

HIGHLIGHTS

Highlight 1: What Is the Role of Small and Medium Enterprises in the “Open Balkans” Initiative?

Sonja Avlijaš¹

Introduction

Regional integration of countries and territories of the Western Balkans is gaining increasing political and media visibility in the context of the region’s post-pandemic economic and social recovery. The Common Regional Market (CRM) initiative and action plan was launched at a summit in Sofia in November 2020, when all leaders in the region agreed that the Western Balkans needed greater integration in the areas of free movement of goods, services, capital, and people. Recently, however, we have been hearing more and more about the “Open Balkans” Initiative, launched by the leaders of Albania, North Macedonia, and Serbia, which Bosnia and Herzegovina, Montenegro, and Kosovo are currently refusing to join. As part of the “Open Balkans”, a summit was held in Ohrid in early June 2022, where agreements were signed between the three participating countries to remove border controls so that exchange of goods could flow more easily, citizens can work in neighbouring countries and mutual recognition of qualifications and diplomas is ensured.

Greater market integration of the region is also supported by the European Union (EU) as part of the region’s preparation for entering the EU single market and convergence with EU Member States.² The EU insists that inclusive integration with participation of all six countries and territories from the Western Balkans would bring the most benefits, and encourages the use of existing institutional structures such as CEFTA and the Regional Cooperation Council (RCC) in this process. EU officials also believe that deeper regional integration is a precondition for greater efficiency of the EUR 30 billion of investments envisaged within the EU Economic and Investment Plan for the Western Balkans adopted in 2020.³

The EU attaches particular importance to the role of the private sector in these processes of deeper integration and development in the Western Balkans. Therefore, investing in the competitiveness and innovation capacity of the private sector, and especially small and medium enterprises (SMEs), is a special focus of the Investment Plan for the region. The focus on SMEs is very justified because in 2018 this sector created between 2/3 and 3/4 of total employment and between 60% and 80% of the gross domestic value (GVA) of countries in the region.⁴ In addition, the SME sector in the region is increasingly internationalised and contributes to exports. In Serbia, this sector accounted for 37% of total exports in 2018, and in Northern Macedonia about 32%.⁵ This trend at least partly occurred due to the opening of new opportunities for the inclusion of SMEs in global supply chains through the digitalisation of production (Industry 4.0) and the consequent reduction in the importance of location where production and service processes take place (for more details, see Pietrobelli, 2021).

This Highlight presents a study conducted as part of the project “Southeast Europe’s emerging growth advocates: Domestic firms, technology and economic governance in institutionally weak states - SEEGROW”. The project analyses processes related to the economic integration of the Western Balkans from the perspective of the SME sector and its needs, and the impact of SMEs on more inclusive socio-economic development. Summarized are the findings of a scientific paper that in December 2021 won the runner up award in a competition organised by the LSEE (Research on South Eastern Europe at the London School of Economics) and the CEFTA Secretariat.⁶ The analysis consists of a review and critique of existing policies and guidelines, and suggestions on how to improve public policies towards the SME sector, both at the level of individual countries and territories, as well as at the level of the entire region. The purpose of the research is to better understand the role of SMEs in the context of the “Open Balkans” initiative and to contribute to reflections on what type of support for the SME sector would contribute to a more balanced and inclusive economic integration of the region.

Empirical data were collected through semi-structured in-depth interviews which I conducted with owners and/or directors of 58 mostly domestic and export-oriented SMEs - of which 28 in Bosnia and Herzegovina (B&H) and 30 in Serbia. The interviews were conducted

¹ University of Belgrade – Faculty of Economics

² CRM is not a substitute for EU, as some commentators describe it.

³ The economic and investment plan focuses on infrastructure investment priorities that will support the development of road and rail links, the transition to more sustainable energy than coal, increasing the energy efficiency of public and private facilities, waste and wastewater infrastructure, and the introduction of broadband infrastructure. The plan converges with the implementation of the Green Agenda for the Western Balkans, also presented in 2020, which focuses on climate action and decarbonisation, the circular economy, biodiversity protection, combating air, water and soil pollution, and developing sustainable food systems and rural areas with the help of digitalisation which underpins these processes.

⁴ Source: 2019 SBA Country Fact Sheets, European Commission.

⁵ Source: 2019 SBA Country Fact Sheets, European Commission.

⁶ The paper can be accessed at the following link: <https://www.lse.ac.uk/LSEE-Research-on-South-Eastern-Europe/Assets/Documents/Research/LSEE-CEFTA-Network/Papers/LSEE-CEFTA-Paper-No5.pdf>

Highlight 1: What Is the Role of Small and Medium Enterprises in the “Open Balkans” Initiative?

between June and December 2021. In the sample of firms from B&H, those from the Federation of B&H and the Republika Srpska are equally represented. The interviewed firms were not selected by sectors of activity. The representativeness of firms by sectors was not the focus of the research, given the high sectoral fragmentation of firms in the Western Balkans. Instead, the interviewed firms represent a mixture of smart service exporters, producers of products sold to other companies, and products sold directly to final consumers. The purpose of the interviews was to explore various perspectives on what it takes for domestic firms belonging to the SME sector to be internationally competitive and then to compare their needs with the efforts underlying the Western Balkans Common Regional Market Action Plan⁷. The research also relies on a detailed review of the academic literature dealing with global economic change in the context of accelerated digitalisation and climate change and is enriched by insights from strategic documents, mainly the European Commission and the OECD, which offer a better overview of global trends in the context of which public policies concerning these processes are developed.

Why is support for the SME sector important?

SME support is important for both the economic and political success of the Common Regional Market initiative. Based on empirical research around the world, it is known that deeper economic integration gives a competitive advantage to larger and financially stronger firms over smaller ones. This phenomenon, which the literature calls “winner-takes-all”, is present because firms with more resources have greater market power and much easier access to talent and workers, as well as more advanced technologies that they can afford (OECD, 2018). Larger companies also have a stronger influence on politicians and policy design than smaller ones, and public policies are often formulated in collaboration with the most influential producer groups (Avlijas et al., 2021).

The dominant influence of larger companies must be kept under control in order to preserve the productivity of the economy. Henrekson and Jacobsson (2001) show that the productivity of the Swedish economy slowed significantly during the 1980s due to the high concentration of private ownership in several large companies. The recent case of Korea also shows that a model of economic development based on large companies loses competitiveness over time and generates

huge social and economic costs, as most of the population remains excluded from the dominant economic model, which then loses talent and innovation potential (Jones and Lee, 2018). Already Schumpeter was concerned that the aspiration of capitalism for increasing efficiency was leading to the growth of the monopolies of large corporations and the destruction of the entrepreneurs who provided capitalism with its institutional and political basis (Henrekson and Jacobsson, 2001).

Smaller companies are also increasingly recognised as key to the transition to a sustainable and digital future because of their greater flexibility, specialisation, ability to adapt and find innovative solutions, as well as their resourcefulness and resilience in conditions of growing uncertainty. Their experiences and organisational knowledge that differ from the corporate sector are therefore extremely important, although still underappreciated (European Commission, 2020). Finally, given the territorial distribution of SMEs as well as a large number of SME employees across the region, increasing their voice and visibility can provide greater political support for the “Open Balkans” initiative. The growth of social trust in the SME sector represents a major shift in public discourse towards domestically owned enterprises, given that large international companies have long been considered to offer much better working conditions, while in the SME sector there is no room for advancement, adequate compensation and acquisition of new skills. The internationalisation of the SME sector over the past ten years and its success in the international market have influenced this public perception to change slowly.

Why are the existing mechanisms insufficient?

The focus of the “Open Balkans” and accompanying investment efforts is to increase the efficiency of the SME sector through technological innovation, reduce the cost of movement of goods and services, and ensure the mobility of factors of production, especially labour and knowledge. This idea of increased mobility of factors of production is based on the economic theory of so-called sorting, where it is assumed that technology, capital, labour, and knowledge will go where they are needed and that increased mobility will be useful for all participants in the common market.

However, the free flow of factors of production can deepen differences between poorer and richer territories, regions or states. We have a number of empirical examples around the world that point to such challenges of deeper economic integration, including the problematic relationship between the centre and the periphery of the EU where some southern and

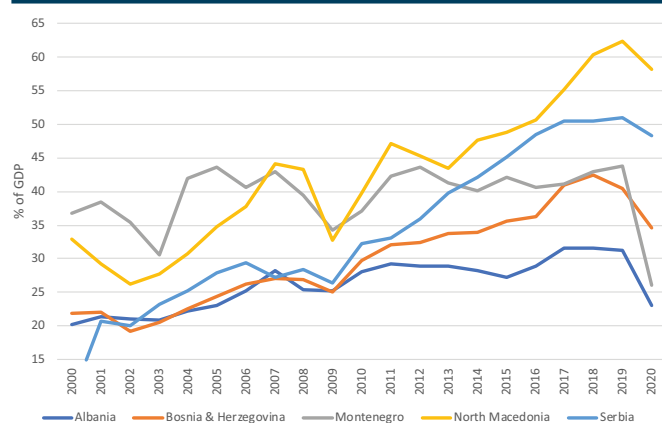
⁷ More information on the Common Regional Market Action Plan can be found here: <https://www.rcc.int/pages/143/common-regional-market>

eastern countries have managed to converge with richer western and northern neighbours, while others became even more peripheralised (Scharpf, 2021). Regional inequalities have also increased in Mexico due to the implementation of the NAFTA free trade agreement. The Western Balkans also had the experience of post-socialist reforms, where the growing openness and trade flows has gone hand in hand with deeper social and economic stratification. In addition, we know that digitalisation can further accelerate the deepening of territorial inequalities in the context of market openness (OECD, 2018).

Despite the fact that all countries and territories of the Western Balkans are at a similar level of economic development and have common problems, there are important differences in the structures of their economies as well as in the development funds and initiatives available to them.

For example, in the past 10 years, Serbia and North Macedonia have had significantly higher export growth than other countries in the region (Graph 1). In other countries in the region, exports are growing much more slowly, and have been significantly affected by the effects of the pandemic, probably because tourism is a significant industry in B&H, Albania, and Montenegro. Research examining differences between countries when it comes to the effects of the CEFTA free trade agreement indicates that not all countries have benefited equally from CEFTA (Uberti & Demukaj, 2019; Matkovski et al., 2022). Although all countries in the region are facing depopulation and emigration, these trends are particularly negative in B&H.

Graph 1 Exports of Goods and Services (% GDP)



Source: World Bank and OECD, national accounts data.

When it comes to state capacities to support the economy, Serbia has done far more to improve the business environment in recent years than B&H. B&H also ranks lowest in the region when it comes to business corruption, while Serbia is the regional leader

in domestic firms' access to the international market. In the context of B&H, the state's capacity to support the economy has been significantly weakened by a complex state structure and ethnically divided governments. However, there are also significant differences between countries that are candidates for EU accession, such as Serbia, North Macedonia, and Montenegro, because this candidacy gives them access to much more considerable EU funds that can further enhance the business environment, but also contribute to the social infrastructure that is needed for the more optimal functioning of the economy, and SMEs in particular.

In addition to state support and the competitiveness of economic models, mutual coordination and cooperation between economic entities is an extremely important factor that can explain why certain places lag behind in development compared to others. Numerous research around the world indicates that the increase in productivity in a certain area does not happen only because one has access to some factors of production, but that it largely depends on what one manages to do with those factors, i.e. how knowledge and innovation are transferred through local networks, social norms, and policy processes (Storper, 2013). In other words, recent theories of economic growth that are interested in how certain locations manage to achieve a so-called higher level of economic complexity⁸ emphasise the great role of cooperation and coordination between different stakeholders in a given context. Companies cannot be seen as individual actors who contribute to local development through individual action but we must understand the ways in which they achieve social and political cooperation with the environment in which they are located.

How do we further strengthen the SME sector and its contribution to more balanced development in the context of the "Open Balkans"?

Despite the general tendency (both in the Western Balkans and beyond) to shift the responsibility for development, but also for problems such as the climate crisis and labour shortages that humanity is increasingly facing, to abstract and apolitical forces such as digitalisation and constant technological progress, it is more than clear that responsible facing of the uncertainties of economic, social and environmental challenges that surround us largely depends on the behaviour of people and their capacity for joint social action. Capacities for this type of action, in turn, depend on human and political factors and efforts such

⁸ The creators of the economic complexity concept are Ricardo Hausman and his team at Harvard University.

Highlight 1: What Is the Role of Small and Medium Enterprises in the “Open Balkans” Initiative?

as building trust within and between communities, but also the development of social innovations, platforms and public policies that can facilitate these processes. Technology, of course, can help speed up and improve these processes, but technology cannot be an end in itself. At the end of the day, the very idea of “Open Balkans” is based on the recognition of the need for greater cooperation and coordination between countries and territories in the region, and it is surprising that the proposed activities do not leave room for developing political mechanisms for better coordination and cooperation between various participants in these processes, especially those from the private sector.

For example, Carter (2018) shows how French wine producers use political organisation to achieve greater value of their products in the international market, thus concluding that markets are not only socially but also politically embedded. Analysing the examples of industrial districts in Bologna and Stuttgart, Farrell (2009) shows that cooperation between organisations in research and development (R&D), as well as cooperation between organisations and their customers, are rational strategies pursued by smaller organisations to gain a competitive advantage in the market. Such insights show that the competitiveness of companies with fewer resources can be strengthened in ways that do not undermine their productivity but improve it.

The findings of my interviews indicate that SMEs in Serbia and B&H are most concerned with the lack of public goods and resources they need to operate successfully, such as knowledge and human resources, but even the lower-skilled workforce. They are also concerned about the instability of access to natural resources and raw materials they need in the production process, but also the general atmosphere of stagnation and de-development in their environments that demotivates their workers and affects their productivity. During the interviews, research participants paid far more attention to these topics than to the problems of access to new technologies and markets, which they find to be going rather smoothly given that there is a growing international interest in goods and services from the Western Balkans. They see cross-border cooperation with other firms (between Serbia and B&H) in the mutual support of smaller firms to innovate together, share the workforce or at least solutions on how to keep them so that they can cope with bigger and more powerful competition. On the other hand, given that emigration and depopulation are a bigger problem in B&H than in Serbia, there is a certain amount of apprehension that greater labour mobility due to mutual recognition of qualifications within the region would pull away the little labour available from the

less developed communities. Therefore, for them, the issue of survival of their own firms is closely related and interdependent with the sustainable development of the local community, and not exclusively a matter of technological improvement and access to new markets.

The companies also spoke extensively about their efforts to motivate the workforce, bring knowledge to their communities, engage in training workers, as well as to fill all those gaps in social infrastructure that the state should traditionally take care of. They believe that the availability of resources that they care about most in some other contexts that have not gone through war conflicts, sanctions, de-development, and depopulation are implied. The fact is that SMEs have much less room to defend themselves from systemic risks because they cannot move production to another location, as is the case with international corporations, which leads to them recognising much more their interdependence with the environments in which they operate. In short, the capacity of interviewed SME exporters from B&H and Serbia to increase their economic value depends primarily on their ability to strategically use embeddedness in their social and political environment, and these topics preoccupy them much more than market access and technological innovations that are the focus of the Common Regional Market and accompanying initiatives.

The Center for Advanced Economic Studies (CEVES) from Belgrade, headed by Dr Kori Udovicki, organised the MSP100 Expo⁹ on June 1, 2022, where they gathered 100 SME champions from Serbia who are proven innovators and important exporters (and some of them even pioneers in green technologies). This initiative was launched to strengthen cooperation between SMEs in areas related to access to common goods such as human resources, access to finance, and green technologies. For example, one of the discussed themes was the problem of retention of employees which were educated and trained in-house, only to then be scooped by larger and more competitive international companies. Creative solutions to overcome these challenges were exchanged. This is an outstanding example of the effort to establish cooperation between SMEs and to expand the idea that by exchanging and acting together, many challenges facing entrepreneurs can be overcome. Although these efforts are currently only at the national level, such initiatives could in the future take on a regional character in the context of the “Open Balkans” initiative.

My interviews also show that smaller firms don’t just work together on common issues. It also happens that certain firms invest in other firms that create content

⁹ For more information, please see <https://msp100.rs/>

improves the quality of the environment in which they live for everyone in the wider community, including them and their employees. One interesting example of this type of cooperation that creates greater social value is the support of the IT sector to firms engaged in the creation of politically independent cultural and media content.

Although cooperation between SMEs is very important for community development, cooperation with other actors interested in the development of a particular area is also extremely important, such as local municipalities, civil society organisations, trade unions, associations, and citizens' associations. As community-based care practices are quite common among SMEs, especially in less developed areas, decision-makers, as well as civil society representatives, need to better recognise the role that the private sector has in dealing with the social challenges facing their municipality or region, as well as the fact that SMEs often compensate for the insufficient presence of the state in areas that should be in the domain of public policies. Therefore, SMEs can also be treated as civil society actors that contribute to local development in many ways, and not only through the direct market mechanism.

Transnational cooperation can be another important source of social innovation and an important lever for a more even distribution of the effects of deeper economic integration of the countries and territories of the Western Balkans. In a number of successful family businesses, I have spoken to second or third-generation owners who have had the opportunity to study abroad, after which they have significantly expanded their family businesses and made them much more export-oriented. They emphasise the importance of the skills they have acquired in other places, but also the contacts they have built there, which now help them to access foreign markets more easily. I also came across examples of people returning as children of the first generation of immigrants from the diaspora with the skills, contacts and understanding of the culture and language of the country where their customers are located, and founding firms in their countries of origin. Moreover, several firms have found that the diaspora is a very important source of demand for their products because people want to support firms from their region or want to work with them to have a reason to travel "home" or use their mother tongue at work. Owners of such firms are very aware that investing in international contacts and communities allows them to remain competitive, not just the technology they possess and the quality of the product itself.

In addition, the quality of the products themselves is improved precisely through these transnational networks

to which these firms belong. For example, the owner of a packaging company from central Bosnia told me the story of many years of informal cooperation with a firm from central Serbia through which they developed innovative machines that helped both firms sell more of their products on international markets. Government programmes in advanced economies can also be useful for firms from countries with less capacity to support their firms and to invest in R&D. The owner of a small Serbian IT firm working as a subcontractor on the German market believes that his firm benefited greatly from public programmes implemented by the German government in its industrial zones. Through German partners who participated in their own government programmes, the Serbian firm was able to gain insider knowledge on the very technologically advanced German car manufacturers' production processes and their software needs, which then allowed them to accumulate new knowledge and develop own business products. Such cases can inspire a new generation of policies in the context of the Common Regional Market in the Western Balkans.

Conclusion

The research presented in this Highlight analyses the growing importance of the SME sector in the socio-economic development of countries and territories of the Western Balkans, and considers implications of these trends for the Common Regional Market, i.e. the "Open Balkans" initiative. Advantages and disadvantages of existing guidelines and recommendations within which deeper economic integration of the region takes place and the implications of these processes for smaller domestically owned firms and for the deepening of territorial inequalities that may occur due to greater economic integration are analysed. Although there is no automatic link between the economic strengthening of the SME sector and more balanced and inclusive economic development, research concludes that this link can be strengthened by developing cooperation and coordination between smaller businesses, both within countries and in the context of cross-border cooperation within the region. In addition, more attention needs to be paid to building links between SMEs and other parties interested in local development. Here we especially emphasise the role of SMEs as actors of civil society, and their interdependence with the environment in which they are located and on which their international competitiveness depends. This perspective complements the limited focus of existing public and EU policies on technological innovation and market expansion for SMEs in the region, and points to the much more complex collective needs of the SME sector, related

Highlight 1: What Is the Role of Small and Medium Enterprises in the “Open Balkans” Initiative?

to the management of local human, communal and natural resources, which caused the participants of this research project most worries. This project does not pretend to offer all the solutions, but aims to map the state of affairs as well as to open a conversation in the direction of formulating a research and public-political agenda that would deal with these issues more closely in the future. Will deeper economic integration of the Western Balkans lead to further territorial stratification, where larger companies, or firms from countries that can provide stronger support to the private sector, will benefit more than firms and regions dealing with more challenging political and socio-economic contexts? This is an important issue on which the success of the “Open Balkans” potentially depends.

References

1. Avlijaš, S., Hassel, A. and Palier, B. (2021) Growth Strategies and Welfare State Reforms in Europe. In: B. Palier and A. Hassel (eds.) *Growth and Welfare in Advanced Capitalist Economies. How Have Growth Regimes Evolved?* Oxford: Oxford University Press.
2. Carter, El. (2018). For What It's Worth: The Political Construction of Quality in French and Italian Wine Markets. *Socio-Economic Review* 16(3), 479–98.
3. European Commission (2020). *An SME Strategy for a sustainable and digital Europe*. (COM(2020) 103 final). Brussels: European Commission.
4. Farrell, H. (2009) *The Political Economy of Trust. Institutions, Interests, and Inter-Firm Cooperation in Italy and Germany*. Cambridge: Cambridge University Press.
5. Henrekson, M. & Jacobsson, U. (2001). Where Schumpeter was nearly right – the Swedish model and Capitalism, Socialism and Democracy. *Journal of Evolutionary Economics*. 11: 331–358.
6. Jones, R. S. & Lee, J. W. (2018). *Enhancing dynamism in SMEs and entrepreneurship in Korea*. (Economics Department, Working Papers No.1510, ECO/WKP(2018)58), Paris: OECD.
7. Matkovski, B., Đokić, D., & Jović, L.V. (2022). *How CEFTA influenced competitiveness of agri-food trade in Western Balkans*. (LSEE-CEFTA Research Papers on International Trade, Research Paper No. 4). London: London School of Economics and Political Science.
8. OECD (2018). *Good Jobs for All in a Changing World of Work: The OECD Jobs Strategy*. Paris: OECD.
9. Pietrobelli, Carlo. (2021). “New Industrial Innovation Policies in a World of Global Value Chains”. In *The Challenges of Technology and Economic Catch-up in Emerging Economies*, edited by Lee et al. Oxford University Press.
10. Scharpf, F. W. (2021). Forced structural convergence in the Eurozone. In B. Palier, & A. Hassel (Eds.), *Growth and Welfare in Advanced Capitalist Economies. How Have Growth Regimes Evolved?* (pp.161-201), Oxford: Oxford University Press.
11. Storper, M. (2013) *Keys to the City: How Economics, Institutions, Social Interaction, and Politics Shape Development*. Princeton University Press
12. Uberti, L. J., & Demukaj, V. (2019). *Regional Integration, Trade and Development in the Balkans: A Dynamic Poisson Approach*. (LSEE-CEFTA Research Papers on International Trade, Research Paper No. 3). London: London School of Economics and Political Science.
13. Udovicki, K., Medic, P. & Avlijas, S. (2019). *Competitiveness of Serbia's Economy in the Context of New Global Economy: Opportunities and Threats*. (Position Paper No.2), Belgrade: Center for Public Policy Research.