Global uncertainties and sectorial focus on nearshoring

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Introduction

- The COVID-19 pandemic caused supply bottlenecks and price increases due to delivery difficulties. As a trustworthy supplier, China lost its reliability and predictability.
- According to the "European Business in China: Position Paper 2022/2023", businesses won't leave China. They could divert investments to mitigate risks, possibly shifting planned or future investments to other markets that are perceived to provide greater reliability, predictability and flexibility.
- On the other side, the war in Ukraine reduced investor confidence and increased borrowing costs while also bringing uncertainty to the purchase price of energy and other commodities.
- FDI flows are expected to become more regionalized as the current GVC may undergo reorganization. In this case, WB economies have a competitive edge over traditional offshoring superpowers as businesses from Western Europe will be less likely to look outside the continent.
- Nearshoring has already been taking place in the WB region, but these two events have accelerated it and made it increasingly popular.

Agri-food value chain in WB Economy-based representation

- Potential in the agri-food sector in all WB economies is strong.
- Fragmented agricultural properties and the unfinished restitution process shaped the structure of the GVC.
- The sector comprises a significant number of small agricultural households and smallholders, with medium-sized processing companies and a smaller number of large-scale processing companies, as well as traders and agricultural cooperatives, representing the sector.
- At the processing level, there is a mixture of ownership (private and foreign).
- Bosnia and Herzegovina and North Macedonia have the most significant potential in bakery and farinaceous goods production.
- In addition to the production of these goods, Serbia has potential in the processing and preserving fruit and vegetables, processing and preserving meat and production of meat products.
- Montenegro and Albania lack the capacity to be actors in the processing industry. Still, they have significant potential to produce seasonal fruits, vines, olives and livestock.
- The sector has potential to increase regional innovation and technology diffusion in both the public and the private sector to increase productivity, as scientific potential and specialisation in agricultural and biological sciences is one of the strongest fields.

Agri-food value chain in WB

Driving forces

- The geographical location is good (abundance of natural resources and favourable climatic conditions);
- Availability of skilled labour;
- The flexibility of the labour market;
- Cost of energy/ supplies and availability of relatively low-wage labour.

Challenges

- Differences across WB economies in the stages of development and institutional capacity of an agricultural knowledge and information innovation system (AKIS);
- Lack of digital skills and poor infrastructure in rural areas;
- Low technology and innovation transfers from R&D to businesses;
- Increased competition from Mediterranean countries (Tunisia, Egypt, Algeria).

Agri-food value chain in WB and global uncertainties

- Nearshoring in agriculture became more visible as a necessity to ensure and protect supply chains from disruptions during COVID-19. The geopolitical situation related to the Ukraine war further intensified the process.
- The Russian Federation and Ukraine are among the world's top food and fertilizer producers.
- Production risks are placed in Ukraine (harvest and possible disease outbreaks), while in Russia, even though food and fertilizer are exempt from international sanctions, there are uncertainties over their ability to export.
- The effects of the shocks to the global food chain are increased food costs in the EU. In poorer countries, the crisis may result in food shortages and humanitarian problems.
- In the short-term, increased costs for electricity, food and fertilizer have a significant impact on nearshoring in the WB.
- The future availability and affordability of energy sources (and possibly fertilizers) in WB will be critical in drawing new business opportunities because agriculture consumes significant energy.
- In addition, Green agenda for WB with the priority area "Promote sustainable methods of food production and supply" has the potential to contribute to attracting new investments.

Textile value chain in WB Economy-based representation

- The textile industry's potential is particularly strong in Serbia and Northern Macedonia (the largest number of textile enterprises and several cluster organisations).
- The textile sector is developing considerably slower in other WB economies (particularly noticeable in Montenegro and Kosovo*).
- Companies that use their manufacturing facilities as secondary manufacturing sites and locally owned firms that produce goods for international brands and offer Cut, Made, Trim (CMT) or full garment production services are both engaged in the GVC.
- SMEs account for the majority of textile and garment businesses in the WB.
- The textile sector's expansion is primarily due to FDI inflows, but indigenous SMEs also played a role.
- The critical challenge for WB economies is attracting FDIs with phases of higher added value (design, branding, promotion, typically centred in more developed countries).

Textile value chain in WB

Driving forces

- Geographical location;
- Customs, tariffs and trade regulations;
- Cost of energy/supplies;
- Macroeconomic environment and incentives provided by the government;
- Availability of skilled labour and labour market flexibility;
- High-quality products at competitive prices.

Challenges

- Lack of skilled workers (in some countries);
- Labour discipline and wage and labour regulations;
- Large turnover of workers, which requires a constant review of the rules as well as the training of new workers;
- Slow pace of digitalisation;
- Losing competitiveness to other regions (Turkey).

Textile value chain in WB and global uncertainties

- Apparel businesses are attempting to alter their mix of sourcing countries and focus on nearshoring to protect the supply chains in the wake of the COVID crisis.
- Bangladesh, Vietnam, Turkey, Indonesia, and China are the most alluring countries. Still, there is a reasonable likelihood that the WB area will be able to draw some of these investments (Revamping fashion sourcing: Speed and flexibility to the fore, McKinsey Apparel CPO Survey 2021).
- Given that the textile industry textile is labour and energy-intensive, the future accessibility and affordability of energy sources in WB will be one of the key factors in luring new business possibilities.
- Nearshoring is already happening in WB, as Benetton brought production closer to home in 2021 in Serbia, Croatia, Turkey, Tunisia and Egypt, with the aim of halving production in Asia from the end of 2022 (Reuters).

Automotive value chain in WB Economy-based representation

- In recent years the automotive industry has experienced a development boost in the WB region, specifically in Serbia, North Macedonia and Bosnia and Herzegovina (largely based on FDIs).
- Main actors are (i) medium-technology foreign-owned manufacturing companies playing the role of first- and second-tier supplier with the potential to increase the economic complexity and position of the region in the automotive GVC,
- (ii) local, domestically owned component manufacturers (suppliers of metal, rubber and plastic components, machinery and equipment to world-renowned automotive producers) involved in the global production systems by sourcing medium-technology components for large vehicle producers abroad and aftermarket and supporting institutions.
- Substantial potential for the region lies in promoting e-mobility and climate-neutral means of transport.

Automotive value chain in WB

Driving forces

- Favourable geographical position (EU27 proximity) and “cultural proximity”;
- Reasonably good transport infrastructure (corridor X) ;
- Relatively skilled and low-wage labour force;
- Favourable taxes;
- Some of the countries (Serbia) are prepared for the electromobility trend.

Challenges

- Lack of a skilled workforce (in some countries);
- Declining interest in the educational profiles of the mechanical and related professions (growing number of vacancies in secondary vocational schools);
- Cooperation between the business sector, academia and R&D institutions is generally modest (except for certain economies);
- The slow pace of digitalisation;
- Lower competitiveness to other regions (Visegrad group countries).

Automotive value chain in WB and global uncertainties

- European businesses are developing more nearshoring possibilities not far from the EU border; the Ukraine War and the COVID Crisis provided opportunities for WB.
- Nearshoring in automotive is already taking place in the WB.
- Continental launched a 140-million-euro plant in Novi Sad, Serbia, in 2021 to complement a research and development facility established in the same city in 2017.
- In 2022, GS-TMT, a German-owned business, opened a new facility in Travnik, B&H.
- Aptiv, an Irish-based automotive technology supplier, has already announced that it would transfer its activities from Ukraine to Poland, Romania, and Serbia.
- Due to the energy-intensive nature of the automobile industry, businesses are concentrating on allowing steady and manageable energy prices.
- A current trend in the automotive is the nearshoring of strategic value chains, including semiconductors and electric vehicle (EV) batteries. This could be an advantage in bringing higher value-added technologies to the region. As there is an initiative to build the EU value chain in Serbia, investments have already been made in the EV/battery arena.

Energy value chain in WB Economy-based representation

- The energy sector in the WB is characterised by former centralised monopolistic systems (replaced by the electricity market), which are in most cases state-controlled.
- Infrastructure, is ageing, limited energy efficiency and productivity, low levels of renewable energy production and limited market mechanisms characterize the system.
- Albania generates most of its electricity from hydropower. The country has the potential for alternative renewables such as photovoltaic (few photovoltaic power plants) and wind plants (no projects).
- B&H generates electricity from thermal power plants and from renewable sources (hydropower). Thr potential for renewable energy is huge (solar photovoltaic energy). So far plants using solar photovoltaic and wind energy have been built only sporadically.
- Montenegro has been producing more than 60% of its electricity from renewable energy sources, mainly hydropower (Piva and Perucica hydropower plants). Additionally, Montenegro has wind farms and is developing a large solar plant.
- North Macedonia produces around 70% of the country's electricity from thermal power plants. There are a number of hydropower plants with varying capacities and several solar energy capacities and a wind park.
- Kosovo* relies on thermal power plants, with a big hydropower plant with unregulated legal status and several small plants. It has one wind farm installed and several others in the pipeline.
- Serbia produces the majority of its energy from thermal power plants (over 60%) and hydropower plants. Other renewable sources account for less than 2%, but they are diversified and include wind parks, solar plants and biomass facilities.
- Several private, highly innovative companies in the manufacturing process and the provision of services have already established cooperation in the region and are included in the GVC. Besides relatively modest installed capacities in solar energy in the region, there is also considerable value creation in the sector.

Energy value chain in WB

Driving forces

- One of the priorities in the region is the promotion of renewable energy and the decarbonisation of local energy sectors.

Challenges

- Lack of skilled workers (i.e. frequent migration of workers to other companies);
- Lack of financing and lack of quality systems;
- Lack of research support;
- Lack of educational attainment.

Energy value chain in WB and global uncertainties

- War in Ukraine raised the energy crisis as one of the top EU crises in 2022.
- A comprehensive Economic and Investment Plan for WB focusing on green and digital transition investments, smart mobility links, sustainable energy, and digital infrastructure will bring significant new investment opportunities.
- EU intends to be a more active partner in reducing reliance on Russian energy (for certain countries) (EPP Position Paper on Western Balkans EPP WG4 paper approved by the EPP Presidency & Political Assembly on 30 May 2022, Rotterdam).
- EU needs to embrace renewable energy sources to a greater extent to achieve the goals of the European Green Deal, with solar energy the most promising.

IT value chain
Economy-based representation

- Most of the ICT sector in the WB region is based on small companies, entrepreneurs and freelancers not included in the GVC.
- Albania's ICT market has opportunities to expand despite having a modest part of the software development market.
- In Montenegro, the most vital part of the ICT is the communications sector, mainly owing to foreign investment by telecom operators. Software engineering has recently experienced development in the sector.
- In Macedonia, most companies specialise in "Software and IT services" and are mainly export-oriented.
- IT sector in Kosovo* is based on outsourcing, while demand for local digital products and services lags.
- Serbia has the most developed ICT sector, also dominated by outsourcing. However, the number of companies developing local software solutions is growing, as is the number of large multinational companies that have opened R&D centres in Serbia.
- The sector is a cost-effective and has potential to become reliable alternative to more established markets.

IT value chain

Driving forces

- The tradition of education;
- Good technical faculties for programmers' education;
- The vast majority of students and graduates have high proficiency in English;
- An outstanding pool of intellectual capital, attractive labour costs, excellent skills;
- Good communications networks.

Challenges

- Non-harmonised education programmes;
- Lack of skilled workers;
- Brain drain – most competent workers move away;
- Limited business capacities.

IT value chain and global uncertainties

- War in Ukraine has been a major trigger for nearshoring in WB recently.
- The ICT industry is an essential enabler of green transformation. It is recognised as such in the Green Agenda for the Western Balkans and in Smart Specialisation Strategies.
- Russian, Belarus and Ukraine IT software professionals are ranked relatively high in different rankings. Using Ukrainian IT professionals is too risky at the moment; on the other hand, there is an aversion to Russian and Belarusian IT professionals.
- Unofficially, over 1,000 new companies from Russia and Ukraine have been registered in WB (Serbia and Montenegro, mainly). The main business focus of these companies is IT and consulting services. While some of these businesses will return to their home country once the war is over, others will stay indefinitely.

Overview of Serbian potential for nearchsoring

- FDI inflows to Serbia during first nine months of 2022 (3 billion EUR) matched both the amount from crisis year of 2020 and first nine months of 2022 despite slower investment trend globally.
- China expanded its investment activity in Serbia in 2022 and for the first time it was the biggest investor in 2022 so far.
- Manufacturing continued to attract the most FDIs in 2022, followed by construction, which suffered greatly in 2020 but quickly recovered in 2021.
- Metal, auto, food, and rubber manufacturing industries have experienced rapid growth in employment, production, and exports as a result of FDI inflows.

Overview of Serbian potential for nearchsoring (cnt)

- Most inward FDIs in Serbia (and WB) originate from the EU countries. Therefore, potential changes in the configuration of GVCs should not be a surprise.
- Although there are indications, the future of nearshoring is uncertain as the process of relocating production is a complex and that could take a long time.
- Serbia currently has good prospects but with particular policy concerns.
- Moving strategic production from Asian countries to continental Europe is an option. Primary reasons include security reasons and market diversification. This might be a chance for Serbia for logistic and geographic location, available workforce, competitive operating costs, and market access.
- Government intervention can speed up production relocation. However, better relations with the EU are an opportunity for increased nearshoring.

Concluding remarks

- Investors are worried about electricity, gas, and supply prices. This will undoubtedly be a significant factor in the region's nearshoring.
- Those who opt to transfer manufacturing won't likely change their decision very soon because of the investment needed.
- When discussing nearshoring in the WB, there are two trends, investments "out of necessity" and strategic. The current economic and geopolitical situation has led to more "out of necessity" investments. Still, we can expect a trend of strategic investments in the coming period.
- China's zero-Covid policy severely impacted GVC, and the Russian invasion of Ukraine has fundamentally disrupted global supply chains. Companies are including geopolitics in their risk calculations and limiting supply chain networks to allies and friendly countries, a phenomenon known as "friendshoring".

Concluding remarks (cnt)

- The quality of logistics services and infrastructure presents formidable challenge for FDI in the WB (CEE have greater attractiveness). The Open Balkan initiative may help to streamline this aspect, as it aims to remove the borders (only Serbia, Albania and North Macedonia).
- Lack of understanding and inconsistent compliance with the ESG standards and principles increase investors' risk (CEE score better).
- The level of corruption is perceived as a medium to high according to the Global Risk Profile.

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Thank you for the attention.