

# TOURISM & HOSPITALITY

## CURRENT SITUATION

The second decade of 21 century is characterized by a quantitative increase and qualitative improvement of accommodation tourist capacities in Serbia after the collapse of post-transitional tourism and the closure of many degrees in the first decade of this century. This period is characterized by the opening of a number of previously missing 4- and 5-star hotels, the start of a number of planned hotels in mountain and spa destinations, and the emergence of congress, spa, and other specialized hotels. On the other hand, the development of rural accommodation and different tourist capacities is flourishing.

The quality structure of accommodation capacities is continuously improving, given that the most significant number of newly opened facilities belong to higher categories. Despite these improvements, Serbian accommodation is not adjusted to the international market expectations, given that the share of hotel accommodation is only 29%<sup>1</sup> of the total accommodation capacity. It can be seen as a disadvantage, but it also represents the considerable opportunity for growth in this segment.

Tourism contribution to the national economy is increasing significantly, along with the increase in business activity. The number of arrivals and overnights continuously increased before the pandemic. Income generated from foreign tourists, approaching 1bn<sup>2</sup> in 2015, increased considerably in just four years to 1.436<sup>3</sup> bn or 51.96% in 2019. However, the other sectors of the economy were also rising, so tourism has kept its share in total export (6.1% in 2019%).

Regarding services, tourism is one of the most significant contributors to services export, participating in more than 1/5<sup>4</sup> of total service export in Serbia. The estimated share of the tourism industry (total) in BDP in 2019 was 6.9%<sup>5</sup>. In the same year, this industry had about 82.5 thousand employees<sup>6</sup>. These results would be even more significant, and the contribution of tourism to the national economy

would be (formally) more outstanding if the grey economy's high share in the hospitality sector were reduced applying effective and continuous tourism and tax inspection supervision.

The mainly positive achievement was a substantial increase in foreign arrivals, overnights, and spending, influencing the Serbian foreign trade balance, traditionally in deficit and positively supported in the period of Tourism Development Strategy the Republic of Serbia 2016-2025 (TDS) implementation. From 2009 to 2019, Serbia recorded an increase in the relative share of foreign tourists in total volume. The number of international arrivals and overnights was growing on average at 11.11% (CAGR) and 10.61% (CAGR), respectively, and in 2019 foreign tourists reached a 50% share in total arrivals and 40% share in total overnights<sup>7</sup>.

From the perspective of strategic planning, the valid TDS is still relevant in many of its segments: key target foreign markets and key tourist products were kept from the former strategy; geographical clusters of Serbian tourism supply are stable; in the process of tourism digitalization, critical step has been undertaken by E-tourist platform introduction. On the other hand, the TDS did not sufficiently cover the area of digital transformation of tourism business. Besides, market segments were not defined based on specific market research, so there is no explicit connection between tourist products and specific market segments for which these products are planned.

Further, key legal documents were upgraded in 2019 according to strategic intentions to support the SME sector and protect consumers starting with laws: Law on tourism and Law on hospitality. Further, in 2021, Strategic Marketing Tourism Plan of Republic of Serbia was adopted.

**Investments in tourism have increased** (from 280 mil EUR in 2015 to 700 mil EUR in 2020)<sup>8</sup>, but at a much lower rate than projected. Namely, significant investments were registered as investments in infrastructure (which is in the function of tourism), buildings (in tourism function), etc. Considering the number of newly opened hotels, doubts about underestimating statistic became important.

1 E tourist, Statistical Office of the Republic of Serbia

2 NBS

3 NBS

4 Statistical Office of the Republic of Serbia

5 WTTC estimation based on Tourism Development Strategy of RS 2016-2025

6 WTTC estimation based on Tourism Development Strategy of RS 2016-2025

7 Statistical Office of the Republic of Serbia

8 WTTC Report

## THE IMPACT OF CURRENT GEOPOLITICAL AND ECONOMIC CHALLENGES ON BUSINESS

Tourism and hospitality are one of the main drivers of economic development and global connectivity. The COVID-19 pandemic has been the worst crisis the global travel industry has faced in modern times. Lockdowns, travel restrictions, consumer fears and economic downturns led to a loss of \$4.5 trillion in T&T GDP and 62 million jobs in 2020 alone<sup>9</sup>.

COVID 19 harmed Serbian tourist traffic in 2020, which resulted in a drop in arrivals by 51% and overnights by 38%<sup>10</sup>. The foreign tourists' arrivals and overnights experienced a significant decline of 76% and 68%<sup>11</sup>, respectively. The crisis particularly affects cities, including city hotels and other accommodation facilities. In 2021, tourist traffic partially recovered but primarily due to a temporary restructuring in the domestic tourist demand pattern (total number of arrivals and overnights accounted for 70% and 81% of those achieved in 2019, respectively, while foreign tourists reached 47% and 60% of arrivals and overnights from 2019, respectively). The positive trend of the Serbian tourism recovery continued in 2022 with the tendency of reaching and even overcoming figures from 2019.

Besides, European as well as Serbian tourism is facing another challenge. The Ukrainian crisis has forced many countries to reduce their forecasts for 2023, affecting the tourism industry in five ways<sup>12</sup>:

- A loss of Russian and Ukrainian tourists/markets;
- Certain restrictions on airlines and use of airspace;
- Rise in inflation;
- Higher food and fuel costs and
- A big hit to traveler confidence and disposable incomes.

## REMAINING ISSUES

The key challenge of the tourism industry in Serbia is to improve its competitiveness and position of Serbia in the global tourism market as a recognizable, attractive, and authentic tourist destination, which creates new jobs, sustainably manages its development and is attractive for new investments.

<sup>9</sup> UNWTO

<sup>10</sup> Statistical Office of the Republic of Serbia

<sup>11</sup> Statistical Office of the Republic of Serbia

<sup>12</sup> Economist Intelligence Unit (EIU), WTTC and UNWTO

### 1. Sustainable Tourism Development Vision and Measurable Strategic Goals are Not Defined

The importance of tourism development programming and integral planning was not sufficiently recognized and implemented in the previous period. Specific strategic vision and well-articulated strategic and measurable objectives, including implementation, and transparently monitoring mechanisms with the upgraded coordination and cooperation of all key stakeholders at all levels, are missing.

Consequently, it is necessary to define a new Tourism Development Strategy, which will consider the "new reality", and the need to redefine strategic and set measurable goals, including implementation and monitoring mechanisms that will ensure sustainable tourism development. Besides, improved coordination and cooperation of all key stakeholders at all levels with more significant participation of local communities in the tourism development process is needed.

The strategic framework has to respect the modern destination management concept, which implies introducing the legal possibility for tourist destinations to be managed by private companies and public-private partnerships.

### 2. Inadequate Methodology of the National Bank of Serbia for the Foreign Currency Income Assessment

Foreign exchange inflow is still calculated according to the inadequate methodology of the NBS for estimating foreign exchange inflow, which is one of the most important topics. The estimation of foreign exchange inflow is related to the work of exchange offices, so there is a discrepancy with tourist peaks. The estimation of the average consumption of foreign tourists based on such calculated foreign exchange inflow is highly unreliable. Consequently, there is no reliable calculation of the tourism industry's contribution to GDP. Furthermore, the budget for national tourism promotion and tourism, in general, is permanently underestimated and insufficient, directly affecting the insufficient promotion of Serbia as a tourist destination.

Modification of the NBS methodology for the assessment of the foreign exchange inflow of the tourism and hospitality industry and its contribution to the national GDP through the introduction of tourism satellite accounts. In this way, the quantification of the economic impact of tourism would be carried out using internationally recognized and accepted methodology.

### 3. Unflexible legal framework that does not provide the possibility of employment in accordance with the Law on Simplified Employment of Seasonal Jobs in Certain Activities

Human resources present a significant barrier to further development in labor-intensive industries such as tourism and hospitality. The number of disposable workforces decreased, causing the rise in wages, and consequently causing an economically rational reaction of employers: part-time jobs, reduction of service (self-service, etc.), and even hiring unregistered employees to reduce labor costs. In addition, the structure of the labor force and the level of its education and training further deteriorated after the pandemic outbreak when a significant number of employees sought work in other industries. The insufficiently flexible legal framework does not recognize the needs of highly seasonal industries such as tourism and hospitality.

Hiring within this industry can be performed only in accordance with the Labor Law provisions ("Official Gazette of RS", no. 24/2005, 61/2005, 54/2009, 32/2013, 75/2014, 13/ 2017 - US decision, 113/2017 and 95/2018 - authentic interpretation), i.e., in a way to come to establishing of employment relationship by concluding an Employment Contract or in such a way that the work takes place outside the employment relationship by concluding a Contract on Temporary and Periodical Jobs, a Purchase Order Contract or a Supplementary Work Contract.

Due to the special characteristics and expressed need for seasonal workers in tourism and hospitality, it is necessary to amend the Law on Simplified Employment of Seasonal Jobs in Certain Activities ("Official Gazette of RS", No. 50/2018) in terms of expanding the circle of employers from Article 2. of the Law on Simplified Employment in Seasonal Jobs in Certain Activities ("Official Gazette of the RS", No. 50/2018) in such a way as to include employers who perform activities in the tourism and hospitality sector.

In this way, it would be possible to implement a simplified procedure for the employment of persons and the payment of taxes and contributions for work on jobs of a seasonal nature and within the scope of activities of a hospitality and tourism nature.

This modality of work engagement would imply mutual benefits both for the employers and for potential seasonal workers. The expected advantages on the employer's side are as follows:

- The employer is given an opportunity of simpler employment procedure, which represents work outside the employment relationship, via a verbal contract on the performance of seasonal work, which is concluded from the moment the seasonal worker access to work.
- The employer can apply a simplified procedure for calculating and paying citizens' income tax and contributions for mandatory social insurance, which in this case only include rights from pension and disability insurance, as well as rights from health insurance, but only in case of injury at work and occupational diseases. The simplified procedure for paying taxes and contributions implies a pre-determined basis for calculating the obligations, regardless of the contracted hourly labor price of a seasonal worker. The stated base is always equal and amounts to a thirtieth part of the amount of the lowest monthly contribution base per day of engagement in seasonal jobs;
- The employer is only obliged, to submit in the stipulated period electronically to the tax administration the data required for the preparation of the evidentiary application, based on which the Tax Administration system automatically prepares and submits the individual tax return on calculated taxes and contributions.

The expected employees' benefits are as follows:

- Creating opportunities for persons in employment to earn additional income by concluding seasonal work contracts;
- Creation of the opportunity to generate additional income for beneficiaries of social assistance, given that the compensation for work received by a seasonal worker has no effect on the realization and use of the right to cash social assistance;
- Creating an opportunity for family pension users to earn additional income, given that there is no suspension of family pension payments if the contracted monthly compensation is realized in an amount lower than the lowest base in employee insurance, valid at the time of payment of contributions.

In addition, it should be emphasized that the law clearly prevents the possibility of abusing the simplified work engagement of a person, considering that a legal limitation of a maximum of 180 days is clearly introduced during the duration of the calendar year on the basis of the contract on performing seasonal work, as well as the relationship between this contract and the contract of Temporary and

Periodical Jobs, where it is prescribed that if the same person is engaged on the basis of both contracts in one calendar year, the total number of working days on the basis of both contracts cannot amount to more than 120 working days in the calendar year.

#### 4. VAT High Tax Rate in Hospitality Sector

Even before the COVID-19 pandemic, most European countries reduced VAT rates on hospitality services which positively impacted competitiveness and boosted their tourism industry. In addition, after the COVID-19 pandemic outbreak, the vast majority of European countries significantly reduced the VAT rate. Serbia, with a 20% VAT rate on hospitality services, became even more uncompetitive, especially in MICE, when the tax burden is crucial for destination selection.

Furthermore, it is necessary to change the legal regulations in the direction that, within the scope of the activities now foreseen, which are taxed at a special, reduced VAT rate of 10%, (such as accommodation services), food consumption services within hospitality business entities should also be added. In this way, domestic tourism and hospitality competitiveness would be enabled compared to competitors primarily from the Region but also from the rest of Europe, especially in MICE tourism.

#### 5. Inadequate Tariff Model Determination According to the Law on Copyright and Related Rights

The improvement of the competitiveness of Serbian tourism is additionally burdened by parafiscal burdens such as the payment of tariffs according to the Law on Copyright and Related Rights. Namely, regardless of whether the accommodation facilities (rooms) are occupied or not, the tariffs must be paid.

In accordance with the Law on Copyright and Related rights, business entities from the tourism and hospitality sector are charged a special fee according to the Tariff issued by the organization for the realization and protection of copyright and related rights.

The most common case of collection of these fees is collection in accordance with a flat rate. When determining the amount of the flat fee, the following criteria are considered:

- the type and method of exploitation of the subject of protection;
- geographic location of the user's headquarters;
- type and size of the space in which the objects of protection are used;
- duration and scope of use and prices of the user's services.

The criteria set in this way for determining the flat rate are inadequate and completely ignore the key circumstance, i.e., the occupancy percentage of the facility's accommodation capacity.

Instead, it is necessary to introduce a fee payment criterion based on the occupancy percentage of the taxpayer's accommodation capacity in the accounting period.

#### 6. The Grey Economy's High Share

The grey economy's high share in the tourism and hospitality sector (reaches up to 40% - 50%, especially among individual owners' accommodation rental via various online platforms) negatively affects the profitability and quality of accommodation services and the overall competitiveness of Serbian tourism. Further, this practice allows unfair competition for facilities that work legally.

### FIC RECOMMENDATIONS

- Adoption of a New Tourism Development Strategy with a Change of the Tourism Destination Management Concept
- Adoption of a New Assessing Methodology for the Tourism Foreign Exchange Inflow of Through the Application of the Tourism Satellite Accounts Methodology

- Amendments to the Law on Simplified Employment of Seasonal Jobs in Certain Activities Expanding the Provisions on Tourism and Hospitality Sector in terms of expanding the circle of employers from Article 2. of the Law on Simplified Employment in Seasonal Jobs in Certain Activities ("Official Gazette of the RS", No. 50/2018) in such a way as to include employers who perform activities in the Tourism and Hospitality sector.
- Amendments to the VAT Law to Expand Activities That Would be Taxed at a Special, Reduced Rate of 10%
- Amendments to the Law on Copyright Regarding the Method of Determining the Copyright and Related Rights Tariff to introduce a fee payment criterion based on the occupancy percentage of the taxpayer's accommodation capacity in the accounting period.
- Suppression of the High Level of the Grey Economy in Tourism and Hospitality Emphasizing Individual Accommodation Services Segment
  - It is necessary to strengthen the capacities of the tourism inspection at the local and national level and to carry out permanent education of inspectors.
  - Accommodation service providers (especially individual accommodation service providers) should be informed and educated about the rights and benefits provided by the legal framework through educational campaigns.
  - Effective and continuous tourism inspection (preventive and regular) supervision must be applied to minimize the grey economy and improve the use of E-tourist, especially among individual accommodation service providers.
  - The tourism inspection (at all levels) should adopt a Strategic and Annual Plan for suppressing the grey economy based on comparing the advertised accommodation facilities on various online platforms and the facilities in the E tourist system. The Annual Plan for the following year should be drawn up by December 15 of the current year.
  - The tourism inspection should make publicly available the Annual Report of the performed supervision according to the newly proposed Strategic and Annual Plan. The Annual Report should be quantified and contain at least the destination name, the number of inspections carried out, the types of facilities inspected, and the supervision results. The Annual Report should be published for the previous year by February 15 of the current year.
  - Legal entities and individual accommodation service providers not registered in the E tourist system cannot be beneficiaries of public funds at the national and local levels.