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FOREIGN DIRECT INVESTMENTS IN SERBIA – STATE AND PERSPECTIVES

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Abstract

The last decade of the twentieth century was very successful for a number of ex socialist countries of Central Europe. That was the decade of prosperity, progress, and getting closer to the modern and developed European countries. This region (Slovenia, Poland, Czech Republic, Hungary, and Slovakia) comprises group of countries in transition, which are in the front line in the process of transformation of their economic systems, implementation of economic reforms and attracting private foreign investments, first of all, foreign direct investment. In contrast to these countries, in the area of former Yugoslavia, the early 1990s were the years of complete disintegration, marked by economic sanctions, huge human casualties, and vast destructions. The dramatic political situation Serbia was in, caused heavy consequences on its social-economic development. The result is that Serbia today is one of the least developed countries in Europe. Position of Serbian economy drastically aggravated in the area of international capital flow.

In this paper we analyze one form of international capital flow that can start up the Serbian economy – foreign direct investment. In the period to come, the development of our country will mostly depend on the value of foreign investments. Without direct foreign investments and conditions of low domestic savings, limited opportunities for crediting, lack of management knowledge, modern technology and export routes, there is not going to be any economic development in Serbia. In that sense, the most prominent is the need to affirm our competitory advantages and to remove the existing limitations for foreign investments so that conditions for foreign investors to realize in the fastest way their ideas for investments are created.

Key words: Capital flow, foreign direct investment, Serbian economy.

Introduction

Long isolation of the Serbian economy from the world economic and trade activities left very negative consequences on its economic performance. Dramatic political situation in Serbia has left heavy economic consequences on its social-economic development, and its position in the international capital flow was drastically worsened.

After reintegration of Serbia into international economic system causes significant improvement of economic relationships, which leads to strengthening foreign direct investment activities, but this strengthening is still below real needs of Serbia.

This paper analyses one of the forms of international capital flow that can instigate progress of Serbian economy in the current global economic crisis – FDI-s. FDI-s development effects are numerous, such as: export growth, modern technologies transfer,

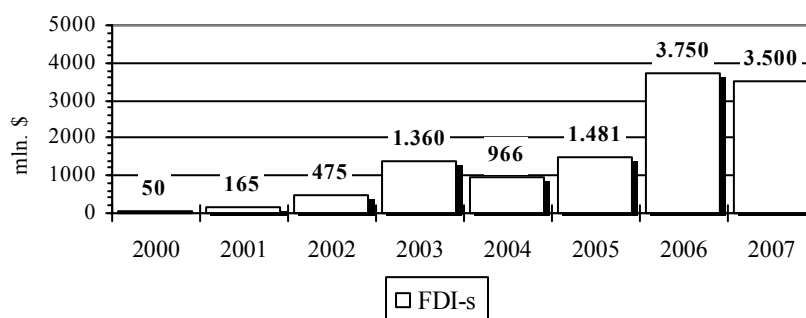
GDP and investments growth and improvement of domestic management skills. All of the above confirm that FDI-s is the necessary precondition of the economic transition of the Serbian economy and its integration in the global economy.

Current results in attracting FDI-s

More significant number and amount of FDI-s in Serbia have been attracted after its reinclusion into contemporary world integration processes. Within that context, in the beginning of 2000s, relationships with the most important financial institutions were regulated, manifold bilateral agreements on investment protection were signed as well. On the other hand new legal regulation that is affirmative for the FDI-s, such as Privatization Law, Law on FDI-s, Law on Concessions, etc were approved. These activities contributed to the improvement of the investment climate in Serbia.

More significant amount of foreign capital was invested in Serbia only after 2000. If Italian and Greek investment into "Telecom Serbia" (USD 740 million in 1997 and USD 113 million in 1998), are left out, net FDI inflow did not get over USD 100 million until 2000. The amount of FDI-s grew from USD 165 million in 2001 to USD 3,500 million in 2007. (USD 165 million in 2001, USD 475 million in 2002, USD 1,360 million in 2003, USD 966 million in 2004, USD 1,481 million in 2005, USD 3,750 million in 2006 and USD 3,500 million in 2007). The inflow of FDI-s in 2000-2007 periods was USD 11.7 billion or USD 1.47 billion annually. The figure below presents the net values of FDI in Serbia during 2000-2007.

Figure 1 - FDI-s in Serbia 2000-2007



Total amount of FDI-s in 2001 was 2.5 times higher than in 2000. More interest from foreign investors in 2001 can be expressed through significant increase of the contracts. According to Federal Ministry for Relations with the Abroad, 1310 contracts with the foreign investments were registered in 2001, which was several times more than in the previous years. Out of the number above, 639 companies were registered as 100% foreign owned, and 638 companies were founded as mixed capital, i.e. joint investment of foreign and domestic companies.

Regarding the sector structure, i.e. activity into which the capital was invested in 2001, different activities were of interest for foreign capital, with the leading position of trade and services (over half of registered contracts were in these sectors).

During 2001 significant amount of FDI-s were in the banking sector when the following banks were founded in Serbia: "Micro-Finance Bank", "Raiffeisen Bank Yugoslavia", "HVB Bank Yugoslavia", "National Bank of Greece" and "Societe Generale Yugoslav Bank".

According to regional distribution of FDI-s, most of companies were founded in Belgrade, Novi Sad, Subotica, Nis, Cacak, Valjevo, Kraljevo, Krusevac, Pancevo, Sombor, Vranje, Uzice and Leskovac.

In 2002 the inflow of FDI-s in the Serbian economy was 475 million. Unlike previous years, during this period most of FDI-s come in the form of cash as a consequence of significant privatizations. In that sense, very important privatizations were "Beochin Cement Factory" to the French "Financiere Lafarge S.A" (USD 50.89 mln), cement factory "Novi Popovac" to the Swiss "Holcim" (USD 52.5 mln) and cement factory "Kosjerich" to the Greek company "Titan" for USD 35.5 mn. Krusevac based factory "Merima" was sold to the foreign partner for USD 42.3 million, while at auctions companies worth USD 16 million were sold to foreign legal persons.

Inflow of FDI-s in 2003 was more than USD 3,300 mln, due to tobacco companies sale, while during 2004 there were less FDI-s as a consequence of slowdown in the privatization process. During 2005 FDI levels was higher again. In 2006 Telecom "Mobi 63" was sold for EUR 1.5 billion and farmaceutical company "Hemofarm" for EUR 485 mln, which together with other investment brought the FDI level at USD 3.5 billion. Similar inflow was achieved in 2007 as well.

The highest inflow of FDI-s during 2000 - 2007 (Table 1) was for the purchase of companies and property through the process of tender and auction privatization (more than 50%). The process of privatization was the most important channel of FDI-s inflow in the Serbian economy, which leads to high correlation level between FDI-s and privatization, where one stimulates the other and vice versa. Apart from sale of domestic companies, one has to emphasize that there were *greenfield* investments, which are more often present in the lower risk surroundings and higher transparency countries and whose effect on the increase of the total investment is larger than the ones from mergers and acquisitions. That means that the effect of the total level of investments in the country depends upon the type of FDI-s.

Table 1 - The largest FDI-s in the Republic of Serbia

Company	Country of Origin	Sector	Investment Type	Amount (EUR min)
Telenor	Norway	Telecommunications	Privatization	1,513
Mobilkom	Austria	Telecommunications	Greenfield	570
Philip Morris – DIN	USA	Tobacco industry	Privatization	518
Stada	Germany	Industry	Capital market	475
Banca Intesa – Delta banka	Italy	Banking	Capital market	462
Interbrew – Apatinska pivara	Belgium	Beer industry	Capital market	430
NBG	Greece	Banking	Privatization	425
Mercator	Slovenia	Retail	Greenfield	240
Lokoil – Beopetrol	Russia	Oil industry	Privatization	210
Holcim – Novi Popovac	Switzerland	Cement industry	Privatization	185
OTP Bank	Hungary	Banking	Privatization	166
Alpha Bank – Jubanka	Greece	Banking	Privatization	152
U. S. Steel – Sartid	USA	Steel	Brownfield	150

Metro Cash & Carry	Germany	Wholesale	Greenfield	150
OMV	Austria	Gas stations	Greenfield	150
Coca Cola	USA	Beverages	Capital market	142
Africa Israel Corp. Tidhar	Israel	Real estate	Capital market	120
Droga Kolinska Grand prom	Slovenia	Industry	Greenfield	100

Source: SIEPA (Serbian FDI Attraction State Agency)

Regarding the amount of investments in Serbia, as of origin of capital, over 76% of FDI-s has come from Norway (24,6%), USA (13,1%), Austria (11,7%), Germany (10,1%), Greece (9,4%) and Italy (7,5%). From the sector point of view most FDI-s came to telecommunications, banking, cement, oil, tobacco industries, etc.

On the basis of the current experience of attracting FDI-s, one can notice that the FDI inflow increased very much after 2000. But, although there were more FDI-s in the recent years, their amount is still not sufficient.

The FDI stock in the Serbian GDP is still below EU average. In 2006 the FDI were 32%, while in the EU then 25 countries was 38%.¹ Although Serbian GDP in 2007 was 45.8% higher than in 2000 (average annual growth of 5.6%) and FDI level was 70 times higher (average annual growth of 83.5%), FDI inflow per capita is still low – 50% lower than in Croatia and more times lower than in Romania, Poland, Hungary and Czech Republic.

The following data show the level of our lagging behind successful transition countries in the area of attracting foreign capital.² For example, Slovakia was the most successful transition country regarding FDI attraction in 2006. It got USD 13 billion, out of which USD 10.9 billion was in corporate and USD 2 billion in the banking sector. The Czech Republic was on the second position. It attracted USD 11.4 billion, out of which USD 5 billion in transport and communications, USD 1.9 billion in real estate, and USD 1.4 billion in production. Poland had USD 7.7 billion of FDI-s, which was significant fall compared to 2004, when it had USD 12.8 billion. In 2005 Hungary had USD 6.8 billion of FDI-s, while it's total FDI level between 1994 and today was USD 63.3 billion. Now there are more than 25,000 companies

¹ Development of Serbia Report 2007, Development Fund of Serbia, Belgrade, 2008, page129.

² Data from daily Danas.

with foreign ownership in Hungary. Romania had USD 6.6 billion of FDI-s in 2005, which was achieved despite the fact that there were no major privatizations that year. In 2006 economy of Romania had USD 6 billion of FDI-s.

Probably the most representative example for Serbia is the case of Bulgaria, which in 2002 had USD 969 million, while in 2003 more than USD 2 billion. Since than FDI-s level was never below USD 2 billion. In 2005 only, Bulgaria had USD 2.3 billion of green field FDI-s.

It is obvious that FDI inflow into Serbian economy was lower compared to other transition countries and that, despite the positive trend since 2000, it is still not sufficient from the point of view of development needs of Serbia.

This conclusion is confirmed by the fact that the structure of FDI-s is not good. Namely, Greenfield investments still do not comprise dominant form of FDI-s in the Serbian economy. Most of FDI-s still comes in the form of domestic companies' privatization. However, that type of inflow is limited by the end of privatization process. Having that in mind as well as the low level of Greenfield investments, it is necessary to take permanent activities for creation of the better investment climate for FDI attraction and stimulation of Greenfield investments.

Examples from the neighbouring countries show that the Greenfield was the significant instigator of the economic development and dynamic of export activities, which is the reason why this type of FDI-s has to become the basis of the Serbian strategy for foreign capital attraction. The future more dynamic inflow of foreign capital must not be based on the sale of parts of the infrastructure system, which is most attractive for the foreign investors, but first of all on the stimulation of FDI-s that can lead to restructuring of the economy which should become more competitive on the global market.

Although the process of reintegration of Serbia into international community contributed to certain increase of foreign investment activities, these are still not sufficient for the start up of economic development process. In order to catch the large lag of Serbian economy time and high GDP growth rates are necessary. In order to achieve both of these more FDI-s are needed.

Comparative advantages of Serbia in the area of FDI-s attraction

Having in mind the conclusion that FDI-s are the most important means of economic recovery of Serbian economy, the strategy of foreign capital inflow has to become the basis of its economic and development policy, particularly in the conditions of the current economic crisis. With that aim, it is very important to define priority sectors for foreign capital, as well as establish the best forms of that inflow. National strategy of foreign capital inflow has to define type of necessary foreign investments, as well as sectors that have to be developed.

Comparative advantages of Serbia define the selection of economic sectors that have to be developed within which foreign investments can be best realized. The basic direction of the strategy for attraction of foreign capital has to be focused towards those sectors that can use Serbian advantages, out of which the following ones are the most important:³

- geographic and strategic position - that has to be used better,
- cheap and educated workforce,
- size and connectivity of domestic market with other markets,
- natural resources and others.

Infrastructure investments are particularly important for Serbian economy having in mind that these can create conditions for investments in other sectors, which would remove underdevelopment of infrastructure as significant limitation for foreign investors. In this context, attraction of foreign capital should be promoted through concessions. Serbian economy can offer concession in the following sectors: highways, railways, mines, spa and mountain tourism, etc.

Metal and chemical complexes of the Serbian economy are its investment opportunity, with the notion that sub-sectors that can be competitive have to be defined on the regional markets. Metal processing industry, some time ago very important exporter has big problems nowadays, and structural changes within it as a result of FDI-s inflow could significantly contribute to the renewal of export.

Telecommunications, where local market determines interests and business decisions of foreign investors has already attracted large foreign investments but it is still investment opportunity of the Serbian economy.

Agriculture and tourism are also important sectors of interest of foreign investors. Having in mind big problems in the financing of agriculture, which is still underdeveloped and does not have its own capital, foreign investments in it are the best solutions for Serbian economy. Foreign partners are particularly interested for financing products that can be produced at the high quality level in their countries: special high quality products with the certificate on health. Tourism as economic sector goes through its peak and is special challenge for countries that find tourist services one of the opportunities for economic development. Serbia belongs to a group of transition countries that confront manifold economic difficulties for which tourism development is an opportunity to overcome. Natural resources of Serbia and good geographic position can be an advantage for attracting foreign investors in the tourism sector. Intensifying foreign investment activities in the tourism assumes the following advantages: construction of new, modern tourist capacities, and modernization of the existing ones, application of contemporary information technology and inclusion into global distribution systems, innovation of

³ D. Đurić, *Ekonomaska tranzicija u Srbiji 2001-2005. – Rezultati, strategije, perspektive*, Ekonomski anali, Tematski broj, Belgrade, April 2006., page. 284.

promotional activities, affirmation of the modern concepts of marketing and management in tourism and raising the level of quality of complex tourist services according to the demands and criteria of the global market.

Qualification and low cost of the workforce are the advantages that can be used for attracting foreign investments into textile and clothing industry. These are the workforce intensive sectors where competition advantages of the Serbian economy related to workforce are expressed. National strategy of foreign capital has to favour competitive sectors whose advantages are not founded only on the qualified workforce and many natural resources, but also tradition in production of certain goods and services. That is why clothing, shoes, furniture, jewellery, drinks, etc are attractive for foreign investments.⁴

Traditional European partners are the most important groups of foreign investors that can be expected in Serbia. Apart from attracting large global organizations that bring huge capital, the interest of the Serbian economy has to take care of small and medium enterprises that are readier for entrepreneurial risk and which take less care of economic and political limitations

Ex socialist countries neighbouring to Serbia are potential investors, because of geographic closeness and their transition experiences. Particularly important are the ex-Yugoslav countries. Calming down of political tensions and manifold connections of economic entities that use to function within a joint economic area provides opportunities for more active investment engagement.

Mobilization of capital and economic potential of Serbian citizens that live and work abroad can also be important source of financing development needs of Serbia. With this aim, the experience of Greece that due to its diasporas (Greek companies and individuals) quintupled its export to Balkan countries during the nineties is useful. In order to achieve good results it is necessary to leave the assumption of patriotic reasons for investment in Serbia of its citizens that work abroad. For achieving success in this area it is important to provide stable institutional ambience that with more efficient work of diplomatic representatives abroad can animate Serbian diasporas to more intensively invest in Serbia.

With the aim of attracting FDI-s it is necessary to have much more aggressive strategy of promotion of Serbia as attractive location for foreign investments. Having in mind that the role of the state in attracting FDI-s nowadays is changed, it has permanently to make efforts to promote potential possibilities for investment in the country and raising the level of services to possible foreign investors.

⁴ D. Đurić, Investicioni gep, Ekonomska politika, no 2815, Belgrade, 2006., page. 17.

Limitations for foreign investments and how to eliminate them

Greater attracting of foreign investments into our country, as we have emphasized, must become crucial for the country's future economic and developmental policy. The task will not be an easy one, especially when having in mind the fact that, according to the estimations of the United Nations Conference on Trade and Development (UNCTAD), foreign direct investments in the world in 2008 decreased more than 20% because of the financial and economic crisis. This only shows that the efforts of the countries which want to attract foreign capital in present conditions need to be enhanced more. In this sense, we point out, in this part of the paper, some limitations for foreign investments in our country and the need to eliminate these so that a better environment for investors from abroad is created in Serbia.

Difficult conditions of international competition which are dominant in the world market demand more modern and efficient countries with stable institutions. The process of creating a stable political and legal framework provides safety for foreign investors. They value the most the stability of a country, not just its profits, market potential, geographical conditions, cheap and specialized work force, knowledge and infrastructure.

Having in mind the previously mentioned characteristics of the legal and political system, it is clear that foreign investments depend directly on the risk of the country in which it is being invested. The most important economic and financial indicators of a country present significant elements of estimating the risks of a country for foreign investments. However, besides these, both the political and social conditions of a country greatly determine the attitude of foreign investors towards the climate for investments and the possibilities for investments. In that sense, the negative image of Serbia in the world, as a consequence of dramatical, political occurrences and the war in the previous period, greatly limited foreign investments in our country.

The lack of an efficient legal system and political security have for many years been the most important restrictive factors of attracting foreign investments to our country. However, bureaucracy is currently a very big problem, when compared to the previous period, when the greatest obstruction for foreign investments was the political risk. For instance, we have the most stimulative tax system but we do not use this advantage enough because of large tax administration.

It is the stable political and economic environment, certainty in business and simple procedures for starting production that is important to foreign investors. The amount of future foreign investments in Serbia depends greatly on the readiness to eliminate the administrative barrier, to simplify the procedures and to increase administrative efficiency. In this sense, it is very important to accelerate the procedure for acquiring building permits. Up to now this has been a very long process and because of it Serbia has been, according to the World bank analysis, on the very bottom of the

world ranking. The World Bank experts have calculated that 271 days (9 months) are needed to realize ideas for investments in Serbia. In all other countries which are our competitors, that period is greatly shorter.

There is a great difference in the readiness and the quality of acquiring investment permits among our municipalities and cities. Municipalities, where procedures for obtaining the necessary permits for investments are easier and more efficient, attract a larger number of foreign investors.

The new Law on arranging the environment and construction, which should significantly simplify the procedure for obtaining permits, as well as a number of space and urban plans which a municipality has to make, to create new penalties for local self-governments which do not give permits and plans in due time, can significantly influence the improvement of competitiveness of our country for foreign investments. Realization of foreign investments also depends on efficiency of business activities of public enterprises, which are also included in the process of issuing certain permits for electrical connection, gas connection, telephone connections, water etc. One of the problems that foreign investors encounter is also the corruption in issuing the needed permits.

Efficient municipalities, the representatives of which think in a manner related to the market, have also recognized the problem that foreign investors encounter in the form of expensive land and organisation of construction sites. Some municipalities, such as Jagodina and Batocina, often give free land or they offer land for a low price if investors satisfy certain conditions.

One of the limitations for foreign investments is also an inadequate educational system which is very often not well-adapted to the new investments. In that sense, it is necessary to introduce new educational programs which will be adjusted to modern market demands.

Insufficient interest for foreign investment in Serbia is also a consequence of absence of adequate information about the possibilities for investments in our country. A great number of investors does not know that we have a special Agreement for free trade with the Russian Federation, Turkey, Belorussia and a preferential status in trade with the European Union and the USA. In order to attract SDI, it is necessary to have a more aggressive strategy in promoting Serbia as an attractive location for foreign investments. Bearing in mind the fact that the role of the country in attracting SDI under current conditions completely changes, it has to make efforts in promoting potential investment opportunities of the country and to improve the service for potential foreign investors.

Conclusion

Foreign capital is with no doubt very important means of economic recovery of Serbian economy. The only form of international flow of capital which can put in motion the production of Serbian economy and increase its employment are direct foreign investments. Managing organs in our country must make continuous efforts to create the necessary conditions for the creation of favourable investment conditions for foreign investments. The low level of domestic savings and a high indebtedness of our economy present the developmental limitations which can be overcome only by active attraction of private foreign capital.

With the aim of securing its attracting in the near future it is necessary to as quickly as possible remove existing barriers and limitations and take measures towards creating good business conditions, faster implementation of the economic reforms, and further inclusion of the country into international financial and political organizations. If the above is not done foreign investors would keep treating Serbia as unattractive and high risk area for investment, which would have negative consequences for the economy of Serbia.

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