



# Weekly Briefing

**Serbia economy briefing:**  
**Export Capacity and International Competitiveness**  
**IPE**

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# Export Capacity and International Competitiveness

## Abstract

*A new free trade agreement (FTA) was signed in October with the Eurasian Economic Union, and the Serbian Government received positive evaluations from the IMF for implementing its policies. As the new agreement expands opportunities for Serbian exports, it becomes increasingly important to what extent the Serbian economy is able to fully exploit them. Several important features of Serbian exports that determine its competitiveness and export capacity will be highlighted.*

*Key words: balance of payment, export, import, competitiveness*

In late October 2019, an FTA was signed in Moscow between Serbia and the Eurasian Economic Union (EAEU - effective from the beginning of 2015), aimed to replace the existing bilateral FTAs of Serbia with Russia, Belarus and Kazakhstan. In this way, the free trade zone is being extended to Armenia and Kyrgyzstan to cover a market of around 183 million people. Given the current level of free trade with the European Union, regional CEFTA and other bilateral FTAs, this new FTA represents an additional opportunity for expansion of Serbian exports. This further confirms the fact that Serbia has had a liberal trade policy for decades. In addition, a successful policy of attracting foreign investment shows that no matter that Serbia is a small open economy, there are no serious obstacles for achieving successful export expansion.

The Serbian internal market of around 7 million inhabitants is small in size and cannot be the basis for dynamic and sustainable economic development. Even significant growth in the standard of living and accelerated industrial development have limited development potential. Therefore, export expansion of goods and services is the only solution.

Insight into real economy data offer better comprehension of the effects of Serbia's trade policy and foreign trade agreements. The basic official data of the National Bank of Serbia clearly show the state and dynamics of economic relations with foreign countries. The current account balance has traditionally been negative and had the following values: 2014: -€1,985 mil; 2015: -€1,234 mil; 2016: -€1,075 mil; 2017: -€2,051 mil; 2018: -€2,223 mil. Two of the four elements of the current account balance provide an explanation: Although trade in goods

and services is growing, the growth of services exports is faster than the growth of imports but the growth of imports of goods is faster than the growth of exports, so the result is following: negative balance of trade in goods 2014: -€4,111 mil; 2015: -€3,645 mil; 2016: -€3,119 mil; 2017: -€3,997 mil; 2018: -€5,245 mil. Balance of trade in services was not sufficient to cover the negative results of trade in goods: 2014: €465 mil; 2015: €729 mil; 2016: €907 mil; 2017: €966 mil; 2018: €1,092 mil. The coverage of imports by exports has been around 75 percent in recent years (European Union 82 percent in 2018).

Secondary income account (element of Current account - shows current transfers between residents and nonresidents) provides us with important information: more than half of its balance is made by personal transfers, which is a solid influx from abroad: 2017: €2,151 mil; 2018: €2,641 mil. In this way, the negative balance of trade in goods was mitigated, as was the case decades ago. During a meeting with IMF officials in Washington in October 2019, the governor of the National Bank of Serbia emphasized that the negative current account balance was fully covered by the Foreign Direct Investments (FDI) inflows.

Serbian exports have an upward trend, increasing from €11,158.5 million in 2014 to €16,271.4 million in 2018. The geographical distribution of Serbian exports in 2018 is as follows: European Union 67% (growth from 64.57% in 2014); CEFTA 17.4% (decline from 22.28%); Russia 5.3% (decline from 6.94%); the USA 1.4% (decline from 2.11%); China 0.5% (growth from 0.1%). Only with CEFTA countries Serbia has a positive balance in trade in goods.

The export capacity and international competitiveness of the Serbian economy depend on its base. Structure of GDP formation shows that gross value added by manufacturing was 15.1% in 2018; wholesale and retail trade, repair of motor vehicles and motorcycles 11.5%; real estate activities 7%; agriculture, forestry and fishing 6.3%; information and communication 4.8%.

Over the last two decades, Serbia has been hit by a strong wave of de-industrialization. New investment is needed for re-industrialization and stable economic growth. Total investment in Serbia were 17.1% (2015–2017) and 17.8% (2018), of which private investment was 7% and FDI net inflows 5–6% of GDP. It is estimated that total investments of 25% is needed for dynamic and stable economic growth. As it stands, public investment is focused on infrastructure projects, while partial re-industrialization will rely on some domestic and foreign private investment. The Serbian Government has managed to attract an impressive amount of FDI so that FDI Inward stock was US\$ 39,833 mil (2018). In doing so, it could have influenced the choice of locations and partly the investment structure. Most FDI plants are export oriented, which is significant for the balance of payments. In addition to mining and steel complexes, a

large number of FDI have been placed in low-tech industries that employ a large number of low-skilled workforce (textile, footwear, wiring). Only in recent years we noticed FDI from advanced industries, which can have a positive and linking effect on domestic SMEs. The question is whether it is a sufficient substitute for serious industrial policy.

There is a strong conviction in the Serbian public that Serbia's biggest export opportunity is agriculture. Such a belief is also encouraged by some political parties. What do the facts tell us? Serbia has 5,097,000 hectares of agricultural land, of which 4,224,000 hectares is arable; 3,355,859 hectares are cultivated while 860,000 hectares remain uncultivated. The average size of the farm is 4.5 hectares, and the share of livestock in the total agricultural production is about 30 percent. Rural population lives in 4,709 villages, of which less than 100 people live in 1,034 villages, while 1,200 are completely uninhabited. About 40 percent of the total population lives in rural areas of Serbia.

In order to reduce further depopulation and develop agricultural production, the Serbian Government has been allocating significant funds for agricultural subsidies for years. In addition, 332 agricultural cooperatives were established and 93 cooperatives were supported by grants.

The share of agriculture in total production activities is 20–23%; if the processing industry would be added, then the percentage would be 40–43. Agriculture has a positive trade balance and about 46% of exports goes to the European Union market. Despite all the problems that burden overall agricultural production, further expansion into the EAEU markets can be expected, as well as the growth of exports of fishery products.

Probably the most promising export sector is Information and Communication Technologies (ICT). ICT services exports have exceeded one billion euros and have been higher than maize exports for the third year. One part of the dynamic growth of this sector is a result of the activities of foreign companies in Serbia, while the other is of an autonomous character. Due to the nature of the business itself, the state is not able to control it completely. According to the announcement, the Government should stimulate ICT. The construction of science parks with the support of Chinese companies (Huawei) will certainly strongly stimulate development of the emerging ICT sector.

One important question remains: to what extent is the Serbian economy able to take advantage of the opportunities offered by the international market under the given conditions? Or: what is the export capacity of the Serbian economy and its international competitiveness?

Most of, or almost all, the obstacles facing Serbian exports are internal. They are also obstacles to development. The main difficulty in removing and overcoming them is their timeline: this cannot be done in the short-term. The Serbian Government and local authorities are actively working to improve business environment, albeit with limited funds. Barriers that limit current exports are precisely those areas that need to be improved in the future. Some of will be listed.

In general, Serbian exports lack three essential components for a more serious penetration into foreign markets: quantity, assortment and quality. All three or individually, are regularly present in Serbian exports. For example, the largest share of agricultural exports is made of fruits, fruit products, wheat, maize and animal feed. About 90% of apple exports go to Russia; the assortment is modest and there are even cases of attempted re-export. Livestock farming is also an illustrative example. At the moment when Serbia has the possibility of serious exports to Turkey, there are simply not enough cattle. At the beginning of this year, there were 878,000 cattle in Serbia, which is a historical minimum. Last year there were 12,000 young beef (bullocks) in fattening and everything was slaughtered. Serbian non-GMO agriculture does not have a quality food processing industry. Exports of low processing products have been characteristic of many other industries over the years (wood, leather, metals). Also, it turned out that Serbia did not have enough quantities for constant deliveries to large markets.

In addition to being the largest importers, our largest foreign-owned exporters also export lower-grade products (steel, copper, aluminum). Factories that are parts of larger supply chains also export simple components (wiring).

With the exception of the best domestic companies, there has been no educated and well-trained staff for international trade for a long time. From the time of foreign trade liberalization, it seemed that anyone could do it, and so it was. However, there were not enough large companies and large contracts where the necessary knowledge and skills could be acquired. The outcome: a lot of unskilled people in serious jobs.

When it comes to the international competitiveness of the Serbian economy, it is clear that it is now of a low degree. This can be seen in the structure of exports and in the balance of trade in goods with some countries and regions. Fortunately, this can be improved. Exports of services have fewer barriers to expansion and can increase significantly and contribute to faster development.

## **Conclusion**

Institutional arrangements and trade agreements concluded by Serbian government with individual countries or forms of regional integration provide the Serbian economy with free access to numerous foreign markets. The Serbian economy now is unable to take full advantage of such opportunities, so there is enough room for future expansion. Since the problems of Serbian exports are mostly internal in nature, solving them and accelerating economic growth can contribute to the growth of its volume and quality. If domestic capital and investment support exports, it will be more stable and sustainable.