
The Characteristics of Foreign Direct Investments in Serbia

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The international movement of capital takes place in three main forms, namely: international mobility of credit capital, portfolio investments and foreign direct investments. Foreign direct investments (Greenfield investments) today are considered as the most desirable form of international capital. They represent such type of capital investment in the company through which ownership control over the company is being acquired. Direct investment of capital can be made in the existing company (modernization, expansion, etc.) abroad, or in the construction of a new capacities ("Greenfield investment"). In both cases the capital owner decides where to invest capital, how to organize production, takes care of the conditions of placements, the financial results of operations and the like, but also bears the risk of doing business. Therefore, foreign direct investments carry the highest business risk, but also bring the most revenue or profit. Foreign direct investments (FDI) play a key role in economic development. When it comes to the exporting countries, export of capital allows increased use of capacities, expansion of markets and new technology development, and essentially comes down to profit maximization, especially in medium and long term. When it comes to importing countries, import of capital provides an additional accumulation, transfer of new technologies and know-how without need to purchase a license, higher exports, the ability to finance new investments which affects the growth of employment, income, labor productivity, increase of budget revenues and other effects.

The paper analyzes the main characteristics of FDI in Serbia.

Keywords: *foreign direct investments, investments in Serbia*

In the contemporary conditions of financial crisis, direct investments mean, more specifically, expansion of existing and establishment of new economic organizations of the so-called parent company. It is a long-term investment of corporate capital abroad. However, in direct investments, where, based on a rule, not only capital is being exported, but also technical and technological processes, know-how, work organization and so forth, the owner of capital reserves both function of ownership as well as the management function, i.e. Exporter of capital organizes and controllers the use of capital. There are several forms of capital investment in the form of foreign direct investments. For example, forms of foreign direct investments are so-called Greenfield investments, which include the complete construction of production facilities ("on the wasteland") in other countries, and mergers and acquisitions, i.e. investment through mergers and takeovers. Mergers represent joining of two or more separate and independent international companies in the new entity. The acquisition involves merging of foreign company by its purchase, in which way the company that was merged gets a new owner and a new management.

Greenfield FDI as investments in foundation of new companies and factories without supporting infrastructure, contribute to increasing the production capacities of a country and hiring new employees, and are therefore of special importance for countries in transition. They have a significant effect on increasing the total investment, but it is difficult to attract them, because they are more sensitive to the investment climate. With mergers and acquisitions, there is a change of ownership of existing resources, so this form of investment does not lead to increase in output and employment. It may even happen that in the initial period there is a reduction in capacity and release a number of workers. However, mergers and acquisitions may cause an increase in total investment in the future and contribute significantly to the country's economic growth through

improving the operation of companies and technology transfer. Also, this type of investment can solve the problem of survival of domestic firms that are dealing with bankruptcy. A particular challenge for investors are abandoned and neglected sites and buildings, mostly in urban areas, so called brown field investments. After a long period of inactivity, building land becomes ecological, social and also aesthetic problem of the city. Therefore, through appropriate policies and instruments investors should be encouraged to re-enable the use of existing industrial facilities and sites where there is already existing infrastructure. Investors can invest capital in the form of joint venture as well.

For example, one of the classifications of FDI, which originates from the World Bank, is the partition according to the investment motives. According to this division, for the purposes of determining the target group of investors, there are:

- a) Investments that require resources (investments that require natural resources such as minerals, raw materials and agricultural products; investments that require less expensive or specialized labor force);
- b) Investments that require market (investments coming to the markets where the imports of certain products are high; investments that track movement of its customers - large companies; investments that track specific market trends and engage local suppliers);
- c) Investments that require increase of production productivity, including the rationalization of production, or linkage of manufacturing operations with other companies aiming to reduce costs and / or specialize production, and finally;
- d) Investments that require existing capacities in order to maintain and promote long-term goals of their company.

Motives for the export of capital in the form of direct investment are different. The aim is to achieve high profits and to provide raw materials and energy basis, in order to ensure the continuity of domestic production. Also, the goal may be to produce final goods using raw materials, that are then being sold at high prices in the country from which the raw materials were imported, or to realize high profits by selling these products at the global

market, because the demand for them is great and prices are very high. The motives can be also seen in import substitution opportunities, economies of scale, avoidance of tariff barriers, creating new space for its activities, the achievement of economic and political dominance, the provision of military-strategic objectives and so on.

Inflow Level of Foreign Direct Investments

Ambient, or adequate conditions for the inflow of FDI in Serbia, are still not favorable in a way of attracting investors in a greater volume. The legal framework for foreign investments consists of a large number of national and international principles and rules that must be fully aligned¹.

The inflow of foreign capital in Serbia is conditioned both by the interests of investors and users. Yet, since 2001 Serbia catches up with other countries in the region in the most important aspects of the transition process. In this sense, FDI have a significant impact on the Serbian economy, by increasing competitive pressure on the domestic market, linking with local producers, improving human capital, affecting the balance of payments etc.

However, since year 2000 Serbia records an increasing inflow of FDI. The record was achieved in 2006, as it was also the case in the region, and it is not expected for this record to be soon repeated or surpassed². The

¹ However, the existing legal and institutional framework for foreign investments in Serbia is still incomplete. Basic current rules that allow foreign investments are Constitution of Republic of Serbia and the Privatization Law. Also, directly or indirectly, foreign investments are allowed by the Law on Foreign Trade, the Law on Securities, the Law on stock exchanges and stock brokers, the Law on Free Zones, the Law on Concessions and so on

² The Record in FDI inflow in 2006. was achieved as a result of the sale of Mobtel. The amount of FDI in 2000. was only 52 million US dollars, and from year to year records growing trend: 2001. - 177; 2002. - 495, 2003. - 1356. However, a mild decline has occurred in 2004. when the amount of FDI in Serbia is 962 million of US dollars. But in the next year (2005.) it reaches 1 572 million US dollars, and continues the trend of growth, and so in the fore mentioned 2006. reaches the culmination of 4 349 million dollars, followed by 3 462 dollars in 2007., 2 994 millions in 2008. The most important FDI were attracted in the field of financial mediation, manufacturing industry, telecommunications, trade etc., and minimum amount the area of

current financial crisis largely contributed to this, and in 2009. Occurred a drastic fall in investments, not only in Serbia but also in other countries of the region. Therefore, the question is how to make Serbia attractive for a large volume of foreign direct investments³. According to the World Bank data, Serbia, for example, had greater FDI than Croatia (thanks to the sale of Mobtel to Telenor worth 1.5 billion Euros), while in 2007 and 2008. Croatia made a significant positive difference compared to Serbia. However, if the data on net inflows of FDI were observed in the two countries from 2000. to 2005. We could see that the difference in favor of Croatia would not be as great as in 2007. and in 2008. Inevitably, question is what led to these changes? It is certainly not the fact that infrastructure is better in Croatia than in Serbia, because then the investments would be much lower in Romania and Bulgaria, which have even worse infrastructure than Serbia. Many experts believe that the answer is in a greater political stability in Croatia than in Serbia, and therefore that is a basic condition that needs to be satisfied in order to make the inflow of FDI more significant (Croatia became a candidate for the EU in 2004 and for NATO in 2007.). On the other hand, Serbia and Croatia should be concerned with data that net FDI in Bulgaria and Romania individually is higher than in Serbia and Croatia together, and not only in the last three years of investment. Investment boom in these two countries starts from 2004 (Romania) and 2005 (Bulgaria). Both countries are members of the European Union and NATO since 2007.

public administration and social security. Before the global economic crisis started, it was estimated that in 2009. Serbia could attract total investment in value of about three billion euros, but the current pace indicates that the inflow of investments will be significantly lower.

³ According to gross income of foreign direct investment in the region, Serbia is in fourth place, just behind Romania, Bulgaria and Croatia (*"The international business sector in Serbia"*, Conference, Belgrade, June, 2010)

Table 1: Foreign direct investment (net inflows in billions of dollars)

Country	2006	2007	2008
Serbia	4.5	3.45	2.99
Croatia	3.46	4.99	4.80
Bulgaria	7.76	11.71	9.20
Romania	11.39	9.93	13.90

Source: World Bank, May 2010

In recent years, Serbia has created a very good and competitive tax system, which is considered to be by far the most competitive among countries in the region. This claim seeks a foothold in the comparative analysis of tax rates observed in the four countries.

Table 2: Taxes and contributions by countries of the region

Country	Monthly income tax	Compulsory social security contributions	TOTAL	Annual personal income tax	Corporate income tax	VAT
Serbia	12%	35.8%	47.8%	10%	10%	18%
Croatia	-	31.6%	31.6%	10%	10%	20%
Bulgaria	-	45.7%	45.7%	16%	16%	19%
Romania	15%	37.2%	52.2%	15%-	20%	20%

Source: World Bank, May 2010

Table of taxes and contributions by countries of the region shows comparative advantage of Serbia when it comes to VAT, and when it comes to income tax, then Serbia and Bulgaria have a comparative advantage over Romania. Croatia is under all sorts of taxes in the studied group non-competitive and expensive. However, when we move into the field of taxes and contributions on salaries of employees then it is Bulgaria, with this aspect, which is the cheapest, which applies to the net income of employees too.

Size of net income is also one of the factors in the calculation of investment justification. Serbia is more favorable than Romania in terms of level of tax rates, but not so much that it would be a decisive factor for investors.

Characteristics of FDI In Serbia Based On Swot Analysis

Modern SWOT analysis, as an important technique for identifying strengths and weaknesses, and examining opportunities and threats, can be also applied at the macroeconomic level⁴. In fact, we should analyze the economic environment in terms of attracting foreign direct investments (uncertain economic environment and low level of competitiveness, of course, do not attract foreign investors, on the contrary). However, external and internal aspects of the SWOT analysis of the investment potential of Serbia are numerous, where all advantage can convert into an opportunity and weakness can occur as a threat and endangering of achieved⁵.

As the **Advantages / Strengths (S)** can be noted:

- clear goals (entering the European Union and WTO),
- relative macroeconomic stability,
- Human resources (low cost of skilled labor, high-quality technical staff, etc)
- access to economies of scale,
- regionally competitive financial risk,
- restructured and privatized banking sector,
- accelerated development of capital market,
- contribution to the development of telecommunications infrastructure,
- liberalized system of tariffs,
- geographical factors (proximity to EU market),
- accelerated development of the private sector,

⁴ SWOT is an acronym of English words: strengths, weaknesses, opportunities and threats

⁵ Kragulj D., CEFTA – Razvojne šanse i izazovi zemalja Jugoistočne Evrope u procesu evropskih integracija, in the monograph *Savremeni trendovi u razvoju menadžmenta*, FON, Beograd, 2007. str.312-319. ISBN 978-86-7680-135-0

- significant level of achieved stimulating fiscal, regulatory and financial measures (competitive in the region),
- adoption of Strategy for encouraging and developing Foreign Investment by the Government of the Republic Serbia and so on.

Weaknesses (W) are as follows:

- inadequate economic structure,
- monopolized economy,
- under-developed infrastructure,
- inflexible labor market,
- insufficient use of production capacities and outdated technology,
- poor liquidity and profitability,
- limited domestic consumption,
- bad market image,
- outflow of skilled personnel abroad,
- uneven regional development,
- corruption - lack of transparency of institutions and procedures,
- administrative barriers,
- implementation gap - lack of effective enforcement of basic laws that apply to foreign investors
- problem of functioning of rule of law,
- lack of clear national program to promote investment etc.

Opportunities (O) that are opening are:

- Free trade zone with countries of South East Europe
- Integration into the European Union,
- Fast market growth and entrance to new markets,
- strengthening of macroeconomic stability,
- Sustainable growth of GDP,
- the ability to move toward more dynamic and profitable industries,
- better use of available human resources,
- adjust the structure of employment needs of foreign investors,
- accelerated development and strengthening of institutions for FDI

- the implementation of laws regulating new types of risk,
- Government's commitment to Serbian program of sustainable economic development, etc

Obstacles / Threats (T) is numerous:

- low level of economic development,
- delays in the transition process,
- delays in the process of integration into the European Union,
- entry of new competitors in their own markets,
- "War of fiscal stimulus measures" in the countries of the SEE region
- inflexibility of labor market,
- adverse demographic changes,
- low level of reinvestment and the potential outflow of foreign capital,
- lack of transparency and inefficiency of the administrative system,
- political instability and so on.

Security of Investment

In the future attraction of foreign direct investments in Serbia will be one of the main challenges of Serbian economic policy. Especially bearing in mind that the processes of privatization are at the end, and attraction of FDI is becoming a major challenge, especially bearing in mind the necessity that Serbian economy primarily relies on a new Greenfield investment. However, even though it comes to economic challenge, the key to this problem still lies in the legal and social sphere. In fact, efficient and profitable activity cannot stand uncertainty. Therefore, the basic precondition for any serious investor, both foreign and domestic, to be willing to invest - is security of investment. First of all, the legal security of property and investments, then the security of compliance with laws and contracts, debt collection, etc.

However, one should not ignore the corruption which is in Serbia over the level of countries in the region. Corruption is present in practically all segments of society. In addition, despite of reforms, the judicial system is

still not able to provide effective law enforcement and effective respect for business contracts. Besides that, collection of receivables due is still very problematic and uncertain⁶. Bearing in mind, the current legal and social environment any plan to attract foreign investors cannot give the expected results. For example, labor costs in Bulgaria and Romania are much lower than in the Czech Republic; however, this country is the most attractive destination for most of the serious foreign investors⁷. This is primarily due to a more secure economic environment and significantly lower level of corruption in comparison with Romania and Bulgaria. Hence the creation of effective regulatory and judicial system represents imperative in the future implementation of economic policies, not only for the purpose of attracting foreign direct investors, but also more widely viewed, in order to create positive and safe business environment and more efficient market economy in Serbia.

However, when it comes to direct economic policy measures, in order to attract foreign investors we should be very careful. Specifically, as budget subsidies cannot solve problems of inefficiency of public enterprises, no budget subsidy for foreign investments can solve the fundamental problems that reject investors.

Conclusions

The economic crisis, which swept the world as a "big bang", leads to a redistribution of power in favor of those countries whose economies continued to record positive growth rate of GDP and which have kept their foreign exchange reserves and balanced state budgets (e.g. China, Russia, South Korea and Japan). Multinational companies, yesterday's biggest investors in developing countries, are trying to sell or lease its daughter companies in developing countries to the new investors and to invest in major markets, whose purchasing power is not that much damaged by the

⁶ Serious investors, to a large extent, this situation discourages and encourages negative economic selection and "hunting in troubled waters".

⁷ The average net salary in the Czech Republic is 700 Euros versus 350 Euros in Romania and 250 Euros in Bulgaria.

crisis (Brazil, Russia, India and China) and therefore leaves little room for developing countries. Yet despite this, in the modern international economy, foreign direct investments are the quickest way for developing a country and region, taking the role of key developmental factor of national economy. This is the reason for the need of proper consideration of the SWOT matrix of the investment potential of Serbia. Looking at the factors, that is, the drivers of FDI, the export of capital may occur: due to lower prices of raw materials and energy in countries that attract capital, cheaper labor abroad, desire to round up the manufacturing process to make production less dependent on external factors, expansion of markets for selling products, as well as facilitated access to other markets across the country recipient of FDI, minimizing the costs caused by the payment of customs duties and other import duties, securing political influence in the country and the region as well as the impact on competition, etc. In developing countries, as opposed to "hunger" for foreign direct investments as well as for any form of long-term loans, is alert and diminished foreign capital which, so far, until the markets don't open, is ready to enter into lease of the existing production capacities and hire labor, for a specified period with a lower additional investment. Serbia needs to see her chance in adapting to the situation imposed by the long-term economic crisis and which is changing patterns and regions of investment, as well as the foreign investors.

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