

FOREIGN DIRECT INVESTMENTS IN SERBIA WHAT HAS BEEN DONE SO FAR AND WHAT CAN WE EXPECT*

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Abstract

Strategic approach to foreign investments in Serbia has changed significantly at the beginning of 21st century. Before 2000 Serbia was a country that used high level of custom and non-custom barriers to protect its economy. During the period of nine transitional years Serbia shifted to completely liberal approach of an open market economy.

A starting impulse to foreign investments in Serbia was given by the new approach to privatization process of state companies, which attracted over 1 billion euros of investments. Stable and transparent political model that was created made significant impact to an increase of foreign investments into the country and growth of foreign capital share in the market as a whole, with over € 1 billion of inflow.

Since transition in Serbia in its full scale begun with ten years delay compared to other eastern and southeastern European countries, so was the first stage of the transition process completed with significant delay. For that reason it is important to understand in which way Serbia will approach second stage of transition, which is critical for sustainable development in the next period. Past experience of other countries should be used to understand what should and what should not be done in order to achieve so called "Virtual Circle of Foreign Investments". Clear strategy and vision of Serbia in the future is required in order to attract not only those FDI which are seeking for fast turnover and use of natural resources, but rather those which are able to provide high level of added value and able to transfer technology and skills to economy as a whole

Key words: Foreign investments, transition, privatization, virtual circle of FDI

1. Strategic approach to FDI in Serbia

Transition from centrally planned economy to market oriented economy is a long and difficult process for most countries. Limitation to foreign ownership and introduction of strict rules protecting certain sectors of the economy by allowing only domestic investments may be devastating for national policy of foreign direct investments. These types of economies are characterized by barriers to imports, which as a rule, are represented by high custom taxes. Generally those countries are not opposed to foreign investments, but their introduction of specific economic measures and strict rules diminishes value of foreign ownership. In such a way, the benefits of export oriented economy and economy with high foreign competition are minimized.

Dual effects of strategy based on barriers to import are protection of national interests on the one side and low level of FDI on the other side. High custom and non-custom barriers have in many cases forced foreign investors to reduce scale of production, which results in non-profitable operations and low level of turnover. Such strategy does not reduce dependency on foreign capital and it reduces national income, income from trade and benefits from increased employment.

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According to Zatezalo (2009) it is recommended that governments, before attracting foreign capital, create viable and sustainable strategy which will define what sectors are priority for attracting FDI. Despite ten years delay in creation of national policy for attraction of FDI compared to other countries in the region, Serbia can use their experiences and chose the best possible direction. After nine years of different methods in attracting FDI there is a consensus among politicians which strategies have shown to be most effective. Core of the strategy should be open and transparent economy based on knowledge.

Stable and transparent political system supports growth of FDI. Knowing that the path which transitional countries have to go through to become open and transparent market economies is very long, it is certain that export oriented strategies guarantee success in attracting FDI. Governments are applying this strategy when there is high level of unemployment, because the highest growth in export oriented countries is generated by attracting foreign investments in production sectors like clothing or electronics.

At the beginning of transition Serbia opened its market. Since then Serbia is getting closer to EU market and regional markets like CEFTA. Becoming a member of WTO and acceptance of sectoral initiatives for reduction of custom rates is a process that significantly facilitated inflow of foreign capital. A study made by several authors was a basis for acceptance of 4 sectoral initiatives by Serbia (ubovi et al, 2007, 2008).

2. Foreign investments in the first stage of transition

Privatization process is most common model to support FDI inflow to transitional economies. There is a high correlation between inflow of FDI and privatization, where one process supports the other and vice versa. Countries which have gone furthest in privatization are known to be attractive locations for investment of capital. On the other hand inflow of capital supports and gives pace to privatization (Hunya, 2003, pp 54).

Serbia is moving through transition with growing levels of foreign investments as a result of its method of privatization through tenders and auctions. Inflow of capital is growing after year 2005 with entrance of Telenor, Mobikom, Phillip Morris Ball Packaging and other multinational companies. During last seven years the initial strategic approach for attracting foreign capital in Serbia was through privatization. Table 1 shows the results of privatization during the period of 8 years. Total level of income from privatization was not very high, but it triggered other investments. Most positive effect of privatization was transfer of employees from state owned to privately owned companies which dramatically changed their work behavior.

Table 1. Privatization of the real sector in Serbia 2002-2009

Type	Total sold/canceled	Selling price	Investments	Social Pro- ra
Tenders	107	1.173.920	1.127.086	276.689
<i>Tenders – canceled</i>	16	8.220	1.928	2.02
Auctions	1.693	1.113.447	222.385	
<i>Auctions – canceled</i>	69	228.960	109	
Capital markets	535	518.083	5.902	
Capital markets – previously canceled	114	58.907		
Capital markets – previously privatized	778	3.289		
Total	2.449	2.867.646	1.355.373	276.689

Source: Serbian privatization agency and chamber of commerce

From table 1 we can see that the number of privatized companies was 2.449, and according to ministry of finance they employed over 330.000 employees (Ministry of finance, 2008). The selling price for those companies was nearly 2.9 billion euros, with additional 1.4 billion reserved for investments and 280 million euros for social program. Unfortunately there is no statistical data about how this capital was used. According to available sources, we might conclude that funds were mostly spent in consumption.

Despite unfavorable status that Serbia enjoys as a investments location, there are many other factors that triggered initial investments. Among them was the privatization process, which in the year 2002 brought 300 million euros of foreign capital. As the process of privatization of so called “social companies” was getting close to the end, so the level of investments grew. Except for the year 2007, there was a constant growth of FDI in Serbia. Table 2 shows the figures about FDI by countris in the period of 7 years.

Table 2. Net FDI in Serbia by country of capital origin in the period 2002-06.2008. (000 US\$)

Country	2002	2003	2004	2005	2006	2007	I-VI 2008	Total
Austria	33,876	93,747	146,104	201,189	520,356	1,161,096	355,039	2,511,407
Greece	12,496	62,268	52,968	249,536	923,698	336,401	46,091	1,683,458
Norway	74	280	0	29	1,546,993	3,187	5,608	1,556,171
Germany	82,801	75,708	51,985	187,320	905,824	69,530	68,923	1,442,091
Netherlands	2,248	598,963	102,008	92,113	-214,119	-27,958	555,200	1,108,455
Italy	7,553	21,325	10,149	18,316	52,752	155,363	385,470	650,928
Slovenia	9,561	29,036	15,706	183,563	201,241	92,856	95,324	627,287
France	87,489	7,858	24,022	62,347	159,085	84,391	69,301	494,493
Luxemburg	3,619	4,108	2,387	108,885	8,843	241,537	67,593	436,972
Hungary	1,167	4,224	16,567	24,677	244,045	31,494	15,806	337,980
UK	6,618	20,631	79,620	63,330	135,915	-26,584	9,163	288,693
Switzerland	2,913	12,559	29,401	56,990	-15,421	96,157	41,359	223,958
Croatia	5,243	34,446	10,806	40,484	25,240	35,944	44,047	196,210
Bulgaria	133	129	9,910	655	54,270	46,916	15,878	127,891
USA	18,099	15,068	18,187	22,257	-29,612	31,825	42,510	118,334
Slovakia	10	18,342	0	25,447	19,325	3,084	333	66,541
Russia	2,556	3,359	538	14,324	15,992	488	27,159	64,416
Latvia	5	15,330	17,082	6,441	10,527	3,535	234	53,154
Israel	260	207	3,052	14,294	4,544	26,510	1,233	50,100
Belgium	344	1,925	2,523	12,407	6,464	24,038	-15,108	32,593
Lichtenstein	57	2,162	2,974	-41,316	-17,538	-2,937	2,593	-54,005
Cyprus	41,717	31,581	16,310	71,551	-387,154	137,427	8,947	-79,621
Bosnia	2,951	5,056	2,104	4,692	-16,750	-838,608	-5,212	-845,767
Others	4,664	13,098	182,000	21,175	131,859	318,605	100,468	771,869
TOTAL	326,454	1,071,410	796,403	1,440,706	4,286,379	2,004,297	1,937,959	11,863,608

Source: *Siepa*

Table 3. Largest foreign investments in Serbia in the period 2002-06.2008.

Company	Country of origin	Sector	Type of investment	Amount
Telenor	Norway	Telecommunications	Privatization	1,602
Fiat	Italy	Car industry	Joint venture	700
Philip Morris - DIN	USA	Tobacco	Privatization	611
Mobilkom	Austria	Telecommunications	Greenfield	570
Banca Intesa	Italy	Banking	Capital market	508
Plaza Centres	Israel	Real Estate	Greenfield	500
Stada	Germany	Pharmaceuticals	Capital market	475
Embassy group	India	Real Estate	Greenfield	428
Interbrew - Apatinska	Belgium	Food and Beverage	Capital market	427
NBG	Greece	Banking	Privatization	425
Biotech Energy	USA/Hungary	Oil industry	Greenfield	380
U. S. Steel - Sartid	USA	Steel and plates	Brownfield	250
Mercator	Slovenia	Retail	Greenfield	240
Fondriaria SAI	Italy	Insurance	Privatization	220
Lukoil - Beopetrol	Russia	Oil industry	Privatization	210
Airport City	Israel	Real estate	Greenfield	200
Blok 67 Associates	Austria/Serbia	Real estate	Greenfield	180
Holcim - Novi Popovac	Switzerland	Cement	Privatization	170
OTP Bank	Hungary	Banking	Privatization	166
Engel group	Israel	Real estate	Greenfield	160
Alpha Bank - Jubanka	Greece	Banking	Privatization	152
Metro Cash & Carry	Germany	Wholesale	Greenfield	150
OMV	Austria	Petrol stations	Greenfield	150
Coca Cola	USA	Beverages	Capital market	142
Lafarge	France	Cement	Privatization	126
San Paolo IMI	Italy	Banking	Capital market	122
CIMOS	Slovenia	Car industry	Privatization	100
JTI	Japan	Tobacco	Privatization	100
Droga Kolinska-Grand	Slovenia	Food and beverage	Greenfield	100
Carlsberg	Danemark	Food and beverage	Greenfield	100

Source: *Siepa*

Table 3 shows the list of top 30 foreign investments in Serbia during transition. Majority of those companies are multinational companies. Since most of them are operating in the economic sectors which bring a high level of additional value, it is to confirm that prerequisites for transfer of technology and knowledge spillover have been fulfilled. Despite the fact that there are no empirical studies to confirm existence of technology transfer, many economic sectors in which there was a high level of investments, like financial sector, retail, tobacco industries and sector of telecommunications show positive results. In our previous paper we presented the exact statistical evidence proving that growth of those sectors is much higher than the others, with financial sector leading in the group (Zubovic, Domazet 2009).

In financial sector, Deposit insurance agency had since 2004 conducted restructuring and privatization of seven banks and one insurance company. The following banks were sold for total of 814 million euros: Jubanka, Novosadska banka, Continental banka, Ni ka banka, Panonska banka, Vojvo anska banka and Nacionalna tedionica. Italian Fondriaria SAI in 200 acquired % of the insurance company DDOR Novi Sad for 220 million euros. After these successful transactions, state remained major owner of four banks (Banka Po tanska tedionica, Creden banka, Privredna banka Pan evo and Srpska banka), co-owner of Komercijalna banka and a anska banka and minority owner in few other banks. Dunav insurance is still in state ownership. Government has recently decided to sell its ownership in another six banks: Creden banka, Privredna banka Pan evo, Srpska banka, Privredna banka Beograd,

JUBMES banka and Agrobanka. If we add sale of private banks owned by Serbian entities to foreign partners we get in total 1.3 billion euros of foreign capital inflow, which equals to 11% of total FDI in Serbia.

As said above, the process of privatization of socially owned companies in Serbia is nearly over. Around 1,000 companies that have not been or are not in the process of privatization will go bankrupt or will be liquidated. Other companies that have not been successfully privatized in prior tender or auction models, might be reorganized and sold by model applied in Zastava Kragujevac, the car manufacturer which signed joint venture agreement with Fiat. This method tends to attract new investments which would enable modernization, growth of employment and exports.

State owned (public) companies are not in the same position. For them does not apply Law of Privatization regarding terms of completion. Government believes that these companies are good potential to attract large scale foreign income, either by sale of majority or minority of ownership. In the period of economic crisis it is not possible to evaluate the amounts of capital that can be raised for such transfers. Privatization of public sector companies is at the very beginning and there are still legislations to be clarified. The first attempts of privatization of state companies were JAT Airways and mining complex RTB Bor, for which foreign investors did not show satisfactory interest. It was followed by sale of NIS for 400 million euros to Russian counterparts. Such small amount does not give incentive to expect overwhelming amounts for sale of state companies unless structural changes are made prior to transfer of ownership. Privatization of RTB Bor which was expected to be of high interest for foreign capital in three attempts was not completed successfully. This is to support our thesis that for privatization of public sector there must be a topic of a public debate where several different methods of privatization or restructuring should be analyzed in order to enable maximum gain for the economy. Serbian Government plans until the end of 2009 to offer Galenika, and Telekom, Airport and EPS in 2010. The expected income for those sale is over 2 billion euros. We believe that the approach which has been used in privatization of public sector does not allow us to be so optimistic.

According to Serbian Government in next few years, 3 billion euros yearly are required to support sustainable development. Since the privatization of public sector does not seem to being these amounts, more attention has to be given to attracting Greenfield and Brownfield investments and other non-privatization methods. Key factor is to have strategic approach to foreign investors, especially those which are ready to intensively participate in transfer of technology and knowledge spillover. For such a strategy to be successful it is required to create competitive advantage for Serbia compared to other transitional countries.

3. The role, opportunities and threats of FDI in the second stage of transition

As in the case of other transition countries, especially those in central and southeastern Europe, Serbia has attracted significant amount of foreign capital in the first stage of transition. According to IMF (2008) liberalization of banking sector has brought large scale capital inflow. Economy development based on high inflow of foreign capital is today more exposed to economic crisis, because high amounts of budget deficit in previous years were cover by foreign capital inflow. In the case of FDI fallout, which is happening this year, macroeconomic problems are to be expected.

Several countries in transition have meanwhile joined EU, and in such a way gained advantage in attracting FDI. Their level of risk is much lower compared to countries which are still in line for EU membership. If we compare the level of FDI in different transition countries we can conclude that there were significant differences among them. Table 4 shows data for period 2000-2007. Unlike several analyses which only cover total FDI per year, in this we show aggregate level of FDI per capita.

Countries which are already members of EU have attracted significantly higher amounts of FDI per capita. It is important to note that Serbia begun with attracting FDI only in year 2000. That was a delay of 0 years compared to other transition countries. It is also interesting to compare country's FDI inflow before and after joining EU. After joining EU all of the countries FDI inflow has risen by at

least two times. That is to say that Serbia needs to speed up its efforts of joining EU in order to at least keep present level of FDI.

Depending on the way country manages their increased capital inflows, especially when analyzing inflows raised by privatization of social or state sectors, there are different results in other aspects of the economy like in foreign exchange rates, inflation, GDP growth rate and others. If the inflows were directed to investments oriented to exports, then all negative effects followed by increased foreign capital inflow will be minimized in a long-term. If the funds were used for consumption, then will country face problems because it will not be possible to enter so called “virtual circle” of foreign investments.

Table 4. Info of DI n rans on o n r s ar and r a a

	2000	2001	2002	2003	2004	2005	2006	2007	per capita inflow	stock per capita
Czech Republic	5404	6296	9012	1863	4007	9374	4752	5000	509	6679
Hungary	2998	4391	3185	1888	3633	6099	4874	4000	239	2600
Poland	10334	6372	4371	4067	10292	7703	11093	12000	667	4005
Slovakia	2089	1768	4397	1914	2441	1694	3324	3000	136	3269
Slovenia	149	412	1722	271	665	445	303	400	488	4059
Estonia	425	603	307	822	776	2349	1282	1300	967	10199
Latonia	447	147	269	270	513	582	1303	1300	568	3083
Latvia	412	499	772	160	623	826	1426	1300	383	2845
Bulgaria	1103	903	980	1851	2736	3103	4104	4000	519	2566
Romania	1147	1294	1212	1946	5183	5213	9082	7000	324	1756
Albania	155	232	143	158	278	224	259	300	95	698
Bosnia	159	133	282	338	534	421	338	400	104	780
Croatia	1138	1502	1197	1785	990	1425	2638	2500	606	5183
Macedonia	189	493	83	84	126	80	279	200	98	1126
Serbia	55	184	504	1204	777	1265	3504	3500	470	1589
Montenegro		5	76	44	53	393	644	600	961	2904
Byelorussia	129	107	262	152	132	245	262	300	33	247
Moldavia	138	115	89	65	120	160	177	200	51	301
Russia	2933	3069	3660	7041	12422	10258	23047	25000	176	1336
Ukraine	644	884	734	1260	1380	6263	4148	5000	107	477

Source: UCTAD web page

As a result of financial crisis, since autumn 2008 world market is experiencing a dramatic shift and decrease of capital inflows in transition countries. In Serbia, except for transfer made for petroleum company NIS, there were no other significant FDIs. According to Petrovi and Vasiljevi (200 , p. 2) the peek in FDI level was at the beginning of 2008. At the same time there was significant increase in budget deficit and increased economic activity. Decrease of foreign investments has shown its first results in loss of value of Dinar compared to all major currencies, increase of inflatory pressures and large decrease in foreign trade. To avoid further cumulative effects, it is necessary to find alternative sources of foreign investments. Government of Serbia has made some positive interventions by signing an agreement with IMF. Depending on use of credit line with IMF, whether it will be used for investments of just for consumption, macroeconomic results will vary.

The role of FDI in sustainable development is not only to increase income. It is necessary to define the political framework and protection of social and natural requirements through investment process. General growth of FDI also brings higher influence of MNC on sustainable development. Multinational companies are strong and effective in spreading new and innovative technologies which support sustainable development (Vuksan, Deli 200). For that reason it is very important to develop a strategy, which will not only attract foreign investments, but which will target MNC that are willing to participate in technology transfer.

The first phase of research of the effects of Greenfield investments in Serbia has shown that despite very dynamic trends and high expectations about future growth of FDI in Eastern and Southeastern Europe, every country has to make attractive investment climate. There is a large competition for attracting FDI among countries because host country, after FDI has arrived, has much more benefits than losses, while the alternative methods of development like savings or crediting from international financial institutions are very risky because of lack of funds for domestic savings and high debts which arise with credit arrangement for financial institutions, which are very difficult to pay back. On the other hand the state has proved to be very poor investor with misallocation of funds, so that alternative methods of development would most probably have catastrophic economic results, like it was in the era of socialism. For that reason the contract signed with IMF has to be used just for short time crisis overcoming, and not in any case for long term development strategy.

Country with high level of debt is becoming a risky country. Unlike that, foreign investors bring capital, know-how, export channels and new organization culture which applies even in the case local laws do not enforce such practices. For example, no one had doubt that foreign investors will pay their severance pay to employees, which would most probably not be the case with local investors.

As a consequence of the world crisis, withdrawal of foreign institutional investors from the market also happened in Serbia. The first results are visible on Belgrade stock market, most liquid capital market, where Belex index fell by 60%. Followed by that there came the fall of economic activity and increase of unemployment. As recovery period in employment only started after 6 years of transitional unemployment increase, it would bring catastrophic results if the unemployment does not stop to grow. For that reason all institutional measures have to be made, so that after the crisis is over, for the economy to get back to rapid recovery pace.

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