FOREIGN DIRECT INVESTMENTS WITH A REVIEW OF THE EFFECTS OF LOHN SYSTEM

Mr. sc. Adriana Ivanović

Abstract:

This paper gives the direct capital flow analyze and the indirect impacts of foreign direct investments income on the economic growth with the particular point on the international outsourcing and the lohn system. Developing effects of foreign direct investments could be expected when the absorbing and adapting possibilities of domestic business subjects are improved and also if active politics towards foreign direct investments is adopted. Governments can attract foreign investments by defining their industrial politics and foreign direct investments politics in order to enable economic growth and development. Politics towards foreign direct investments should take into account global investment tendencies, regional and sector investment perspectives and also investment modalities. Encouraging and stimulus measurement should be precisely directed towards particular group of investitures and investments projects.

Key words: direct investments, the lohn system, international outsourcing

INTRODUCTION

Foreign direct investments (FDI) have become one of the leading factors in the process of globalization and integration of transition economies into the global economy, especially in the European Union. The main economic goal of every state is the growth of living standard of all citizens in such conditions, the inflow of foreign direct investments and increased exports are the primary targets. This is particularly important for small countries with limited resources.

EXPOSITION

At the same time, the following characteristics of foreign direct investments resulting from the globalization of markets could be noticed:

- Foreign companies decide to engagement only after experiencing internal difficulties or have a negative trend in the business. As an example it can be pointed out, the failure to make a product at a competitive price or to develop new technology fast enough. Foreign companies are not coming to Serbia with a plan to complete the transfer of knowledge and technology to local manufacturers, but they implement business policy by which they intended to make some parts of the assembly or subassemblies of a particular finished product.
- Employment for the majority of the workforce is no longer safe or permanent (lasts until the realization of the project), and this is a consequence of the modern conception, to have the most powerful economic knowledge, technology and ideas, and anything else they may and can rent. This leads to that that it is more important for them to have factories and manufacturing/production in places where they achieve higher profits, so they do not need to have their own production facilities in the country, where the company is established and its central management is located. This kind of situation is very widespread nowadays.
- High-quality and reliable products offer, with reasonable market prices that results from lowering of production costs. The traditional notion of a direct connection between the quality and the amount of expenses has changed. This is achieved only with the expansion of the market horizon in planning a strategy of growth of production and development of the company.

Foreign direct investments affect economic justification only if they increase the volume of foreign trade, the export competitiveness of the country, the employment rate and if they reduce the current account deficit and trade deficit by the time.

Considering global proportions, the competitiveness that is calculated, is calculated based on the competitiveness of new goods,

new technologies, new supply resources, new types of organization - competence which dictates the decision-making costs or quality advantage, and which are not based on profit margins and on their life span.

The aim of the investors in the case of the lohn system is to provide the maximum possible profit, and the objective for the company is to rapidly evolve/develop. The investor realizes its profit taking advantages like; good-quality and affordable labour force, capital, knowledge and experience. At the same time as the user of capital, company has its interests as: the reduction of differences in technological development, the reduction of the differences in the rate of economic growth, and the difference in foreign exchange inflow and outflow. In order to keep the flow of foreign investments, foreign investors must be motivated to invest.

In the case of lohn system, the investors are export-oriented and want to have a stable political situation, in order not to jeopardize their investments, they want to have a highly skilled workforce that is the prerequisite for high-quality products, stable social situation without strikes and unnecessary loss of working time and costs, social care and so on.

In cases where these conditions are met there is a flow of foreign capital. If one or more of these conditions are not met the reduction in investment or transfer of profits generated mostly in the country of origin occurs, and also a problem, the arrival of other investors creates.

In the case of company engaged in lohn business, it is easy to conclude that foreign direct investment encouraged and accelerated the economic development of the whole environment.

At this point, regarding the state of the economy, foreign direct investments entry are the only chance for recovering of the economy and society as a whole. Foreign direct investment inflow, considering the lack of market development and development of market institutions, is possible through the privatization process, lohn system or direct foreign investments. And here comes the problem. The privatization process, which was implemented by the final legislation, did not give the expected results. The development of markets and market institutions and full membership in the European Union is not possible without new legislation, which should set a new modern architecture of the market economy.

Foreign direct investments entering our country are mostly vertical foreign direct investments that are resource-oriented and are mainly determined by low labour costs, geographic proximity, and often regional integration. Investments originate from developed countries, governed by the cost principle, where the huge amount of human capital had an important role. Predominant part of their production is re-exported in Serbia and has the character of the additional procedures/work, or in other words, lohn business or work on improving materials.

Foreign direct investments into lohn business significantly affect financing of the growing current account deficit over a six year period, without compromising future growth due to anticipated outflows. As Hungary, the Czech Republic and Poland, as countries with the largest inflows of foreign direct investments, and our region, thanks to these investments can maintain and even reduce the level of its foreign trade debt. This, in turn, significantly improves the credit ability in the eyes of potential investors. A better credit rating or ranking makes greater inflow of capital that should contribute to greater economic growth. Greater potential for economic growth attracts new capital investments, thus creating the basis for achieving long-term growth. Naturally, these effects act with a certain time of delay, but that does not diminish their importance. In order to comprehend the full impact of FDI on the balance of payments, we must take into account the impact of FDI on imports and exports of the country, as well as the size and re-participation of the reinvested profits.

Foreign direct investments into lohn/ improving of materials are financing the import of equipment, machinery and raw materials needed for the lohn process. Given investments include making of stronger bonds and links to local producers, for what some time is needed and those investments were aimed at the export (and better use of existing resources in the host country), so that the effect of foreign direct investments to the current balance could be positive.

If you look at import and export data in the North - Backa region, in the period January - December 2007, considering type of foreign trade business, we can notice that the affairs of inward/improving/lohn business have a larger percentage of increase than of imports. Besides the effects here stated, the effects on foreign trade balance appear within the transactions done after the lohn, because the company makes deals with local suppliers which increases the capacity utilization in the region. It can be also concluded that the inward jobs and jobs after inward processing activities, which are the most widespread in the region after the traditional buying and selling activities.

Table 1: Exports and imports per selected types of foreign-trade business in the period January-December 2007, in the Northern Serbia (Bačka) region

	Export		**Import**		**Share in total izvozu**	**Share in total uvozu**
	2007	Index 2007/2006	**2007**	Index 2007/2006		
In total	8.824,8	137,3	18.350,4	139,3	100,0	100,0
Buying and selling	7.092,6	139,2	16.706,5	138,4	80,4	91,0
Barter agreements	90,1	280,4	49,2	213,9	1,0	0,3
Returns	65,1	243,8	29,8	115,9	0,7	0,2
Lohn work	605,6	146,4	1.010,6	144,4	6,9	5,5
Business after lohn work	736,4	116,2	89,6	122,7	8,3	0,5
Investments by foreign entities	0,8	221,0	198,8	196,1	0,0	1,1
Operations in free zones	172,4	132,0	117,8	312,8	1,9	0,6
Other types of foreign trade	61,8		148,1		0,8	0,8

Source: Regional Chamber of Commerce

Table 2: Overview of the Northern Serbia (Bačka) region export per types of foreign-trade business in period January-December 2007

Type	**Amount in $ 2007**	**Amount in $ 2006**	density ratio **2007/2006 in %**
Buying	175.362.784	112.307.205	156%
Lohn work	72.256.065	48.943.931	148%
Business after lohn work	7.403.411	7.024.813	105%
Returns	602.913	745.672	81%
Other types of work	357.293	373.547	96%
Operations in free zones	246.566	152.966	161%
intermediation	111.012	600.457	18%
Replacement for returned goods	52.703	76.432	69%
Long-term production cooperation	44.775	173.667	26%
Shipments financed by EU	20.686	0.000	matchlessly
Other delivery of government assistance	15.849	0.000	matchlessly
Test samples, commission business	10.967	13.106	84%
Returned goods replacements	7.894	4.672	169%
Barter agreements	4.204	993.790	matchlessly
International fair compensation	0.000	7.022	matchlessly
Other types of foreign trade business	0.000	32.387	matchlessly
Total for region	**256.497.122**	**171.449.667**	**150%**

Source: Regional Chamber of Commerce

The lohn business in North Bačka (Serbia) region in 2006 had a share of 5.5% compared to the overall foreign trade balance. In addition to the sales relationship lohn processing operations are the most important part of the foreign trade balance. In 2007 the share of lohn processing increased to 6.9% of total exports. In addition to lohn processing of

goods as more important branch the jobs after lohn processing appear. Lohn Processing operations bring about the production capacity, expand and reduce the unemployment rate.

CONCLUSION

The potential host country of foreign direct investments brings an integrated package of tangible and intangible resources (capital, technology, management, marketing, organizational knowledge, training, labour, etc...) to serve as an alternative to migration of labour force and as a stimulant to economic development. Investment package, on the one hand, supplements the available domestic factors of production and creates conditions for new employment and work, and on the other hand, stimulates the growth of the host country through technology transfer, labour force training, establishing links with the rest of the economy and opening the roads for domestic producers towards world market. By opening subsidiaries in the host country foreign companies enter the modern technologies and other necessary knowledge into host countries. They train local staff to work at the level of modern technology, educate staff in office management and modern production processes organization.

Companies of all sizes are spread across national borders searching the new markets and creative partnership. Consumers benefit from better quality, wider choices and lower prices of goods and services that they are buying. Direct investments are aimed at sectors that are growing rapidly. FDI serves as a successful example of local, foreign company that has a role in reducing the constraints of the development of the necessary changes. Thus, foreign direct investments may lead to the establishment of local industrial sector. These sectors can rise up to the point where local production takes over and pushes the company established by the means of foreign direct investment.

Lohn business was for long been exclusively related to the textile production and leather industry. These are the simple processing tasks. At the present time lohn processing is present in electro-mechanical industry. Using these kinds of processes and operations, we get a lot of the developed technology, we employ labour/ work force and all that together will affect the rapid development of the region in which such production is located. In addition to these features regarding the lohn processing, it will affect well the balance of payments in the region, such as the net export-oriented business activities.

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