

**FOREIGN DIRECT INVESTMENT IN SERBIA
IN THE PERIOD 2004 – 2006
- Accent on agriculture: collision of economic needs
and institutional limitations- ***

UDC 330.322

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Abstract. *Competition of Serbian economy is extremely low and this is evident through the high foreign trade deficit, unfavorable export structure of goods and a high degree of state's indebtedness. As the domestic accumulation is not sufficient for carrying on the sustainable economic growth, led by modern and innovative technologies, between the foreign investment and credit arrangement - it is justified that Serbia opens its door for the foreign capital. However, according to the evaluations of economists in Serbia and the analysis of many international organizations and institutions - the basic problems of economic growth, higher competition and bigger attraction of foreign investment in Serbia are present in ineffective institutions of the system (especially judiciary and financial markets) and underdeveloped infrastructure. The paper is, at the same time, an inspection of measures needed for Serbia to make foreign investors more interested in long-term investment in Serbian economy, especially in the area of agriculture and processing industry (production of food).*

Key words: *foreign direct investment, institutions, infrastructure, agricultural, competition*

JEL classification: Q18

1. INTRODUCTION

A degree of certainty that economic growth marks high rates and reduction of exterior debt in future - is the function of proper growth of investment and export. High final spending, low domestic accumulation and contribution of gross investment in GDP of only 17.7% - do not provide the sustainable position of Serbian economic growth in the future. Having a

Received June 26, 2007

* As a part of project "Multifunctional agriculture and rural development in Serbia", research was sponsored by a research grant from the Ministry of Science and Environmental Protection of Republic of Serbia

high external debt of Serbia in mind, primarily the indebtedness of banks and enterprises (contribution of external debt in the frame of annual export of goods and services in 2006 is 228%), new indebtednesses are not an acceptable economic option. So, turning toward foreign investment seems to be the basic economic need, but a need for whose satisfaction the basic institutional and infrastructural conditions are not fulfilled.

2. BRIEF VIEW OF THE SERBIAN ECONOMY IN THE PERIOD 2004-2006

The Serbian economy is suffering today from high inflation and unemployment, low investment activities and low productivity, high public spending, high foreign trade deficit and high indebtedness. All those things contribute further to low competitiveness and a low level of living standard of the population. The reasons of such Serbian economical image, according to the evaluations of international institutions and organizations, proceed from ineffective system institutions and underdeveloped infrastructure.

During the period 2002-2006 gross domestic product of Serbia marks a constant real growth. Although the dynamics of the real Serbian GDP growth follows the one in the region, GDP per capita is significantly lagging behind the advanced regional countries. The economic growth in Serbia is primarily led by the growth of domestic demand, as a result of the actual earnings and pension growth. Regarding this are the suggestions of the World Bank for the stimulation of economic growth in Serbia which refers, in the first place, to reduction of public sector (to create the gap for higher domestic savings and investment of private sector), as well as to the change of public spending structure in order to reduce expenses for salaries, pensions and subventions, and increase expenses for public investment (Economic Growth and Employment Program, report No 29258-YU, World Bank, 2004).

Table 1 Main macroeconomic indicators of Serbia in the period 2004-2006

	2004	2005	2006
GDP (% changes regarding the previous year) ¹	8.4	6.2	5.7
GDP per capita (nominal) USD ²	3229	3697	4157
Unemployment (% share in active population) ¹	23.9	25.3	26.6
Retail prices (average of current/average of previous year in %) ¹	10.1	16.5	12.7
Average net earnings nominally (in % regarding to the previous year) ¹	22.7	23.6	24.1
Public spending (% in regard to GDP) ³	45.3	43.1	-
Balance of payments-in millions of USD ⁴	448	2027	5422
I Current transactions	-2833	-2225	-3656
II Capital and financial transaction	3075	4734	9361
External debt/GDP (%) ⁴	63.1	63.8	71.1
External debt/export of goods and services (%) ⁴	272.1	251.2	228.1

Source: ¹ <http://webrzs.statserb.sr.gov.yu/>;

² International Monetary Fund, World Economic Outlook Database, September 2006 (www.imf.org) and author's account; population in Serbia in the middle of the 2005 - 7.44 million;

³ Transition report 2006: Finance in transition, November 2006, EBRD;

⁴ <http://www.nbs.yu/>;

Observed through sectors of economy, a tertiary sector dominates in creation of GDP, whose contribution is increasing during the year (62.8% in 2006). In the second place is a secondary sector with contribution of 22.8% (2006) and in the third place is the primary sector, whose contribution was 14.4% in 2006 (Quarterly Gross Domestic Product, 4th Quarter 2006, Statistical Office of the Republic of Serbia, 2007). Compared with EU-25, the Serbian structure of GDP is very unfavorable. According to the Eurostat data, agriculture, hunting and fishing contribute to GDP in 2005 with only 1.9%, secondary sector with 26.6%, and the tertiary one contributes in creation of GDP with as much as 71.6% (Europe in figures, p.157, European Commission 2007).

Talking about the distribution of GDP, the least available statistic data are given for 2004. Up to 2002 the value of final consumption in Serbia was higher than the value of realized GDP, which means that more was spent than produced. In 2004 the expenses for final consumption are about 90.5% of GDP (The System of National Accounts of the Republic of Serbia 1997-2004, p.17, Statistical Office of the Republic of Serbia). Positive trend appears in growth of total investment activity, so the contribution of gross investment in GDP in 2004 was 17.7% (up to 2002 this contribution was around 10%). This value is still lower than desirable one, which should be higher than 20% of GDP value.

3. RESULTS OF FOREIGN INVESTMENT IN SERBIA DURING 2004-2006

Foreign direct investment (FDI) is the category of international investment in which an enterprise from one country (direct investor) buys the owner's share amounting to at least 10% of the enterprise from another country. Other forms of FDI are: establishment of a new enterprise (Greenfield investment), as well as the complete or partial "conquer" of the existing firms, through mergers or acquisitions. For firms to be invested in, FDI usually means: access to new markets and better information about them, better market service, new working places and increase of production, introduction of new technologies and knowledge, new ways of business organization, new management and marketing techniques. With all of that, FDI increases productivity and competition of domestic companies in which they enter. FDI contributes to export growth, economic growth and increases the living standard of the population. Foreign investment stimulates other domestic companies too for higher efficiency, productivity and competition and makes itself an appropriate catalyst of higher investment and technological progress (European Union, Foreign Direct Investment Yearbook 2006, page 20).

Level of direct investment in Serbia from 2001 does not seem to be sufficiently high to stimulate the economic growth significantly. On the other hand, the need for investment in Serbia is enormous. Experiences of other countries, which turned to foreign direct investment, prove that this is the fastest way to create stable economic growth and increase of competition. Example of Czech Republic confirms it especially – just because of a high number of foreign companies, which operate on its territory, this country today marks a fast export growth and high foreign trade surplus.

Table 2 Foreign direct investment
- Comparative view with neighboring countries -
- Million EUR -

Direct investment, net	2004	2005	2006
Croatia	708	1230	2670 ^{/1}
Romania	5127	5237	9052 ^{/2}
Poland	9.656	5.210	7774 ^{/3}
Serbia	777	1274	3430 ^{/4}

Sources: ^{/1} Bulletin 124, Croatian National Bank; 2007; page 82;

^{/2} Monthly Bulletin 2/2007, National Bank of Romania, 2007, page 48;

^{/3} <http://www.nbp.pl/>;

^{/4} <http://www.nbs.co.yu/>;

In contrast to Czech Republic and Hungary, as examples of countries where foreign investment was one of the main generators for changes in economy structure in favor of capital and technological intensive activity, there are no indicators that foreign investment in Serbia has significantly influenced the change of export structure yet. However, statistic data show that those investments considerably affected the growth of export value. Most obvious is the evidence of steel export from Serbia done by the only Serbian steel enterprise, owned by the American company - US Steel.

The higher numbers of foreign investment in Serbia during 2005 were in the following fields: financial transactions (39%), trade (23%) and manufacturing industry (19.6%). Within the manufacturing industry, most was invested in food and drinks production (52.3%), then in metal products (except machines) – 46.5% and in production of tobacco products (35.1%). During 2006, as much as 46% of the total foreign investment in Serbia covered the field of financial transaction, 36% the field of traffic (telecommunication) and 22.7% of total investment were targeted to manufacturing industry (in manufacturing industry 66,6% of foreign investment went to chemical production and products).

It is certain that from the total amount of foreign investment that enter Serbia, the dominant part came through privatization, although Greenfield investments and acquisitions are becoming increasingly frequent (the inflow of Greenfield investment was up to now dominantly channeled to service sector, especially trade and banking, while the volume of investment in manufacturing industry was lower). The following period will naturally bring deceleration of privatization inflows and unavoidable transfer to Greenfield investment. It is a type of investment that is necessary for Serbia; however, for such projects it is not easy to attract foreign investors, especially having in mind that Serbia is still a country of big transitional problems.

4. THE NEED FOR FOREIGN DIRECT INVESTMENT IN THE CONTEXT OF AGRICULTURE

Problems in the Serbian agriculture primarily refer to: lack of capital (underdeveloped market of rural credits, high interest rate and low rate of accumulation), high protection of domestic production, inadequate functioning of land market, slow privatization with low foreign investment, unbalanced development of rural and urban areas, poorly developed infrastructure, institutions and marketing organization.

The most critical problem is money, which is always a scarce resource and limiting factor for new investment in agriculture. Because of that, higher foreign investment is the basic need. Though juristically environment is not agreeable for foreign investors, especially in the field of agriculture, many positive economic effects for domestic agricultural producers and investors are possible in the sphere of processing industry (production of food).

With adequate agrarian policy and with foreign investment, which can influence the growth of production, Serbian agriculture can build competition and give a significant contribution to the economic development of the country. Though quite a lot has been done in the field of systemic reforms, a key role of the state in the following period will be in establishing the acceptable and stimulant macroeconomic and business environment, which is the only way for higher foreign investment and for the stimulating agrarian policy.

To achieve agricultural competition, Serbian macroeconomic management has some strategies and politics, but only on paper. The Government has adapted the Strategy of Serbian agriculture in November 2004, which is to be implemented in the next period up to 2008/2009. Officially, the targets of agrarian policy are fortified and ways of development suggested which should be followed in order to realize appointed goals. In the Strategy for Development of Agriculture, several targets of the agrarian sector are marked and the first one on the list is the following one (Serbian Agricultural Strategy 2004, page 14):

- To build up a viable and effective agricultural sector that can compete at the world market, contributing to the growth of the national income.

At the same time, the main courses of agriculture for realization of defined targets are (Serbian Agricultural Strategy 2004, page 14):

- Restructuring (of producers, ownership, institutions);
- Marketing development and its mechanism;
- Rural development and protection of living space;

For the implementation of these policies, it is necessary for Serbia to provide some postulates, which can enable stimulant environment for new domestic and foreign investment:

- Political stability;
- Stable macroeconomic policy;
- Strengthening, establishing and reformation of institutions (protection of owner's rights, protection of contracts and creditors' rights, strengthening of competition, more effective judiciary, reduction of corruption, reduction of administrative barriers and public administration reform, development of non bank financial institutions);
- Suspension of monopoly and restructuring of public sector and large systems;
- Reduction of public spending and increase of investment in economy and infrastructure;
- Open market and development of financial market;
- Building of infrastructure (especially physical: improvement and construction of traffic, energetic, telecommunication infrastructure);

Creation and provision of Serbian agricultural competition is the task of the state in the first place. Effective administration, public services and institutions, enforcing contracts, clear laws, developed infrastructure, open market and development of financial market - today are the basic assumptions (which are missing in Serbia) in a transition country for competition of economic subjects and for attracting new foreign capital investors. To realize agricultural competition, macroeconomic management has to recoup and reconstitute the elementary infrastructural and institutional conditions. Also, macroeconomic management has to change basic elements of agricultural developing strategies, in the first place, towards creation of sustainable agricultural systems, whose growth is conducted by knowledge and innovations.

5. THE BASIC SERBIAN PROBLEM IN ATTRACTING FOREIGN INVESTMENT

Whether a county will successfully attract foreign investors depends upon its business climate and economic policy. According to estimations of the economists gathered around Serbian Chamber of Commerce, as well as of many international institutions and organizations (World Economic Forum, European Bank for Reconstruction and Development, World Bank, International Financial Corporation, Jefferson Institute, Economist Intelligence Unit), competition barriers in sustainable Serbian economic growth are, in the first place, in the domain of insufficiently effective institutions: inefficiency of judiciary (specially of trade judiciaries), unresolved ownership problems, bureaucratic treatments and ineffective administration, mostly on local level. The list of economic legal absurdities and illogicalnesses in Serbian economy is a very long one, and according to the evaluation of Serbian Chamber of Commerce, the economists and investors in Serbia complain less about the deficit of laws and much more about non-implementation of the current ones (for instance, not a single regulation from the Constitution covering the economic sphere is operative).

It is emphasized in the previous part, that Serbia is still a country with numerous transitional problems and risks. According to the latest report of the European Bank for Reconstruction and Development in 2006 (Transition Report 2006: Finance in Transition, November 2006, EBRD), Serbia has the worst estimation in the following 6 of total 9 analyzed indicators: competition policy, infrastructure reforms, securities markets and non bank financial institutions, enterprise restructuring, privatization of large enterprises, reforms of the banking sector and liberalization of interest rate.

In the process of ranking countries by the Global Competitiveness Index (GCI), according to the Report of the World Economic Forum, Serbia was in 2006 on the 87th place of the total 125 countries of the world. Observed by sub index of the GCI, Serbia was ranked the worst concerning "basic requirements" (position 99), which imply effective institutions, infrastructure and macro economy (Global Competitiveness Report 2006-2007, pages 12, 17).

Analytic team of Jefferson's Institute in the study "Competitiveness of the Serbian Economy 2006" for the most critical bottleneck for the sustainable economic growth in Serbia, finds today the weak protection of ownership rights (Competitiveness of the Serbian Economy 2006, page 135). Results of the poll which, for the need of the World Economic Forum, was conducted during 2006 by the Jefferson Institute, show that the atti-

tudes of the economists very much coincide with the reports of international institutions when identification of problems concerning competitiveness is in question. Namely, according to the mentioned research of Jefferson's Institute, as the most problematic factors, i.e. business barriers in Serbia, the economists selected the following: instability of economic policy, inefficient state administration and insufficient access to the financial resources, underdeveloped financial markets, high corruption and underdeveloped infrastructure.

Table 3 Political, economical and infrastructural risk in 2007

	Overall assessment, rating, score	Security risk, rating, score	Political stability risk, rating, score	Macro-economic risk, rating, score	Financial risk, rating, score	Infrastructure risk, rating, score
Serbia	C - 52	C - 57	C - 60	C - 50	D - 63	C - 44
Albania	C - 51	C - 46	C - 55	B - 40	D - 63	D - 63
Bosnia and Herzegovina	C - 49	B - 39	C - 50	A - 20	C - 54	D - 63
Macedonia	C - 50	C - 50	C - 60	B - 35	D - 63	C - 59
Croatia	B - 39	B - 25	C - 45	B - 30	B - 38	B - 38

Source: Economist Intelligence Unit (<http://www.eiu.com>), evaluation for 2007, February 2007;

Legend: Rank for expression by descriptive marks from A to E, where A marks the lowest risk and E the highest. Common evaluation numerically expresses common rank.

The potential foreign investors are primarily interested in the investment risk, which further on is still very high in Serbia. As can be seen from the evaluation of the risks edited by Economist Intelligence Unit (Table No. 3: Political, economical and infrastructural risk in 2007), with rank of common risk C and evaluation of 52, Serbia is the most risky country in the region, worse ranked than Albania. The risk is especially high within the financial area. This dissuades foreign and domestic investors and can be taken as the common reason for slower growth of Serbian economy than it could be.

6. WHAT SERBIA MUST DO TO ATTRACT FOREIGN INVESTORS AND WHAT IS ESPECIALLY INTERESTING FOR POTENTIAL INVESTORS IN SERBIA

There is space for foreign capital in Serbia, but confidence of the world's companies must be gained. It is possible only if clear regulations exist, laws adjusted with European ones, as well as the defined projects where money could be invested.

It is necessary for Serbia for further attraction of foreign investment, especially export-oriented Greenfield projects, to have:

- Political stability;
- Stable macro economic policy;
- Strengthening, establishing and reformation of institutions (protection of owner's rights, protection of contracts and creditors' rights, strengthening of competition policy, more effective judiciary, reduction of corruption, reduction of administra-

- tive barriers and public administration reform, development of non-bank financial institutions and similar things);
- Suspension of monopoly and restructuring of public sector and large systems;
 - Reduction of public spending and increase of investment in economy and infrastructure;
 - Open market and development of financial market;
 - Building of infrastructure (especially physical: improvement and construction of traffic, energetic, telecommunication infrastructure);

To obtain a new, higher level of investment, the structure of foreign investment must be enriched as well. Serbia has to attract big capital investors, who are interested in so-called portfolio investment. They are looking for investment not only in individual projects, but also in whole programs through domestic financial institutions. When Serbia creates and proves to big institutional investors such as "Morgan Stanley", "Goldman Sachs", "Lohman Brothers", the image of reliable, arranged and organized country, in which the banks and other financial institutions and individual entrepreneurs can realize the possibility of profitable investment, without non commercial risks, money will enter Serbia in a very short period of time.

At last, things that are interesting for the foreign investors are listed in the latest publication of Serbia Investment and Export Promotion Agency – SIEPA. Namely, in publication "Investing in Serbia" the following investor's questions are marked as most frequent, when speaking of possibilities of investing in Serbia: basic information about the country, infrastructure (traffic, transport, telephony, internet), macro economic indicators, beginning of business activities, privatization, land, foreign trade, tax regime, labor force market, educational system. The most noted questions were related to the field of tax regime and employment and earnings (collective contracts, working hours, gross and net earnings, minimal earning).

7. CONCLUSION

The most critical problem in Serbian agriculture is money, which is always a scarce resource and limitation factor for new investment. Because of that, higher foreign investment is the basic need for agricultural producers in Serbia. Though juristically environment is not agreeable for foreign investors, especially in the field of agriculture, many positive economic effects for domestic agricultural producers and investors are possible in the sphere of processing industry (production of food). Observed all together, there are three basic problems for larger attraction of foreign investment in Serbia: bureaucratic actions and ineffective administration, especially on local level; unsolved ownership problems, mostly regarding construction lands, inefficiency of judiciary especially of the trade ones. The short conclusion would be that for Serbian success for further attraction of foreign investment the following are necessary: political and macro economic stability in the country, strengthening, establishing and reforms of institutions, suspension of monopoly and restructuring of public sector and big systems, development of financial market and infrastructure building up, especially the physical one.

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**DIREKTNA STRANA ULAGANJA U SRBIJI
U PERIODU 2004-2006. GODINA
– akcenat na poljoprivredi: sukob ekonomskih potreba i
institucionalnih ograničenja -**

Vesna Paraušić

Konkurentnosti privrede Srbije izuzetno je niska, a evidentna je kroz visok spoljno-trgovinski deficit, nepovoljnu strukturu robnog izvoza i visok stepen zaduženosti zemlje. Kako je domaća akumulacija nedovoljna za održiv privredni rast, vodjen savremenim i inovativnim tehnologijama, između stranih investicija i kreditnih zaduženja – opravdano je što Srbija svoja vrata otvara stranom kapitalu. Međutim, prema oceni privrednika u Srbiji i analizama mnogih međunarodnih organizacija i institucija – osnovni problemi privrednog rasta, veće konkurentnosti i većeg privlačenja stranih investicija u Srbiji leže u neefikasnim institucijama sistema (posebno oblast sudova i finansijskih tržišta) i nerazvijenoj infrastrukturi. Rad je ujedno prikaz mera koje su Srbiji neophodne da bi strani ulagači bili više zainteresovani za dugoročna investiranja u privredu i infrastrukturu Srbije

Ključne reči: Strane direktne investicije, institucije, infrastruktura, poljoprivreda, konkurentnost.