FOREIGN DIRECT INVESTMENT AS A FACTOR OF ECONOMIC GROWTH AND DEVELOPMENT OF THE SERBIA*

Saša Stefanović[1], Mirjana Radović-Marković[2], Tamara Ćirilović[3]

Abstract

In the globalized economy, foreign direct investment (FDI) represent one of the key factors of the country development. For an invest destination, FDI means new job creation, export stimulation and in general, that presents the generator of economic growth and development. Until 2000, Serbia was not an attractive destination for foreign investors, but after the democratic changes, the country became one of the most atractivness European destinations where the volume of FDI have noted a large expansion. The global economic crisis, that reduced the volume of FDI inflows, also affected their inflows in Serbia and the other countries of the same region which among the other factors, led to a significant slowing down of the economic growth, and other adverse macroeconomic consequences. The paper describes the analysis performed and the scope and structure of FDI in Serbia in the period after the democratic changes of 2000. It determined a positive relationship between the volume and structure of FDI and economic growth and development of Serbian economy. Inflow of FDI is the factor that had a large impact on the rapid economic growth, as well as the establishment of macroeconomic stability. Notwithstanding the positive impact on employment and the growth of budget revenues as well as the significant acceleration in the growth and development of a number of branches, such as the banking system, telecommunications, and other activities. Also, we have found factors that will in future have a key influence on the scope and structure of FDI in Serbia.

Key words*: foreign direct investment (FDI), Serbia, economic growth and development, the world financial crisis.*

Introduction

The foreign direct investments (FDI) involves a capital investment by company or individual to carry out profitable activities in the territory of one country. In today's world economy, foreign direct investments are the fastest way of the development of a country and region and, as such, are welcome in the most developed countries of the world as well. Foreign investors may be a company whose seat is abroad, a foreign natural person and citizen of Serbia residing abroad more than a year, and the highest number of foreign investors in Serbia comes from the European Union and the United States.

The division of foreign direct investment can be made according to several criteria. One of them can be division on the primary and special shapes. According to this criteria, the basic forms of foreign direct investment includes: the establishment of companies (Greenfield investment) and the acquisition of majority shares owned by the existing companies (the purchase through the privatization, share purchase or direct purchase of property shares - acquisition). As special forms of foreign direct investment are considered: concessions, B.O.T. (Build-operate-transfer), business (approval of foreign investors to build and use the facility or plant, as well as infrastructure and communication facilities,

* This paper is a part of researching project No. 159004, financed by the Ministry of Science and Technological Development of Republic of Serbia, named: "*The Integration of Serbian Economy into the EU – Planning and Financing of Regional and Rural Development and Enterprise Development Policy*".

[1] Sa a Stefanovi , MSc, Institute of Economic Sciences, Belgrade

[2] Mirjana Radovi -Markovi , PhD, Institute of Economic Sciences, Belgrade

[3] Tamara irilovi , BSc, Faculty for Law, Politics, Economics and Management, University of Nice-Sophia Antipolis, Nice

with the obligation to transfer ownership to the state by the end of the contract). One of the classification of foreign direct investment, which comes from the World Bank, is the division according to the motives for investment. This division can be very useful, because in this way the target group of investors can easily be determined. According to this division, there are: investments that require resources, investments that require market, investments looking for existing capacities in order to maintain and promote long-term goals of own company (they are facing, first of all, privatization, and acquisition, because by purchasing one of existing companies they keep production program and existing market).

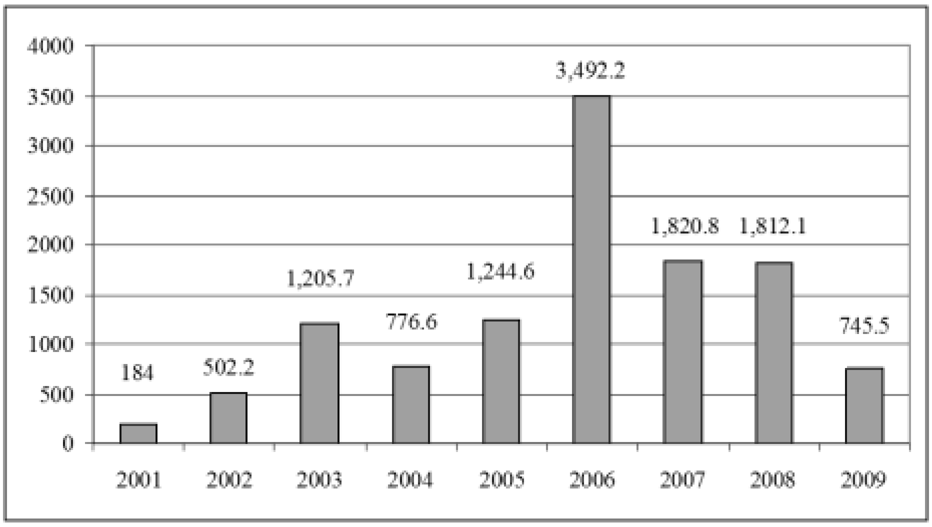
The division of foreign direct investment can be done in other ways. However, it is important to understand that each company has different reasons for making decisions about where and how to invest. Whether one foreign company decide to invest capital in one country depends on many factors, and, above all, the estimates of profit that can be made, long-term of business, and the readiness of the host country to accept, speed up and facilitate business. Thus, each state is to create a good investment climate, and clear and stable framework for business to attract the best companies.

FDI are now one of the basic mechanisms of the globalization of world economy, taking the role of the key factor of development of each state. For a country in which are invested, foreign direct investment means new jobs, increase exports and, in general, initiation of economic growth and development. On the other hand, direct investment, as a form of investment of foreign capital, enable the investor to acquire ownership, control and management on the basis of invested capital. In addition to new markets, investments in other countries can also mean faster and better supply of raw materials, electricity, easier transportation, or access to free economic zone. Because the goal of the paper is description of the FDI as the factor of economic growth and development of Serbia in the first step analysis of volume and the structure of FDI in Serbia in the period after the democratic changes of 2000. year is carried out. After that, at the positive link between FDI and economic growth and development of serbian economy is pointed out. As well as their impact on employment and the growth of budget revenues as well as the acceleration of growth and development of a number of branches. At the end, it is pointed out to some of the factors that will have a significant impact on the scope and structure of FDI in Serbia in future, and especially in the world financial crisis.

1. Foreign direct investment in Serbia volume and structure

Since the onset of economic reforms in 2001, Serbia has grown into one of the premier emerging investment locations in Central and Eastern Europe. To date, FDI inflow in the country has exceeded $17 billion. The scope of FDI in Serbia noted, until 2006, mainly significant growth rates to the year and had its peak (that year the net FDI amounted to EUR 3.49 billion), and later under the influence of political instability in the country, and after that the impact of world financial crisis that took hold of Serbia, came to the significant fall.

Figure 1. Foreign direct investments in Serbia, net, in million EUR (2001–2009)



Source: *MoF*

Serbia's strong FDI track-record is substantiated by internationally recognized awards for local Greenfield investors. Between 2004 and 2006, Greenfield projects in Serbia were awarded by OECD as the largest investments of this type in South East Europe. The first Award was presented to Ball Packaging Europe (headquartered in USA), followed by METRO Cash & Carry (Germany), and Israeli Africa-Israel Corporation/Tidhar Group for their Airport City Belgrade real estate project.

In terms of the country structure, investors from the European Union lead the way accounting for about 85% of the total FDI influx. The top spot on the country list is held by Austria, followed by Greece, Norway, Germany, and Netherlands, while significant investment also stems from the United States, Slovenia, France, Great Britain, and other world's leading economies. The actual amount of U.S. investment is significantly higher than the official figure due to their companies investing primarily through European affiliates. This also holds for Slovenia, Italy, Israel, Belgium, Russia, and a number of other countries.

Table 1. Net FDI in cash by countries (2000-2008)

Country	**Investment value ($000)**	**Country**	**Investment value ($000)**
Austria	2,633,585	Italy	753,942
Greece	1,687,437	Switzerland	305,283
Norway	1,556,700	Montenegro	296,134
Germany	1,477,990	Croatia	296,407
Netherlands	1,063,757	Bulgaria	133,897
Slovenia	655,439	USA	133,409
France	503,618	Slovakia	67,692
Luxembourg	445,654	Latvia	53,659
Hungary	353,479	Israel	48,155
Great Britain	295,291	Belgium	63,947

Source: *NBS and SIEPA*

According to the NBS in the period January-March 2009 net FDI in Serbia amounted more than $ 805.8 million, of which the largest part belong to Russia ($ 511 mill), and then follows Austria ($ 115 mill) and Switzerland ($ 40.9 mill).

Over the past five years, service sectors have proven to be the most attractive to international investors. The financial sector recorded the biggest FDI inflow of $ 5,2 billion, with telecommunications holding the 2nd spot with $3.1 billion, while manufacturing sectors ranking 3rd with $2.77 billion.

Table 2. Inward FDI by industries in mill USD (2004-march 2009)

Industry	Total investments
Financial intermediation	5,193.4
Transport and telecommunications	3,107.2
Manufacturing	2,773.6
Real estate, renting	1,954.5
Wholesale, retail, repairs	1,909.6
Mining and quarrying	576.1
Construction	345.4
Agriculture	119.2
Hotels and restaurants	93.2
Electricity, gas, and water	89

Source: *□BS*

Table 3. Leding foreign investors (2002-2009)

Company	Country	Industry	Investment type	Amount (EUR mill)
Telenor	Norway	Telecommunications	Privatization	1,602
Gazprom Neft	Russia	Energy	Privatization	947
Philip Morris	USA	Tobaco	Privatization	611
Mobilkom	Austria	Telecommunications	Greenfield	570
Intesa San-paolo	Italy	Banking	Acquisition	508
Stada	Germany	Pharmaceutical	Acquisition	475
AB InBev	Belgium	Food	Acquisition	427
NBG	Greece	Banking	Privatization	425
Mercator	Slovenia	Retail		240
Fondiaria SAI	Italy	Insurance	Privatization	220
Lukoil	Russia	Energy	Privatization	210
Airport City BG	Israel	Real estate	Greenfield	200
Block 67 Ass.	Austria&Serbia	Real estate	Greenfield	180
Holcim	Switzerland	Construction	Privatization	170
OTP Bank	Hungary	Banking	Privatization	166
Carlsberg	Denmark	Food	Acquisition	152
U.S. Steel	USA	Metail	Privatization	150
METRO	Germany	Wholesale	Greenfield	150
Coca-Cola	USA	Food	Acquisition	142
Lafarge	France	Construction	Privatization	141

Source: *SIEPA*

The list of leading foreign investors is topped by world-class companies and banks, such as Telenor, Gasprom Neft, Fiat, Philip Morris, Mobilkom, Banca Intesa, InBev, and many others.

2. The impact of FDI on the previous and future development of Serbian economy

The effects of current FDI inflows are proportional to their modest scale, in which Serbia share the experience of other transition countries. FDI have followed the process of privatization, and most placed in the take over of existing firms. A smaller part refered to greenfield investments, and it started to grow only in the past few years . By the end of privatization such a relationship will be detained. As is shown, most of the FDI is placed in the service sector: banking, trade, telecommunications, tourism and catering, business services, distribution of petroleum products. In the manufacturing sector, FDI is placed in the primary and secondary processing of metal and non-metals, the exploitation of mineral water, food industry, production of beer, milk and milk products. Past effects of FDI inflows to the Serbian market and the economy can be summarized in the following: buying the market before buying production capacity, market distortions (oligopoly in wholesale distribution and hypermarket chains, banking, manufacturing cigarettes, beer, coffee, milk and milk products; monopoly in the production of steel), and a growth of competition as well, increase exports, and imports (most important: U.S. Steel Serbia); begining of greenfield FDI oriented on export at foreign market, creating a modest vertical connections with domestic firms; taking over management knowledge of the local successful companies; rudiments of involvement of local ICT companies in the international production and distribution network.

Insufficient use of the potential positive effects of (modest) inflow of FDI in the Serbian economy can be explained by: taking over of companies in the privatization process, spending privatization revenues on social needs and imports, the concentration of FDI in the service sector, high technology gap betwen serbian economy and the developed world, low absorption capacity of domestic firms to assumption the new technology and knowledge; unstable political and legal system, and unfinished institutions.

The specific impact of FDI on growth and development of serbian economy can be best viewed using the movement of some macroeconomic indicators of the serbian economy in the period after the democratic changes and substantial initialization of the transition, as it is given in the table below.

Table 4. Republic of Serbia - Basic macroeconomic indicators in the period 2001 - June 2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross domestic product, in millions EUR	12,820.9	16,033.7	17,416.4	19,075.0	20,358.0	23,520.6	29,542.7	34.2591	30.8631
Gross domestic product, per capita, EUR	1,708.7	2,137.8	2,328.2	2,555.9	2,736.0	3,173.5	4,002.2	4.6511	4.1901
Gross domestic product, real growth, in %	5.6	3.9	2.4	8,3	5.6	5,2	6,9	5,42	-2,01
Consumer prices, period average	93.3	16.6	9.9	11.4	16,2	11,7	7.0	13.5	9.1
Export of goods	1,922.2	2,870.4	2,441.0	2,831.6	3,608.3	5,102.5	6,432.2	7,428.3	2,254.4
Import of goods	4,759.2	5,956.6	6,585.5	8,623.3	8,439.2	10,462.6	13,506.8	15,580.5	4,495.1
Foreign trade deficit	-2,837.0	-3,754.7	-4,144.3	-5,791.7	-4,831.0	-5,360.1	-7,074.5	-8,152.1	-2,240.7
Current account deficit (excluding donations)5	977.0	-1,842.7	-1,674.8	-2,688.4	-2,050.0	-3,091.8	4780,96	-6,086.2	-990.3
Current account deficit (excl.donations), % of GDP	-7.6	-11.5	-9.6	-14.1	-10.1	-13.1	-16.2	-17.8	-
Balance of payments, total5	559.9	981.1	813.5	360.2	1,627.6	4,316.1	742.1	-1,714.6	-213.6
Foreign direct investments, net, in million EUR	184.0	502.2	1,205.7	776.6	1,244.6	3,492.2	1,820.8	1,812.1	745.5
Foreign currency reserves of NBS, in million EUR	1,325	2,186	2,84	3,117	4,935	9,025	9,641	8,16	8,914
Citizen savings, million EUR, end of period	329.8	812.9	1,099.6	1,464.6	2,274.7	3,414.1	5,028.5	4,881.0	5,02
Employment level, average (thousands)	2,102	2,067	2,04	2,051	2,069	2,026	2,002	1,999	1,977
Unemployment level, end of period (thousands)	-	-	-	-	896	916	785	728	768
Net wages - real growth rates	16.5	29.9	13.6	10.1	6.4	11.4	19.5	3.9	2.4

Source: *MoF*

You should bear in mind that between the implementation of FDI and its effect on economic growth, there is a certain time delay. It is a consequence of the fact that the period of time is needed in order to activate investment, which means that in the coming period significant effects as a result of activation of current FDI can be expected. Both variables, the net inflow of FDI and value of nominal GDP of Serbia shows a similar trend. GDP and net FDI of Serbia shows a strong, high and positive correlation that exists between these two variables, which is in line with accepted economic theory about positive effects of FDI inflows on economic growth which is the main conclusion based on the idea that the inflow of FDI provides high quality transfer of technology and know-how and, increasing productivity in the recipients of FDI inflow. High inflow of FDI had significant effects on the growth of deposits and consequently on the development of the banking system and capital markets. Effect on the growth of deposits was a two-sided. On the one hand as a result of sales of companies the part of received money is puted in the banking system in the form of deposits. On the other hand through the process of foreign investment in the Montenegrin market, credible foreign companies had come that have become a significant customer of the banking system as a depositor and as a loaner. The process of foreign investment had a significant effect on the budget. The process of foreign investment influenced on the one hand the growth of economic activity and the growth in tax revenues, and on the other hand significant number of job places is saved through the process of foreign investment. Altought, FDI had some negative effects. Thus, for example FDI directly affected the growth of deficit of current account balance of payments. On the one hand it is a consequence of accelerated development, because foreign investors made additional investments in companies that they bought, in order to increase their level of competitiveness.

After a period of time, this investment should have significant positive effects on economic growth. The second course was a consequence of the fact that a large number of individuals significantly increased their level of living standards by selling shares. In such conditions there was a significant increase in consumption of cars, household equipment and the like. They are durable consumer goods that are not produced in Serbia, so the result was the growth of import. Interrelationship between foreign direct investment and imports is not specific only for Serbia, but also for other economies in transition

Conclusion

It is undivided positive opinion about the importance of FDI for the successful transition of former socialist countries, and Serbia as well, and their growth and development. It is undoubted that they have a large positive potential. Will it be used, depends on many factors. The main conclusions about FDI and its effects can be summarized as follows: FDI have a strong development potential: first, they are an additional inflow of investment capital, particularly important for countries that have a small rate and volume of domestic savings, secondly, they start a new economic activity or increase existing in the manufacturing or service sector; third, one of the most important effects is the overflow technology, knowledge and productivity.

In general unfavorable conditions, in which Serbia already is, it is difficult to design and implement a successful development policy. One of the ways out from the difficult situation has been, for some time, is seen in the stronger attraction of FDI. It is counted on the undoubtedly potential beneficial effects of their presence. In accordance with the results of numerous empirical studies on the effects of FDI on the domestic economy and the effects of incentives policy, remains in force recommendation that the good governance in the area of FDI policy to consider the package of measures of investment incentives as part of the overall industrial policy of the country, and every incentive to make available under equal conditions to all investors, both foreign and local. Stimulus should be focused particularly on those activities that create the strongest potential for overflow, including the links between foreign and local firms, education, training, R & D.

On possible benefits and damage of the presence of FDI in the Serbian economy should be looked to objectively, consider the experience of others. There are examples of one and the second, and successful and unsuccessful. Investors are managed by their logic, and the FDI per se have a neutral sign. Where will they be able to be placed, and how, depends on the domestic legal system and business environment. They do not come with ready solutions, and potential benefits of their presence may be materialized only by domestic firms.

At the end it should be awared that the positive global conjuncture had large impact on the movement of foreign direct investment. The appearance of the global financial crisis that affects a large number of business firms, throughout out whole world, and that will lead to negative effect of welfare will inevitably have a negative effect on attracting foreign direct investment in the coming period.

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