovo may not be of direct interest to many investors, especially those who have praised Serbia's business climate, but should Belgrade and Priština reach a workable agreement, the former will be one giant step closer to EU membership, which will increase the country's market potential even more, and thus attract more businesses. ▲

Serbia's economy looks positive, but problems remain

Stephen Ndegwa, the World Bank's country manager for Serbia, and Peter Tabak, lead regional economist at the European Bank for Reconstruction and Development (EBRD) spoke to Andrew Wrobel, about the challenges the Serbian economy is facing and the opportunities it offers.

Andrew Wrobel



After enjoying positive yet modest growth of 1.9 per cent in 2017, the Serbian economy is expected to increase by 3.4 per cent in 2018 and by 3.2 per cent in 2019. According to Focus Economics, data for Q2 2018 shows a solid economic performance with the domestic economy expected to be the main engine of growth this year and next. This on the back of declining unemployment, rising wages and sizeable FDI inflows.

Multiple challenges, however, remain.

"The first quarter of this year was exceptionally strong, with 4.6 per cent growth, driven mainly by strong investment growth, but it remains to be seen if the performance can be repeated throughout the rest of the year," says the EBRD's Peter Tabak. "Medium-term growth prospects depend on the implementation of structural reforms. An acceleration of medium-term growth would need further business environment reforms and restructuring or privatisation of poorly performing state-owned enterprises, as well as further non-performing loans (NPL) resolution and progress with corporate over-indebtedness."

Working on efficiency

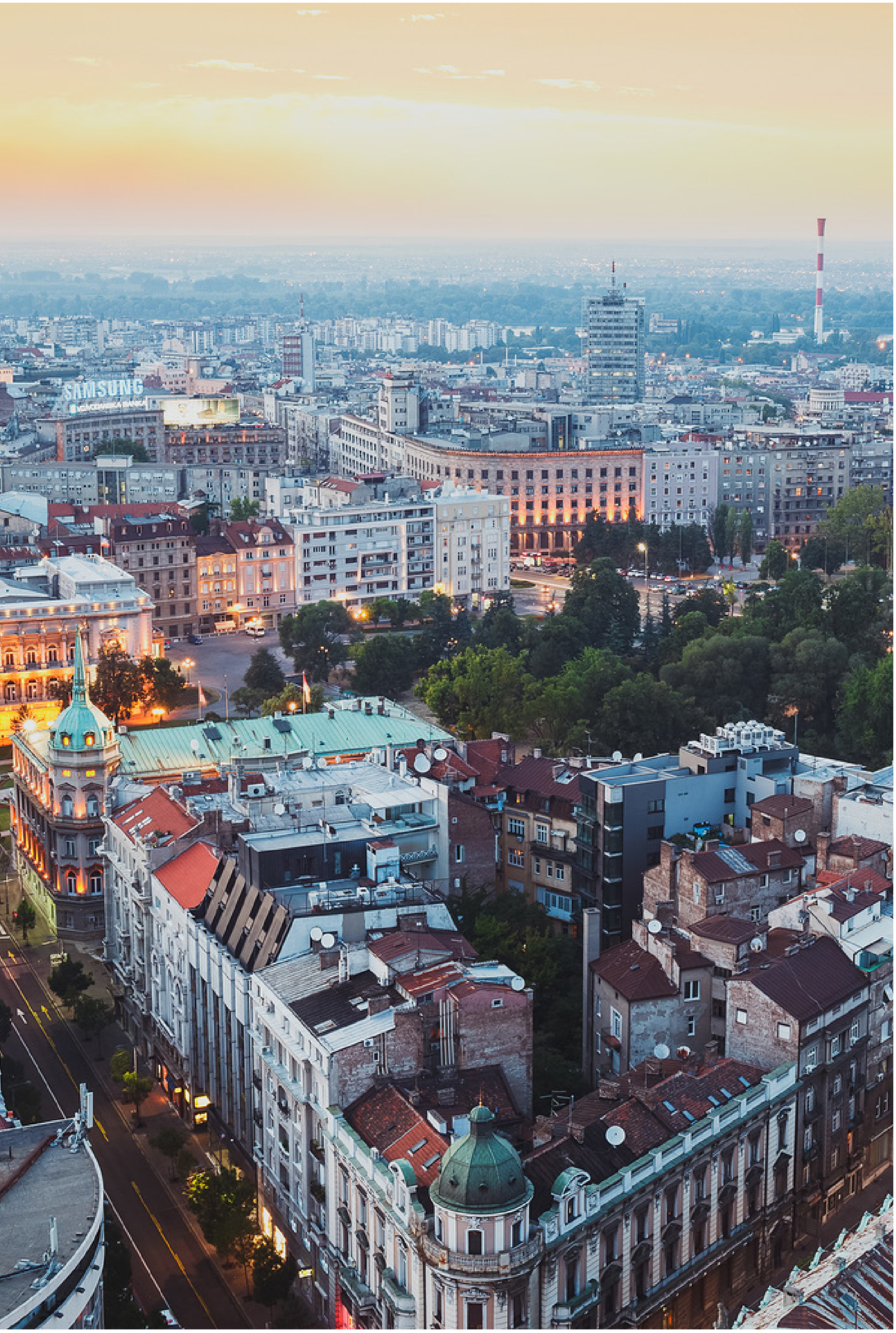
The World Bank's Stephen Ndegwa agrees that regaining the momentum in resolving inefficient and costly state-owned enterprises (SOEs) is key.

"Despite progress in recent years, SOEs retain an important role, and impose significant cost," he says. "They employ over 200,000 people and are the largest companies in many sectors of the economy, for example, in energy, mining, rail and road transport, insurance, telecommunications, construction, etc. The outsized presence of SOEs deters private investment, innovation and competitiveness. Furthermore, SOEs pose substantial fiscal risks. Although we have seen recent decline, expenditures supporting SOEs are large."

Over the past three years the government has spent more than two billion euros on propping up the SOEs — this includes direct subsidies, soft loans and payment of activated guarantees on loans.

"The partnership between Serbia and the World Bank has been good for quite some time. Working together we made strides in reforming many areas, which ultimately helped macroeconomic stabilisation. Some of the reforms were politically and socially very challenging, for example, in an excellent cooperation with Serbian authorities and with our financial support a good part of the SOE legacy was resolved, though some tough cookies – such as Petrohemija, MSK, RTB Bor, Resavica mines – still remain an issue impacting public finances," Mr Ndegwa adds.

"Reducing these expenditures would free up significant public resources for productive use, and resolving legacy SOEs, either through privatisation or bankruptcies, would open up important sectors of the



economy to more investment," he says.

The EBRD's Mr Tabak says that the private sector in Serbia accounts for around 70 per cent of total employment.

"While small-scale privatisations have mostly been completed, some large companies remain publicly owned and operate with low efficiency and high cost. Our analysis shows that Serbia's state-owned enterprises are among the least efficient and least profitable among their peers in central and south eastern Europe, barely breaking even on average. They might also receive explicit or implicit subsidies from public sources, for example, being allowed not to pay taxes or utility bills. Improving the efficiency of these enterprises or their privatisation could reduce strains on public finances and improve the quality of services. Last but not least, it would create a more level playing field where some public companies in the same sector do not get privileged treatment compared to other private ones," he adds.

Empowering the private sector

In the meantime, smaller companies in Serbia face a number of issues, including the challenging business environment, competition from the grey economy, high para-fiscal (i.e. non-tax) charges and access to finance, while medium-sized and large companies often lack appropriate corporate governance and are frequently over-indebted, which limits their access to finance and thus their investment capacity.

"While low wages make Serbia cost competitive in sectors such as manufacturing and construction, this is not desirable and sustainable in the long run. Serbia should invest more in education and training of its people – its most important asset. Long-term competitiveness also requires further

Peter Tabak. Photo: EBRD

improvement of the business environment, including a stronger focus on enhanced corporate governance in public and private enterprises, more efficient judicial processes, better quality public services, inclusive employment and education that better matches business needs. Our Investment Climate and Governance Initiative is aimed at tackling many of these issues, including governance in state-owned enterprises and public procurement practices," Mr Tabak tells *Emerging Europe*.

The EBRD's lead regional economist believes that although there are some foreign and locally-owned companies that operate as efficiently as those in western Europe, the majority of Serbian companies are significantly less productive, with value added per employee five times lower than the EU average.

"Our latest diagnostic paper shows that more inclusive labour practices (for example involving more young people at an early stage through training and internship programmes) and better governance (both in the public and private sectors) would support productivity the most. Higher-quality infrastructure, improved energy efficiency and a more stable macroeconomic environment would also be important contributors," he says.

Corruption still a big issue

Serbia's EU prospects are undoIn the World Bank's Doing Business Report 2018, Serbia ranked 43rd, four notches higher than in 2017. When we look at individual elements it seems that starting a business is relatively easy. Getting electricity, paying taxes, protecting minority inversions and enforcing contracts are still problematic.

"In terms of the business environment, Serbia has made excellent progress in some areas over the past few years," Mr Ndegwa says. "However, surveys suggest that rule of law remains a key issue. For instance, according to the World Bank Doing Business survey, on the indicator related to Enforcing Contracts, the distance to frontier is 61.4 per cent, well below the regional average. It takes 635 days to enforce a contract in Serbia, and the cost reaches 41 per cent of the claim value. Similarly, the World Justice Report's Rule of Law Index shows Serbia as a negative outlier in the region, with especially weak rankings for 'Constraints on Government Powers', 'Absence of Corruption' and 'Criminal Justice'. It is often the SMEs that struggle most with cumbersome and expensive court and administrative procedures and addressing these should now be top priorities for growth to flourish," he adds.

According to Transparency International's Corruption Perception Index, Serbia is ranked 77th among 180 countries worldwide.

"Among Serbia's Western Balkans peers only Montenegro is rated higher," Mr Tabak says. "However, there is no room for complacency: in the past two years Serbia has dropped six places and it remains the only Western Balkans country on the Financial Action Task Force black list — high risk and other monitored jurisdictions — identified as having strategic deficiencies related to anti-money laundering and combating the financing of terrorism," he adds.

Mr Ndegwa notices another challenge — despite neighbouring the European Union, the country is not fully benefiting from its location.

"Serbia has a fairly well-educated labour force and is competitive in terms of costs. However, despite these advantages, until recently its exports underperformed," he says. "In other successful middle-income economies exports were driving economic activity. Happily, recently, we are seeing a similar trend in Serbia's economy, as exports in some segments of the economy are growing strongly. We observe this across the sectors, and it is two groups of companies that are at the forefront of this trend – companies established through green-field foreign direct investment (FDI) and domestic de-novo SMEs. This presents a tremendous opportunity that the government can further strengthen by enhancing stability and predictability of the business environment."

The role of FDI

According to the UNCTAD World Investment Report, in 2017, Serbia attracted FDI worth 2.87 billion US dollars, 22 per cent more than in 2016.

"Over the last several years Serbia has been very successful in attracting foreign direct investment (FDI). It is among the top ranked countries in Europe in terms of FDI jobs created per capita. Yet companies established through FDI are almost fully reliant on foreign suppliers. There seems to be significant untapped opportunities in linking local SMEs to FDI companies through targeted SME upgrading programs, so that foreign investors use more local inputs beside labour," Mr Ndegwa says.

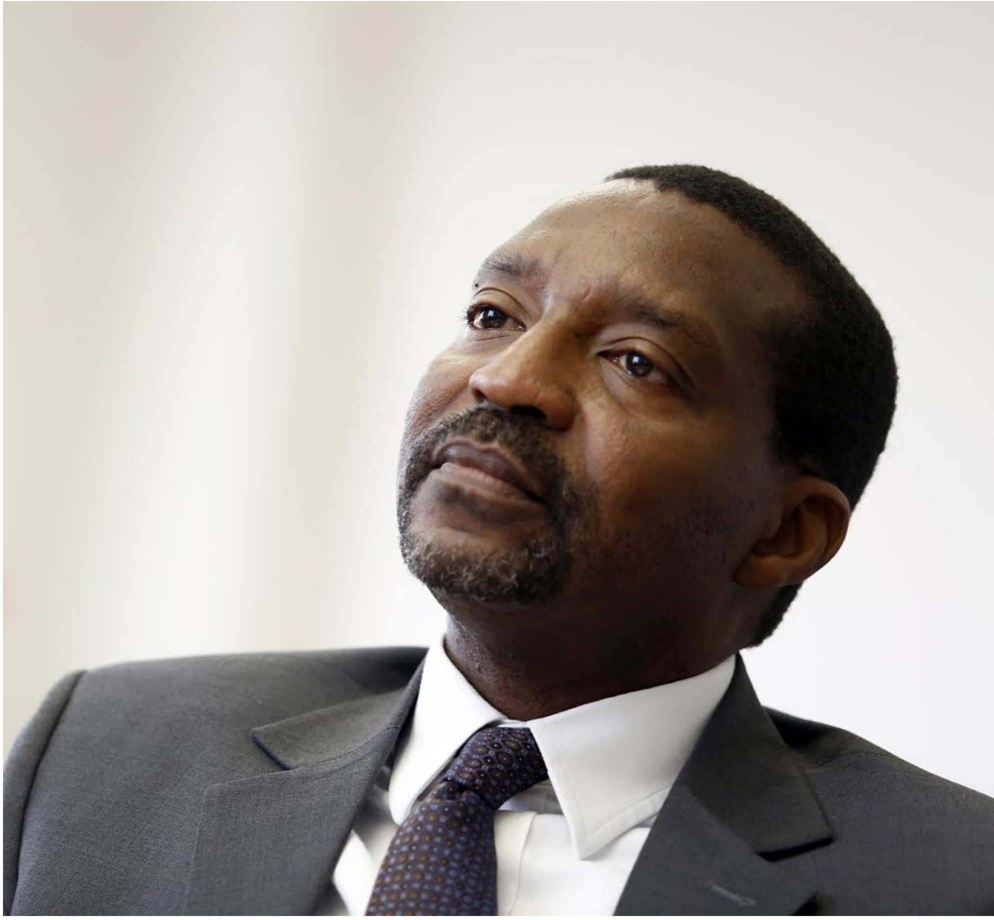
He believes there are important opportunities in the ecosystem of innovative entrepreneurs, including in IT, digital and creative industries. "This sector is growing strongly, but the momentum could be lost due to constrained supply of IT, managerial, and creative skills; and lack of financing for innovative early-stage and growth-stage enterprises," Mr Ndegwa adds.

He feels that the EU accession process can help enhance the efficiency of the public sector in many ways: improving the legal and regulatory environment through the gradual adoption of EU regulations, strong incentives for further reforms, raising the attractiveness of Serbia as an investment destination and the opening of EU markets for Serbian exporters.

The World Bank is supporting Serbia in creating a competitive and inclusive market economy and, through this, to achieve integration into the EU.

"We have been engaged in supporting the government's ambitious reform programme for several years now and through a series of budget support loans have helped tackle one of the highest country's priorities: state-owned enterprise reform, public utilities in the transport sector and electric power, and reform of public expenditures. Our 1.8 billion US dollar portfolio of 13 projects addresses a range of different needs in areas of transport, real estate management, health, early childhood education, business environment, competitiveness, financial sector, and job creation, and disaster risk management and insurance," Mr Ndegwa says.

Stephen Ndegwa. Photo: World Bank



A light at the end of the tunnel?

The EBRD's current portfolio of projects in Serbia is worth 2.2 billion euros. Since the beginning of its involvement, the bank has been engaged in 220 projects worth over 4.8 billion euros. In March, the EBRD published a new strategy for Serbia.

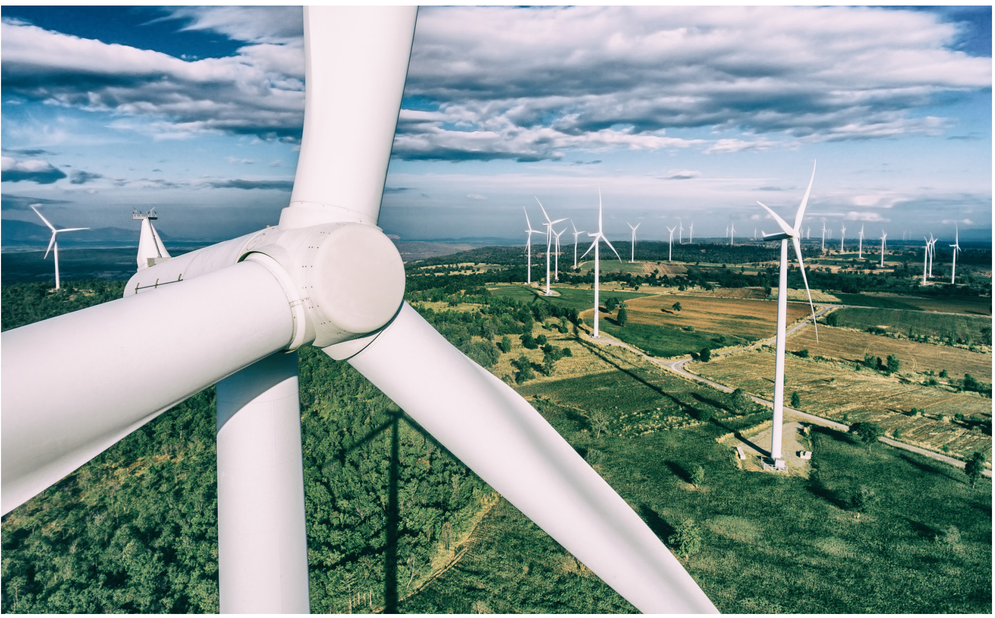
"The EBRD country strategy for Serbia identifies priority areas where the EBRD aims to provide crucial support with its investments and engagement: private sector, financial sector and public utilities in infrastructure and energy. We have concluded several projects and have more in the pipeline and we will aim to deliver as much as possible in the coming months," Mr Tabak says.

"Serbia continues to be politically stable, focused on making progress on its path to EU accession path, and bold when strong reforms must be made. I believe this is something that helps attract investment. In the coming years, Serbia has the opportunity to be even more ambitious in its goals, bolder in its reforms, and transform into one of the most competitive economies in the region as it prepares to enter the EU," he adds. ▲

Serbian energy: A windy attempt to reach a renewables target

Serbia needs to do much more in order for its energy market to reach the standards required by the European Union. Better use of renewables is just the beginning.

Yoan Stanev



Mostly reliant on domestic production for its energy needs, Serbia generates 70 per cent of its electricity from coal, with the remaining 30 per cent being provided mainly by hydropower. The national power utility EPS (Elektroprivreda Srbije – Power Industry of Serbia) dominates the country's electricity market – it owns all the large generation capacities and supplies most consumers – 95 per cent of all electricity is supplied by EPS.

In its Secretariat's Implementation Report for 2017, the Energy Community, an international organisation which brings together the European Union and its neighbours to create an integrated pan-European energy market, states: "Serbia is generally doing well in transposing the Energy Community acquis, but with modest progress during this reporting period. The Energy Law and the adopted secondary legislation constitute a largely compliant legal framework." Yet, the report highlights that implementation is lagging behind, in particular with regard to the unbundling of the transmission system operators, EMS (state-owned Elektromreža Srbije; Electricity Network of Serbia) in electricity and Yugorosgas Transport and Srbijagas in natural gas, which has led to an increase in infringement cases. Furthermore, the report adds that Serbia must also facilitate the implementation of agreements it has signed with Kosovo.

Wind them up

Despite Serbia's dependence on coal, the country is seeking to boost its renewable energy production, the bulk of which comes from wind power. According to Euractiv Serbia, 2018 will be a crucial year for the country's energy sector as 250 megawatts from renewable sources are to be connected to the grid, followed by the same amount in 2019. As of May 2018, wind power construction has been revitalised. In its energy strategy implementation plan, Serbia has committed to bring online more than 500 MW of wind power by the end of 2020.

The Čibuk wind farm is the largest not only in Serbia, but in the entire Western Balkans to date: it is a 300-million-euro project of 57 wind turbines supplied by General Electric and will cover an area of about 40 km^2. The windfarm has a capacity of 158 MW and is expected to provide electricity to around 113,000 homes, while reducing CO_2 emissions by more than 370,000 tonnes. Čibuk is developed by a consortium that includes UAE-based renewable energy company Masdar, Finnish financial group Taaleri and German development finance institution DEG, part of KfW Group. The development of the wind farm will be funded by a 215 million-euro loan provided by the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC).

KfW, a German government-owned development bank, and the European Investment Bank (EIB) initiated the Green for Growth Fund (GGF) in 2009, which is providing direct financial support for Čibuk. GGF's website states that the Fund's mission is, in the form of a public private partnership, "to contribute to enhancing energy efficiency and fostering renewable energies in South-eastern Europe." GFF has since increased the total financing it has provided to final borrowers to over 600 million euros across more than 25,000 individual projects.

Mohamed Al Ramahi, CEO of Masdar, added: "At Masdar, we are proud to be able to contribute our expertise and experience to the diversification of Serbia's energy mix, working alongside our joint-venture partners. This project highlights the attractiveness of the Serbian market for renewable energy investment and has the potential to be a hub for additional projects in the region."

The EBRD is providing a loan of 107.7 million euros, 55 million euros of which is syndicated to Erste Bank, GGF, UniCredit and Banca Intesa under an A/B loan structure. In parallel, the World Bank's IFC is providing 107.7 million euros, partially through its Managed Co-Lending Portfolio Programme and partially through syndicated B loans.

Harry Boyd-Carpenter, EBRD director of power and energy utilities, stated: "The Čibuk wind farm is a breakthrough for Serbia as the country works to meet its commitment to produce 27 per cent of domestic power needs from renewable energy sources by 2020. The EBRD has worked closely with the government to develop and refine the regulatory framework for the sector and these efforts have now unlocked job-generating foreign investment and the first wave of renewable-energy projects."

Achievable targets

When it comes to renewable energ-GFF is also providing direct financial support for the Alibunar wind farm, as well as indirect support for the Malibunar wind farm, to assist the country in achieving the 27 per cent target. The Malibunar wind farm is the first project to be commissioned under the GGF framework. It has been operational since September 2017 and it is an 8 MW project comprised of four wind turbines. The larger 42 MW Alibunar wind farm is made up of 21 turbines and is in the final stages of construction. Earlier this year in April, German wind turbine manufacturer Senvion completed the installation of the 14th turbine at Alibunar and the wind farm is expected to produce enough energy to power around 27,600 households on average per year. Senvion entered the Serbian market with the installation of Malibunar wind farm in 2017. Belgian renewable energy producer Elicio NV, the developer of the Alibunar and Malibunar wind farm projects, has been present in Serbia since 2010, when the legal framework for the renewable energy sector was established.

The Košava wind farm is yet another renewable energy project in Serbia. Serbian renewable energy company MK Fintel Wind, a joint venture between MK Group and the Italian Fintel Energia Group, started the construction of the wind farm back in June 2017 near the town of Vršac, near the border with Romania. It is estimated to be completed by the end of 2018 and cost a total of 124 million euros. In addition, Danish wind turbine producer Vestas is to deliver 20 turbines for the 69 MW wind farm, which is expected to supply electricity to approximately 40,000 households.

Only the first half of 2018 has passed, yet Serbia has already seen increasing interest in its wind energy potential. Coal production may continue to be a vital source of energy, but Serbia is taking steps to adapt its infrastructure towards renewable energy. And the government has been broadly supportive. How quickly Serbia is doing all this is a different question. In an article written for *Emerging Europe*, Sir Suma Chakrabarti, President of the EBRD, states: "Today, climate change is perhaps the number one global challenge" and that, "although green finance is on the increase, we, including emerging Europe and Serbia, must do more and quicker." ▲

Serbian Manufacturing: Steady, solid growth

Juliette Bretan

Serbia Serbia is continuing to grow its manufacturing capabilities, developing new strategies and opportunities in the sector, particularly through collaboration with other nations. Despite a decrease in manufacturing output, down to 168.7 billion Serbian Dinar in the first quarter of 2018 from 176.1 billion in the fourth quarter of 2017, year-on-year figures actually saw an increase of 1 per cent in April 2018 over the same month in 2017, and efforts are being made to improve output.

Concerns over worker inactivity remain high, though unemployment is decreasing and many international companies, particularly in the automotive industry, are committed to continuing production in Serbia. The editor of Macroeconomic Analysis and Trends (MAT) magazine, Ivan Nikolic, said earlier this year that the slow growth of manufacture in Serbia was offset by significant advances (of 21.6 per cent) in the production of the electric power industry, resulting in overall industrial production growth, following slow production last year. Serbia's strengths continue to lie in construction, with the central export being automobiles, though imports have been growing this year.

Germany First

Germany is the central foreign trader with Serbia, and German companies currently have plans to build two manufacturing facilities in the country. The German company ZF, which is an international leader in driveline, chassis and safety technology, will open a factory in the industrial region of Pancevo, employing 1000 people. Michael Hankel, a member of the ZF management board, said: "the demand for our electric motors and all-electric drives develops dynamically. Since vehicles with hybrid and all-electric drives are set to become more established in the future, we are adapting our worldwide production network to cope with the rise in demand."

Vorwerk Autotec will also construct a plant in Serbia, at Cacak. The German cable and harnessing manufacturer Leoni, which has already invested 75 million euros into Serbia, is set to open a fourth plant in the country, as well as a production unit in Nis with a workforce of 1250 employees, making it the largest employer in the country.

The UK is set to see its third major investment in Serbia with the creation of a new factory in Ruma by engine components maker Albon. French car parts constructor Le Belier opened a new aluminium casting unit in Kikinda, northern Serbia, in June, investing 7.5 million euros into the project. Their new factory will join its already-existing plant in Kikinda, which has been operating since 2003. Meanwhile, Italian firm Plastikcam East has opened a factory for thermoplastic processing in Subotica, following an investment of 3 million euros in the development.

The June 2018 Conference on The Industry 4.0 Model for Advanced Manufacturing in Belgrade involved leading world experts who discussed innovative manufacturing techniques whilst acknowledging limitations, promoting cyber technology advancement in the region.

Indeed, the IT and engineering sector in Serbia is reporting constant growth, which suggests it to be a promising area of manufacture. Around 50,000 people are employed in the field of IT in Serbia, with the average salary at 1,433 euros, with information suggesting the industry is exceeding corn export rates. Reports show employees use half of resources opposed to the average in all industries, though generate six times higher profit. Canada is deeply involved with the Serbian IT industry, as well as with agriculture, agri-food, pharmaceuticals and light manufacture. IT and technological development is bolstered by its inclusion in university curriculums, particular in Novi Sad, which is aiming to become the IT hub for the entire Western Balkans. The Ministry of Education, Science and Technological Development has also promoted technical and technological programs, encouraging industry growth.

The Arab Connection

Serbian-Arabic collaboration continues to be steady, with military arms and chip manufacturing being exported,

and agricultural and banking investment coming into Serbia. Air Serbia, however, is facing difficulties following Etihad Airways acquisition of 49 per cent of its shares in 2014: Etihad is considering cancelling the purchase of new aircaft, or potentially altering orders for up to 160 aircraft ordered in 2013. Boeing and Airbus are preparing for disruption as Etihad works to promote sustainable operations following recent financial difficulties. Air Serbia is continuing to perform successfully, though there are suggestions that Etihad may leave the partnership.

In May, Belgrade hosted the 62nd Fair of Technology and Technical Achievement which promoted new technologies and developments, showcasing 600 exhibitors from over 30 nations. Minister without portfolio in charge of innovations Nenad Popović suggested the number of exhibitors demonstrates a growing importance of industry in Serbia, as "technological development based on innovative capacities is beginning to spark positive changes in Serbia's economy." Mr Popović also remarked that the technological capacities of Serbia's industrial sector are advancing, along with improved digitization to strengthen manufacture, in order to move Serbia closer to the Industry 4.0 idea.

Renewables

Serbia is also focusing on increasing its renewable energy output, with plans to generate 27 per cent of its energy consumption from renewables by 2020. The country currently uses coal for 70 per cent of its energy, though The Green for Growth Fund, promoting energy efficiency in Eastern and Southern Europe, the Middle East and North Africa, said in June that it would provide 32 million euros financing for the first large-scale wind farms in the nation, to kick-start renewable development. The farms are to be constructed 50 kilometres north-east of Belgrade, and funding of 215 million euros has already been promised from The European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC). Construction of the 57 turbines is a joint enterprise between Abu Dhabi-based renewable-energy developer Masdar, and US-based wind energy developer Cibuk Wind Holding. The farm will have capacity to supply 113,000 households. Green for Growth Fund chairman Christopher Knowles said: "We are proud to support the growth of the renewable energy sector in Serbia at its inception."

Serbian state-run copper mining and smelting company RTB Bor said the company's copper concentrate output expanded by 20 per cent to 4,336 tonnes in May 2018, which is the largest monthly production figure in the last 20 years. It also explained it had increased the production of copper ore by 32 per cent every year to 3.67 million tonnes in May.

It has also been reported that Serbia's cement industry could play a vital role in environmental protection, with co-processing methods encouraged to seek safer and more controlled strategies. Waste management currently remains poor in the nation, though efforts are being made to collaborate between institutions to attain a national system.

Serbia has also recently begun drafting a new industrial policy to close Chapter 20 of pre-accession negotiations with the EU, and is promoting collaboration with universities and scientific institutes to remain a key player in the industrial market. ▲

Serbia's growing ICT scene

Serbia has become an ICT powerhouse. Both state and private business are playing their part in driving this success.

Shakhil Shah

Milan Šolaja, CEO, Vojvodina ICT Cluster (VOICT), writes in the forward of the report ICT *in Serbia – At a Glance 2018*: "You journalists should pay more attention to what is going on. Everyone is writing about the Serbian export of raspberries as a huge national success, and nobody knows that we export more software than raspberries." Mr Šolaja said this to a journalist at the DanubeIT Conference in Novi Sad early in 2011.

The ICT sector in Serbia is constantly growing and has recently seen double digit growth, and in 2017 Serbia's ICT exports reached 900 million euros (21.5 per cent more than in 2016). The reason for Serbia's success in the ICT sector has to do with a strong push from the government as well as various initiatives by private companies and non-profit organisations.

In recent years the country has undergone a lot of development when it comes to IT and digitisation. According to the Serbian Prime Minister Ana Brnabić, Serbia could become a leader when in e-services. "The government is on the right track on this issue," she says. "When it comes to e-government, the first thing that had to be done was to transfer birth, death, marriage and citizenship registers into electronic format."

Serbia's greatest potential

At a press conference in April 2018, the Ms Brnabić announced that: "the IT sector represents Serbia's greatest potential, which in the first two months of this year recorded a 34 per cent increase."

In addition, Ms Brnabić outlined planned spending on IT for the next three years.

"Over 65 million euros shall be spent to develop IT infrastructure in Serbia, with 70 million euros being invested in projects which will enable all schools to be connected to high speed internet."

Ana Ilić, advisor to the prime minister for digital and creative industries, confirmed the government's plans and even welcomes foreign investors to apply for tenders.

"There are heavy ongoing government investments into innovation infrastructure and educational system. We are aiming to create a world-class business environment in Serbia, especially for knowledge-based industries. Private investments are an essential part of the innovation ecosystem we are creating, and they are most welcome," says Ms Ilić.

In spite of the advancements and the planned spending, the Serbian Statistics Office's findings in its 2017 report on *Usage of Information and Communications Technology in the Republic of Serbia 2017* indicate quite a disconnect from the ambitions of the government and businesses to how individuals and households make use of ICT services.

Further education needed

According to the WEF Global Competitiveness Index for 2017-2018, Serbia is ranked 64 of 137 countries in ICT use, and 62nd in mobile-cellular telephone subscriptions.

"Although we are in the better half of global economies, we still expect that our rank will significantly improve due to government investments. There is also some interesting anecdotal data, such as Serbia having one of the highest rates of Facebook accounts per capita in the world. There is also a significant divide between those in tech industries and those who are not, but the situation is improving every day," adds Ms Ilić.

Whilst most people are discussing the fact that ICT in Serbia is developing quickly, there seem to be concerns over the Serbian population's digital skills. At the first meeting on June 28 of the Working Group for the Creation of the Proposal of Strategy of Digital Skills Development, Tatjana Matić, state secretary in the ministry of trade, tourism, and telecommunications stated:

"in Serbia, 51 per cent of people aged 15 and higher are computer illiterate, 34.2 per cent of people are computer literate, while

14.8 per cent are partially computer literate."

The future

"The fact that there are not many successful, venture-backed companies can be attributed to the lack of capital more than anything else, especially a couple of years ago," adds Ms Ilić. "The situation is improving each year though. In addition, many foreign companies have invested in offices and research and development centres in Serbia. Their presence has improved the whole ecosystem."

According to Switzerland Global Enterprise and their market analysis on Serbia, there are 35,000 or so ICT professionals in the country. However, Ms Ilić is sceptical about the data, suggesting that the figures do not provide an accurate overview of the sector, and adds that the numbers should be much higher.

"It's really hard to tell the exact number due to the high level of freelancing and professionals working directly for foreign clients. Most ICT experts in Serbia have a STEM background that is traditionally strong in our country. It is also one of the main reasons for our success in this area. The Serbian growth rate in export of ICT services is over 30 per cent annually, and we expect it to accelerate further," she says.

The future, however, is bright for Serbian ICT.

"With continuous improvements in the business and living environment in Serbia, we expect many ICT experts to return, and this is a trend we are already seeing. There is also a significant number of foreign ICT experts that came to Serbia to accelerate their professional career - or they just love living here, since Serbia offers a much better quality of life for those on ICT salary than many other countries," concludes Ms Ilić. ▲

Usage of Information and Communications Technology in the Republic of Serbia 2017

Key findings

- Over 3.12 million people use a computer everyday (an increase of about 50,000 people compared to 2016).
- Over 4.9 million people use a mobile phone.

Enterprises

- According to the survey, enterprises are still slow to exchange information regarding supply chain management with clients or suppliers, only 48.7 per cent of enterprise do, which means that over 50 per cent do not.
- Around 42.4 per cent of enterprises have a broadband connection of at least 10Mbit/s and not faster than 30Mbit/s, compared to only 29.1 per cent that have a broadband speed of 30Mbit/s but less than 100Mbit/s.
- In 2017 only 6.3 per cent of enterprises felt a fixed internet connection did not suffice when it comes to running their business, whilst 93.7 per cent of the companies surveyed found that a fixed internet connection is sufficient. However, the results also showed that 81.9 per cent of enterprises do in fact use mobile broadband internet connections (3G or 4G) on portable devices.
- Shockingly, the number of companies that have a website has gone down in comparison to 2016, although only by a fraction of a per cent: 80.4 per cent compared to 80.9 per cent in 2016.
- The use of cloud services is also still low when it comes to enterprises in Serbia, only 9.3 per cent of those surveyed pay for cloud services. The question here is what is the reason behind such a low turnout? Could it be due to distrust of cloud services, could it be cost related or simply a lack of knowledge when it comes to cloud services.

*(The 2018 report will be published by the Serbian Statistics Office in September 2018)

Serbia's automotive industry: Increasingly attractive

More than 10 per cent of Serbian exports and around 14 per cent of the value of the country's foreign investments are accounted for by the automotive industry. The sector employs more than 40,000 people, and is a crucial part of the country's economy.

Tamara Karelidze

The history of Serbian automotive starts in the late 1930s, when there was considerable local interest to developing this particular field of industry, and Zastava, a local manufacturer of motor vehicles, produced its first automobile under license from Fiat. Thanks to high-quality production, Serbia later became a destination for Mercedes, Opel, Ford and other producers. However, the political situation in the 1990s and the break-up of Yugoslavia reduced production and foreign capital. The has changed since 2000, and by 2009 the automotive industry consisted of six manufacturing motor vehicles companies and around 70 component suppliers.

According to research carried out by the Chamber of Commerce and Industry of Serbia, the automotive is as today as it has ever been. The ease of doing business and flexible suggestions attract international capital to invest in the country. The research shows that around 60 companies from Europe, the US and Asia have already spent around two billion euros and have created about 30,000 jobs. One of the largest investors in Serbian automotive is Fiat, represented by FCA (Fiat Chrysler Automobile). The company produces over 100,000 vehicles per year and exports to the US and EU markets.

Among production, the most popular field for foreign investments is engine component manufacturing, brake discs and drums. Since 2005 many companies have entered the Serbian market, and their investment has rapidly changed the sector's turnover.

Alongside foreign investment, the number of domestic companies active in the sector has also risen steadily. One of the reasons for the positive development is the excellent geographical location Serbia can boast, as well as good export conditions. The country benefits from free trade agreements with the EU and CEFTA (Central European Free Trade Agreement), convenient for every investor. That is to say that automotive has two main market destinations. One of them is the EU, a large market which Serbia has the flexibility to enter without customs or other fees. The other market is the former Yugoslavia and Russia, which is Serbia's fourth largest export destination: 31 per cent of its automotive products are exported to Russia.

It is worth mentioning that half of the companies operating in Serbia's automotive industry are large in size, with medium enterprises accounting for around 38 per cent, and only 14 per cent of the production being carried out by small business. Two-thirds of these companies have local owners. Among international investors, Slovenian companies are the most active, followed by Germany and France.

Serbia pays significant attention to education in the automotive field, and the fast-growing nature of the sector means that there is massive interest from students as well. According to official information, around one-third of new professionals are graduates from technical universities (approximately 13,000 students). Besides higher education, Serbia has about 71 professional schools, suggesting different technical training and offering a different specialisation to the young people.

Interest towards Serbia's automotive industry is increasing rapidly. Among western countries, German companies are now showing considerable interest. Moreover, the government supports the development of the sector and is making doing business as easy as possible in order to attract as many investors as it can. Automotive is likely to remain a key sector of the Serbian economy for many years to come. ▲

Serbian talent to the fore

Serbia's wealth of talent, not least in the IT field, makes it a prime location for investors. Some gaps in the labour market, and a mismatch of education and skills, remain, however.

Yoan Stanev

The Serbian labour market is generally characterised by low employment and activity rates, especially amongst women and young people. *Emerging Europe* got in touch with Nikola Milosavljević, operations director at Adecco Serbia, who stated that, on the whole, the Serbian labour market has been experiencing slow but constant growth for the past few years. In general, there has been an observable skills mismatch, which applies not only to Serbia, but the entire Western Balkan region: the educational and professional training of the workforce has changed only marginally over recent years, but not enough to respond to the skills demanded of the Serbian economy. Mr Milosavljević added that the automotive sector has been the most prominent sector experiencing constant growth. As such, Serbian employers are demanding more manual labour, but also skilled specialists in various fields, such as engineering, machining, quality and design. "The shortage of blue collar workers is almost an everyday hustle," precisely due to the education and skills mismatch.

Youth employment in Serbia has recently been experiencing a different kind of 'skills mismatch.' In a 2017 report by the Social Inclusion and Poverty Reduction Unit, a government agency established in 2009, young Serbians have been taking on jobs that they are overqualified for, especially young Serbian women. According to 2015 data, one in five young workers are overqualified and the figures for young women are more striking: whilst one in seven young men are overeducated for their job, the figure for young women is one in four. This is mainly because of the ongoing gender imbalance and inequality in the labour market: on the whole, young women continue to find it harder to find employment, therefore they accept jobs below their competences and educational qualifications.

Unemployment figures, however, vary across Serbia's regions. This is something that new market entrants are not always taking advantage of. One of the biggest issues affecting the Serbian labour market is that new market entrants are starting their businesses in the areas with really low unemployment rates, according to Mr Milosavljević, therefore not utilising the abundance of potential labour elsewhere. Workforce availability and characteristics, among other significant factors, is known to be one of the distinctive factors in choosing the right location within the country. Manpower Group, a human resources corporation, provides a useful overview of the regional characteristics of Serbia's labour market. For example, one of the most promising regions of Serbia for foreign investors is the eastern part of central Serbia. It is located on the E75 highway that runs through the entire country from north to south, connecting the cities of Kragujevac in central Serbia and Niš, the country's third-largest city, in southern Serbia with the capital Belgrade. With its key geographical location, the region has the high potential to source candidates for managerial roles. A high unemployment rate of 40 per cent and youth unemployment remain troublesome issues, but the region offers conditions favourable to potential investors.

A decade after the global financial crisis, the unemployment rate stands at 14.8 per cent for the first quarter of 2018, according to the Statistical Office of the Republic of Serbia. The country can thus boast one of the lowest rates of unemployment in the Western Balkan region: Croatia's unemployment rate stands at 9.6 per cent, Montenegro's – 18.42, Macedonia's at 21.6, Kosovo's – 26.5 and Bosnia's – 35.93. The country's Labour, Employment, Veteran and Social Policy Minister Zoran Đorđević stated recently that: "Serbia is on the right path to keep the unemployment rate below 10 per cent." ▲

Treat claims about Russia's influence in Serbia with caution

James Ker-Lindsay

Over the past couple of years, Russia's role in the Western Balkans has been gaining ever more attention. While we know that Moscow is trying to extend its influence into a region that is prone to conflict and instability, it is also important to put these moves into their proper context. Truth be told, Russia's influence is more limited than many suppose. Croatia, Albania and Montenegro are all NATO members. Macedonia has just received an invitation to join, subject to the recent name deal with Greece having been finalised. Kosovo is pro-Western to its core. In truth, the main areas of concern are Serbia, and Republika Srpska, the Bosnian Serb entity, which is in a position to shape Bosnian national policy on NATO.

Many outsiders believe that Serbia is innately Russophile. In truth, much of Moscow's influence really comes down to just one factor: Kosovo. In 2008, the former Serbian province unilaterally declared independence. Serbia relies on Moscow's veto in the Security Council to prevent Kosovo from gaining UN membership, and thus general international acceptance and recognition. However, this support has come at a high price. It has given Russia a degree of influence over Serbia. It has used it to good effect to gain control over the energy sector. This has in turn caused a degree of resentment amongst Serbia's political elite. Many believe that the Russians are exploiting the country. Unfortunately, there is little Belgrade can do. As long as Serbia opposes Kosovo's independence, it will need Russia's support.

Moscow has also been very clever at spotting other opportunities to extend its influence over the country. For example, in 2015, a resolution was presented to the Security Council to commemorate the genocide in the Bosnian town of Srebrenica. However, it was terribly drafted. Rather than focus on trying to prevent further atrocities, it concentrated on condemning Serbia. Belgrade therefore sought Moscow's support to block the resolution. Russia duly obliged. Serbia now owed Russia another favour.

As a result of all this, there is no doubt that many Serbs feel that Russia is now their closest ally. Indeed, surveys suggest that Serbs believe that Russia is the largest foreign aid donor to the country, when of course the EU holds that honour. But while many Serbs may feel an instinctive sympathy for Russia, it is not as ingrained as many might suspect. Few Serbs speak Russian or have ever been there. More importantly, most also know that Russia is not the future. In a much-publicised opinion poll in 2016, Serbs were roughly split on support for Russia and the EU. However, on the question of where they would like their children to live, the results were overwhelming: 70 per cent said the EU, versus just 17 per cent for Russia.

This caution not to over-emphasise Russia's influence in Serbia can also be illustrated in other ways. A personal favourite story concerns the opening of a cafe named after Vladimir Putin in Novi Sad, Serbia's second city, in 2014. This received widespread media coverage, regionally and internationally. And yet it was a tiny place. Interestingly, and wholly unreported in the media, was the fact that there was an upmarket restaurant just 100 metres away that was named after the great British statesman, Winston Churchill. Even better, two years later the Putin café was gone. In its place was a new café named after a character from Only Fools and Horses, a British comedy show that was extremely popular in Serbia. It is a small example that says a lot.

The one area where there is perhaps greater cause for concern is Bosnia. In recent years, Milorad Dodik, the president of Republika Srpska has been courting Russia as he makes worrying noises about pursuing independence. However, while Moscow may be happy to see some instability, it seems highly doubtful that it would want to provoke a full-scale crisis, let alone a unilateral declaration of independence.

There is no doubt that Russia is trying to expand its presence in the Western Balkans, especially over Serbia and in Bosnia. And in many ways, it has successfully managed to lever its advantages as best it can. However, it is also important to put this in its proper context. Most people in Serbia understand that the European Union is still their future. ▲

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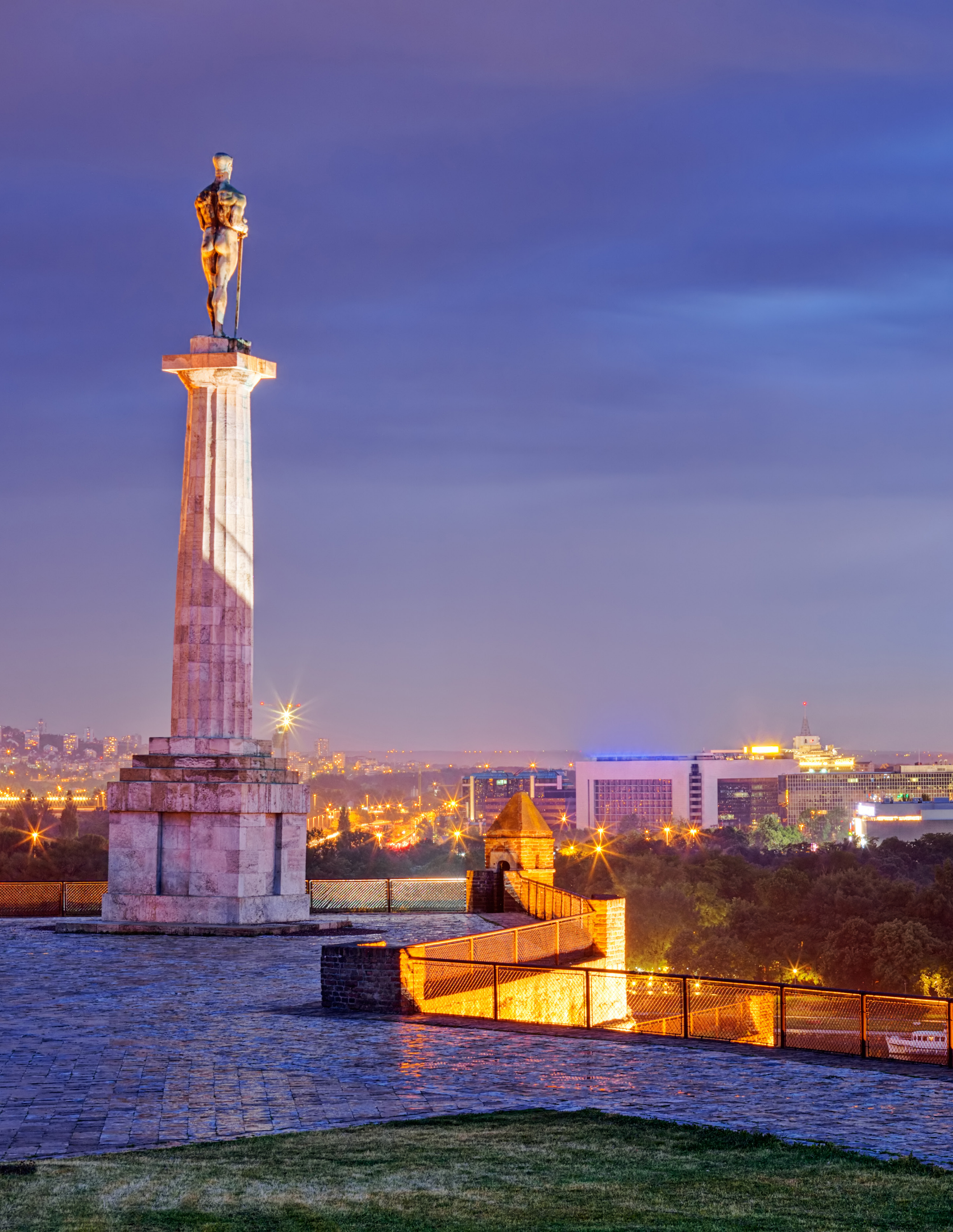

How to end the Serbia-Kosovo impasse?

Jelena Milić

The current format of negotiations on the normalisation of relations between Serbia and Kosovo under the auspices of the EU has come to a complete standstill. Additionally, Kosovo's internal affairs are becoming increasingly complicated. This impasse is creating a series of political, security and political threats for Serbia, Kosovo and the Western Balkans, but also the EU and NATO and their member states. Five and a half years after the adoption of the Brussels Agreement on the principles governing the normalisation of relations between Serbia and Kosovo, five EU countries, of which are four are NATO members, still do not recognise Kosovo's independence. This stalemate impedes EU polices towards the region, which was painfully obvious during EU-Western Balkans summit in Sofia earlier this year.

Unfortunately, almost 20 years after the war in Kosovo, almost no trials have been brought related to the more than 1500 Serbian civilian casualties. Serbia on the other hand has at least completed its obligations towards the International Criminal Tribunal for the former Yugoslavia (ICTY), although it also has a huge responsibility to continue prosecutions in domestic courts for remaining unpunished crimes. Oddly enough, Kosovo's Prime Minister Ramush Haradinaj has said that Serbia should recognise Kosovo and that Kosovo would then push for reconciliation, implying no further trials are necessary.

The threats caused by this impasse, and Russia exploiting it for its goals of impeding the region's consolidation and integration into the political structures of the West, include a decline in democratic standards, increased corruption and poor regional cooperation on security and defense. These are, however, considered far less than other options that would lead towards the formalisation of relations, including the adjustment of the administrative border which would allegedly cause a domino effect and trigger violence. But these arguments are not valid, as it is 2018, EUFOR is in Bosnia, KFOR is in Kosovo, and all the countries of the region are in the process of EU integration. Croatia, Albania and Montenegro are all NATO members, and Macedonia hopefully will be soon. It is a very good news that Admiral James Foggo, commander of US Naval Forces Europe, said during his recent visit to north Kosovo that KFOR is capable of providing security in case of any political agreement that may or may not cause some turmoil. None of this was the case ten years ago.

International commentators and decision makers fail to understand that while the Serb authorities command strong political support in general, this is not necessarily extended to a solution that would immediately satisfy Kosovo and the West.

Negotiations should be organised on the correction of the administrative border between Serbia and Kosovo, which would be traced more or less along the present four municipalities in the north of Kosovo (Northern Mitrovica, Leposavić, Zvečan and Zubin Potok), inhabited mainly by the Serbian population. This correction would immediately be followed by a comprehensive agreement on the normalisation of relations. Ideally, this should be agreed in a wider format that would include Albania, Macedonia, Montenegro, Bosnia and Herzegovina, and Croatia, where Serbia's border disputes with Bosnia and Herzegovina and Croatia would also be settled.

This is not a proposal for the ethnic division of Kosovo because the majority of the Serbs live south of the line. Additionally, the municipalities of inner Serbia populated by Albanians should not be part of the deal. The current administrative line can be corrected – exchanged – to accommodate some strategic demands in locations that can be of political interest in the West. Those who formally oppose a correction of the administrative border, among them Kosovo's Foreign Minister Behgjet Pacolli, claim that this would affect the status of Serbs south of the river Ibar.

With this move the West would, with little risk and the possibility for huge gains, in effect put President Aleksandar Vučić and the Serbian Government in a position where they can effectively show a genuine readiness to take Serbia along the path of European integration. This is all relevant to the strengthening of the rule of law and reducing the space for malign Russian influence.

Progress in the normalisation of relations between Serbia and Kosovo would advance the cooperation among countries of the Western Balkans in the areas of security and defense, which is especially important in the light of new regional and global challenges and threats, from a potential new wave of refugees and migrants to the growing malign influence of Russia in the region. Any improvement in regional cooperation in these areas would lessen the effect of their eventual spillover to EU and NATO. ▲

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