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THE IMPACT OF ATTRACTING FOREIGN DIRECT INVESTMENTS ON SERBIA'S FOREIGN POLICY

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Abstract: *At the beginning of 21st century, it seems that interweaving of policy and economics is getting more intensified day by day. Especially in Serbia where this interaction is getting more and more intense, and by all odds, dominant for Serbia's economic position. Having in mind that policy can be divided into foreign and domestic policy, the purpose of this research is to point the importance of foreign policy with an aim of creating more attractive business environment, or more precisely for foreign investments. This comes from the fact that Serbia is the EU candidate and strengthening her transatlantic position as an important priority of foreign policy. On the other hand, these relations and processes are not only a guarantee of safety, but also a kind of magnet for investors who are mainly from USA and EU, but also China, Russia and other countries in the world. This foreign policy position, and then the strategy, will provide the favorable conditions for Serbia to transfer from the status of the object to the status of the subject in international relations. The time has come for Serbia to take its well-deserved place in the European hierarchy, which is based on the rule of law, democratic institutions and the free market as its fundamental principles. Serbia's perspectives are based on potentials and possibilities for solving problems, which will result in more active participation of Serbia on the world investment chart, as well as further management of active foreign policy, and aims to achieve the same goals related to Euro-Atlantic integration*

Keywords*: development, FDI, economy growth, foreign policy, possibilities.*

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1. Introductionary remarks

Higher investment rates in Serbia are needed for faster economy growth in the years to come. The insufficiency of domestic accumulation rises the necessity for extensive foreign investments, such as Foreign Direct Investments (FDI) Current volume of Serbia's indebtedness abroad, as well as decreased absorption capacity of Serbian companies, result in limited access to international capital markets. This means that over indebtedness could become a limiting factor of economic growth. Higher inflow of FDI is needed in order to avoid possible risks of further foreign indebtedness, so the additional foreign accumulation should be assured. Therefore, economic policy must be incorporated into an integrated foreign policy of Serbia, with determined structure and aspects of FDI. Besides that, the key determinants of Serbia's foreign policy are the harmonization with FDI, export and balance of payments. Improving the institutional environment should be a main direction for stimulating foreign investors, as well as further development of infrastructure, containment of economic stability, so as for other forms of encouragement. Political and economic stability is the key for attracting foreign direct investments. With constant implementation of reform measures in the coming period, it is necessary to resolve problems that hinder business, such as legal uncertainty, corruption and the rise of the grey economy. Besides making potentially large effects on Serbia's economy growth, foreign direct investments, through various channels (through the impact on the quality and quantity of forming capital, technology transfer, increasing the level of development of human resources, expending trade opportunities) affect the quality of the environment, with certain implications for long- term sustainability of economy growth and the possibility of achieving sustainable development.

2. Economic growth and investments

Foreign direct investments, nowadays, represent the key initiator of international economic integrations. Foreign direct investments can provide financial stability, economic growth and overall prosperity of a society, with appropriate framework of economic policy. In the last decade, the largest contribution to Serbia's economic growth was given by foreign direct investments which comprise three components: equity capital, reinvested earnings and inside-company borrowings. According to opinion of numerous experts, country's sustainable economic progress requires that total investments, in years to come, will have to grow 10% faster than GDP, until they reach about a quarter of everything attained in one year. In doing so, the reduction of incentives to foreign investors should be made. In that sense, it is necessary to adjust Investment Law and Regulation (2015) to the conditions and the method of attracting direct investments (2016.), which includes the financing of investment projects in the production sector and the service sector which can be a subject of international trade. Certainly, FDI inflows, especially if investors were transnational companies, bring ownership technology and knowledge, changing the existing balance in the host country market. Two following effects may appear: first is the effect of competition, and the second is the effect of relations. The effect of competition manifests in two ways: international companies substitute domestic producers of final products and with their presence, they enhance competition on the market. The result of their actions might be harmful for the part of the local industry. On the other hand, the result might be useful through making connections: forward linkages with local companies which are buyers of their products, and backward linkages which are the result of demands of foreign companies for local industry products. Here comes the emergence of complementarity between foreign and local companies. It is considered that the creation of links, that support the production and trade of intermediate products, leads to the appearance of certain technological externalities, such as spillover of technology, knowledge and productivity, or demonstration effect. Considering that the investment policy is an integral part of the European Union common trade policy, the European Commission (EC, 2017) has the authority to enact laws on investments, with the European Parliament and the Council of the EU. The EU's investment policy contributes to the goals of smart, sustainable and comprehensive growth, defined by the „Europe 2020 Strategy". This policy aims to provide free access to the market for investors and investments, as well as legal security, stable, predictable, fairly and adequately regulated business environment. The EU investment policy is focused on the following relevant aspects (EC, 2017): (1) increased access to the market, (2) support of legal security and transparency; on the other hand, Serbia has chosen to encourage foreign direct investments by systematic measures based on public expenditure policy. „This type of state aid is built-in the country's economic system with the intention to function as one of the basic factors in attracting foreign direct investments. State incentives can at the same time be treated as an important instrument for stabilizing fiscal policy, and as an instrument of long-term economic development and development policy" (Ganjatović, 2016, pp. 131-139). However, the constant lack of investments from own accumulation that has been transferred abroad, is superseded by economic policy measures for attracting foreign investments, but consideration should be given to the long-term consequences that these effects can have in terms of accelerated economic growth. Therefore, critical approaches to the policy of attracting foreign direct investments are not surprising (Drašković, Milojević, 2016, p. 230): foreign direct investments and privatization have not met the expectation that the transition to a market economy will lead to economic growth, development, and an increase in employment. Thereby should be noted that countries are using, in practice, four types of incentives to attract foreign direct investment: fiscal, financial, regulatory and other incentives. The most common remarks, pointed out by foreign investors for the present, still unsatisfactory position of Serbia, as the destination for investments are (Petrović, 2014, pp. 113-124): (1) the presence of the state in the economy is still high, while the private sector is still weak and legally insufficiently protected; (2) State aid goes to subsidies and tax reliefs, instead of research and development; (3) budget spending is still out of control, and records the highest level; (4) a fairly high level of unemployment;(5) quite poor management of public companies. (6) the functioning of the market mechanism is seriously undermined by legal uncertainties and corruption, while the grey economy is on the rise; this suggests that the Serbian economy has to "tackle" in order to face the competitive pressures and market forces that exist in the European Union. A massive inflow of foreign direct investment is a way of achieving this. By reviving economic reforms, Serbia is changing its approach to foreign investment and becoming the leading country in region by greenfield investments (regulatory reforms, cost-effective labor costs and access to a single EU market). This is achieved by attracting most investors as an export platform, rather than a market itself. According to the global index of greenfield direct foreign investments, Serbia had a score of 12.02 points in 2016, which indicates that it attracted 12 times more of these investments than it could be expected from an economy of this size.[2] Regarding this, the importance of different approach towards foreign investors that Serbia has today should be noted: from the promotion of the country as an investment destination and individual projects in the world, to the support of investors during the preparation and realization of the projects. It should always be kept in mind that the inflow of these investments has positive effects on economic growth only if their structure is suitable. In fact, if these investments go to the tertiary sector, they will have a negative effect and they will not reflect on the economic efficiency. On the other hand, the participation of foreign direct investment in the secondary sector increases the impact on economic growth and has positive effects on productivity. However, opposite opinions are also not rare: "When it comes to foreign direct investments, it should be noted that internationalization, as a dynamic process of human development and improvement, is a natural legitimacy, and it cannot and should not be avoided. It should be kept in mind that internationalization is characterized by an increasing interdependence of national economies with the world economy and the increasing interdependence of national science with world achievements. World countries are linked into a multinational network of economic, scientific, technological, social and political connections. The rapid development of highly-sophisticated technologies has enabled the rapid overcoming of geographic distances, the rapid flow of goods, capital and people, but also the improvement of the production, and the development of the economy and all segments of society. These are the benefits of internationalization and they are opposed to the imperialist globalization through which economically powerful forces seek to occupy capital of less developed countries." (Drobnjak, 2013, November 26). Therefore, we believe that Serbian foreign policy, in the field of economic diplomacy, should selectively or cautiously act to attract foreign direct investments. Generally, a flexible and argumentative approach to attracting foreign capital, especially the private one, is desirable.

3. Inflow of foreign direct investments

The effects of Serbia's foreign policy can be seen from the aspect of raising the level of inflows from net investments. Insufficient domestic accumulation requires the injection of foreign capital, as the first assumption for permanent rise of economic growth rate on another level. Serbia is now in a position where more dynamic economic growth can no longer be provided without foreign investments, primarily without foreign direct investments. However, this is not the only reason; as the key factors of the FDI increase, in transitional countries, there are: improved business environment, stricter regulations on commercial and financial business, reduction of political risk, i.e. political stability. With an addition of indirect effect, which is a new way of organizing and managing companies, s the achieved results of these companies gradually overlap in the rest of the economy, thereby raising its overall efficiency (Stamenković, Kovačević, 2016, p.37). Now, when privatization inflows have been heavily exhausted and when the reduction in state subsidies to ensure fiscal sustainability is inevitable, Serbia needs to find new ways to attract foreign investors in the future, inter alia, in order to balance its own balance of payments, revive domestic companies, and economy in total, ensure economic growth and increase employment and exports. All this would result in a much higher living standard. There are still some factors that discourage foreign investors from investing in Serbia, such as: insufficient macroeconomic stability (high external

[2] Financial Times, London, according to: "Politika", Belgrade, August 12, 2017, p.3.

imbalance: public and external debt, deficit of payment accounts in balance of payments), occasional political risks, business conditions - business environment - flexible environment, institutional factors (ineffective legal regulation and bureaucratic obstacles, poor infrastructure). There are also few positive factors which make Serbia more attractive destination for investments than other Central European countries: low labor costs, good geographical position and relatively low tax liabilities. The total amount of FDI in Serbia at the end of 2015 reached EUR 26.5 billion, which is almost equal to the external debt of the country of EUR 26.4 billion, at the end of the same year.[3] In those terms, the review in the following table, which refers to the entire transition in the range of 22 years for the countries of South East Europe (SEE), is very illustrative.

Table 1: Inflow of FDI per capita and Inflow of FDI as % of GDP in SEE countries from 1992 to 2014

Inflow of FDI per capita *unit: Euro			Inflow of FDI as % of GDP		
Rank	Country	Average value for the period 1992- 2015	Rank	Country	Average value for the period 1992- 2015
1	Montenegro	1237	1	Montenegro	17,93
2	Croatia	362	2	Bulgaria	7,43
3	Bulgaria	333	3	Serbia	6,07
4	Serbia	321	4	Albania	4,70
5	Romania	153	5	Croatia	3,59
6	Albania	134	6	Romania	3,18
7	Macedonia	80	7	B&H	2,68
8	B&H	87	8	Macedonia	2,41

N / A: Data for Serbia and Montenegro refers to the period 2008-2015

Source: (Đorđević, 2016, p.151.)

Increased inflow of FDI directly affects the increase in exports, and the efforts to increase its volume and effects on the country's balance of payments (and thus the leveling of external indebtedness) impose a specialization in production, which leads to the growth of productivity and competitiveness, and cooperation with companies in the foreign market affects the adoption and use of new knowledge in production and management. The impact of FDI on exports is defined by the character of FDI, i.e. whether they are market-oriented or production-oriented, and whether the integration is horizontal or vertical, where production-oriented FDIs and vertical integration usually lead to an increase in foreign trade and exports as well (Kutan, Vukšić, 2007, pp.430-445).These ratings of the reputable “Ernst & Young” seems very encouraging; not only do they indicate that Serbia's attractiveness for foreign investors is growing, but also that investment in industry in 2016, which creates interchangeable goods for export, has opened twice more working places than the previous year. Serbia also needs to become a member of the World Trade Organization. "By joining the World Trade Organization Serbia sends a clear signal to foreign investors that Serbia is ready to guarantee the national treatment, and will not use illegal measures that are prohibited by the agreements of this organization, among which

[3] https://www.nbs.rs/internet/cirilic a/80/ino_ekonomski_odnosi/mip/index.html, Accessed: 10/12/2016.

The Agreement on Trade-Related Investment Measures, moreover known as TRIMS, stands out. On the other hand, in 2017, public investment, that is, the investment of the state and public companies, dropped for 6.7 percent, while the fall of private companies is estimated at about four percent. From 2007 to 2017 in Serbia, between 17 and 19 percent of the total production was invested in, while in the countries of Central and Eastern Europe around 23 percent. With such small investments, it is not possible to achieve high rates of economic growth, higher profits and a higher living standard. For sustainable earnings and standard growth, it is necessary to invest at least 25 percent of what we produce. The reason for our slow development and lagging behind countries in the region is insufficiency of domestic investment - public, that is, by state and domestic companies, which are particularly desirable (Arsić, 2017, p.33). In Serbia, domestic investments are low - private investments make about 10 percent of GDP, while 15 percent in countries of Central and Eastern Europe. Public investments in Serbia make 3% of GDP, while in CEE countries 4.5%. Public investments are low due to the inefficiency of the state, which is visible in the delay in construction of infrastructure facilities, particularly roads.

Table 2: GDP growth and share of investments in GDP in 2014-2017

Countries	2014	2015	2016	Investments share in GDP
Serbia	-1,8	0,8	2,8	17,7
Surrounding states (weighted average)	2,7	3,4	3,5	22,7
Albania	1,8	2,2	3,4	27,2
Bosnia and Hercegovina	1,2	3	3,1	17,3
Bulgaria	1,4	3,6	3,4	21,0
Croatia	-0,5	2,3	3,0	19,5
Hungary	4,1	3,1	2,0	21,7
Macedonia	3,6	3,8	2,4	23,3
Montenegro	1,8	3,4	2,5	20,3
Romania	3,0	4,0	4,8	24,7
Central and East Europe	2,9	3,7	3,0	22,0

Source: Eurostat, statistical offices of individual countries and EU Commission

4. FDI in foreign policy of other countries

In general, a flexible and argumentative approach to attracting foreign capital, especially the private one, is desirable. Besides still ongoing financial crisis, especially in the euro zone, Europe continues to play the role of the largest foreign direct investor in the world. On the other hand, for example in 2014, is recorded significant growth in FDI inflows to the European Union. With an outflow of FDI of USD576 billion, the EU has become the largest investment region in the world (UNCTAD, 2016, p.10). In the last decade, almost 50% of global inflows of foreign direct investment has been received by only five countries: China, the United States, Brazil, Canada and Russia. Regarding foreign policy of these countries, the biggest importance is given to the capital inflows in the form of FDI. The primary goal of the BRICS countries (Brazil, Russia, India, China and South Africa) is also an increase of investments based on foreign investments. However, the USA kept the position of leading investment economy. In the region, i.e. OECD countries, inflows of foreign direct investments increased by 11% (for example, in 2013 to $ 641 billion, while OECD's foreign investments remained stable (to $ 933 billion, a fall of only 2%). The capital component of FDI flows decreased in 2013 partly due to increased disinvestment, while on the other hand, the company's debt and reinvestment of earnings increased. Similarly, G20 inflows increased by 11%, while outflows dropped by 6%, although in this case, the drop was entirely due to the OECD-G20 countries. FDI outflows of other G-20 countries increased by 41%. European Union inflows increased by 14%. The increased FDI flow in many OECD countries is mainly a result of inside-company borrowing as capital. Transactions in that area decreased for about 13% partly because of significant disinvestment. For example, the FDI inflow has increased by 45% in Canada (from $ 43 billion to $ 62 billion) and doubled in Germany. In some countries, such as Italy, Mexico or the United States, there has been an increase. Foreign direct investment inflows increased due to capital transactions, not interbrain loans. All in all, the inflows of foreign direct investment, for example, in Italy, Mexico and the US reached $ 17 billion (in comparison to USD 9.1 billion in 2012-Italy), USD 35 billion (in comparison to USD 17 billion - Mexico) and 193 billion (in comparison to USD 166 billion - USA).It seems that one of the effects of the economic crisis was the increase in the international separation of capital transactions. It is reflected in number of reported negative inflows of foreign direct investments e.g. Belgium in the amount of USD -2 billion, Finland to USD - 1 billion, Poland with USD - 6 billion, and Switzerland with USD - 5 billion. The case of France emphasizes how different components of FDI can in whole have effect on economy growth. Although, for example, capital transactions in France remained stable between 2012 and 2013, total FDI inflows dropped by 80% (from USD 25 billion to USD 5 billion), mainly due to significant loans which were extended. For example, at the end of 2013, the investments were nearly ten times higher than at the end of 1990. Regarding economic sectors which attracts FDI, the most dominant sector for direct investment in the OECD countries is the service sector, which accounted for 60% of its internal investment stocks at the end of 2012, as an obvious example, and 65% of foreign investment. Then the production sector which, integrally, represents 23% of internal investments and over 21% of foreign project investments (OECD, 2014, pp.32-45). Data separate bilateral partner countries (worldwide) and through economic activities. Direct investment statistics includes all cross-border transactions and positions between companies which are integral part of the same group of companies. FDI statistics include direct investment positions (capital and other capital), direct investment flows (distributed earnings, reinvested earnings, interest income), and direct investment flows (capital, reinvested earnings, and debt).[4] On the other hand, the sustainable development concept represents a new development paradigm, a new strategy and social development philosophy. Sustainable development concept represents the biggest challenge in 21th century. The world today is characterized by extreme poverty, economic instability, social inequalities and environmental degradation, and they could be solved only through the cooperation on global scale. Having in mind the positive impact of FDI on economic growth, it is considered important to highlight some of the factors that make some countries more successful than others in attracting FDI (Gligorijević, 2013,

[4] Direct investment is the category of cross-border investments of a resident in an economy to establish at least 10% of the equity interest in the company (i.e. the company for direct investments) which is a resident in an economy which is not a direct investor.

pp.12-16): a) size of the market, its dynamics, openness and structure; b) input costs, labor costs, energy and raw materials; c) macroeconomic stability (possibility of depreciation of domestic currency, high inflation, high and increasing fiscal deficits); d) institutional and political stability (absence of capital controls and other constraints, e) a tax system that is market-oriented, f) strict current legislation, g) low level of corruption, h) a high level of political freedom, i) high level of price liberalization, j) the flexibility of economic measures and an adequate method of privatization; k) foreign trade liberalization and membership in trade organizations, l) integration and transparency with the EU; m) subsidies for attracting FDI, agglomeration, quality of infrastructure. According to a research conducted by the UNCTAD, and published in the World Investment Report 2017, in 2016, the total FDI inflow of USD 1.746 billion dropped for 1.6% than in 2015. Despite Brexit, the inflow of FDI in the United Kingdom increased by 7.7 times, from 33 to USD 253.8 billion, which disproves the connection between political and economic risks in the European Union. "The growing trend of foreign direct investments contributes to optimism among developing countries about their potential to integrate into the world economy, not only because the inflow itself, but also because of the accompanying inflows of technology, marketing and organizational knowledge, and sometimes facilitating access to the market of developed countries (Jelisavac, Rapajić, 2014, pp.418-435).Anyway, the aspiration of all countries, and not only those that are still in transition processes or in development, is to attract as many foreign direct investments in industry and agriculture as possible i.e. production sectors.

5. Perspectives of the FDI inflow and guidelines in policy

In recent years, foreign investments recorded a major expansion worldwide. The creation of a global economy was accelerated, and information and communication networks created a unified space out of world. The international movement of goods, services, technology, capital and labor has also been globalized and internationalized. In order for the economic development to be achieved, it is necessary to define and harmonize goals. Each country should take care of the proper choice of development priorities, as well as to provide the material conditions that are necessary for achieving the desired goals. The essence of the process of economic development is that the available funds are used in such a manner that with as little cost as possible to achieve the highest level of satisfaction of needs. Foreign direct investments (FDI) take over the role of key development factor in world economy and, along with trade, become the basic mechanism of globalization of the world economy and the companies' business. FDI is a capital investment by an investor resident of a country in a resident (company) of another country, which establishes a long-term cooperation in order to achieve common goals (Madžar, 2016, pp-132-142). The consolidation of economy in Serbia is successful, and due to conveyed reform measures, some of the planed goals for 2015 and 2016 were even exceeded. The economy is on rise due to the consolidation of state finances, stability and export demand. So far, consolidation has been mainly based on austerity measures and income growth, primarily due to the increase in value added tax and the growth of excise incomes, with the significant impact of low import prices of energy products. It is a good starting point for relaxation of public debt and relaxation of savings in domain of earnings in public sector salaries and pensions, but it is not enough as a basis for permanent securing of fiscal and foreign trade balance and balance of payments.

6. Conclusion

The content and intensity of these relations are increasingly reflected, besides trade, by investment flows which ensure internationalization and integration into the dynamics of the global market. The goal of Serbia's foreign policy should be, among other things, to contribute to the investments to make a quarter of the achieved gross domestic product in one year. In doing so, it would be ideal that the share of foreign and public investments in the given percentage of GDP of total annual investment in development be five percentage points, and private investments ten percent. However, private domestic investments over time should increase, while those foreign should decrease. At the same time public spending would only begin to decrease after the construction of solid infrastructure. What follows from the above-mentioned paragraph is that foreign investments, in relation to the growth of total investments, contain three key assumptions for constant growth: (1) infrastructure, (2) SME development, (3) country ratings and systemic conditions (fiscal, financial, regulatory, etc.). From the aspect of Serbian foreign policy, it should be noted that the FDI inflow has multiple positive effects on the economy on three basis: (1) introduction of modern technologies that improve the productivity of the rest of the economy; (2) foreign investors already have worldwide dispersed sales networks, which can be used as effective channels for exporting products to foreign markets (contributing to the reduction of trade deficit and, therefore, the deficit of payment accounts in balance of payments ; (3) the input of FDI is also a substitution for foreign borrowing to cover the current account deficit (that borrowing involves fixed repayment of principal and interest in proportion to the interest rate, while the profit depends on FDI profitability). The overall economic policy measures, as well as overall foreign policy, should focus on improving the investment climate for all types of domestic and foreign capital. This would be a credible approach to attract green-field investments, but also a method for Serbia to avoid additional borrowing in the international capital market.

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UTICAJ PRIVLAČENJA STRANIH DIREKTNIH INVESTICIJA NA SPOLJNU POLITIKU SRBIJE

Rezime: *Početkom dvadesetprvog veka, preplitanje politike i ekonomije kao da svaki dan dobija na intenzitetu, odnosno sve više utiču jedna na drugu. Ovo je posebno karakteristično za Srbiju gde je ova interakcija sve intenzivnija, i po svemu sudeći, dominantna za srpsku ekonomsku poziciju. Imajući u vidu da se politika deli na onu unutrašnju i spoljnu, ideja ovog rada je da ukaže na važnost spoljne politike, u cilju kreiranja atraktivnog ambijenta za poslovanje, odnosno za strane investicije. To proizilazi iz činjenice da je Srbija kandidat za prijem u EU, da jača njene transatlantska pozicija, što su bitni prioriteti spoljne politike. S druge strane, ovi odnosi i procesi predstavljaju ne samo garanciju sigurnosti, nego i svojevrstan magnet za investitore, koji dolaze pre svega iz SAD i EU, ali i Kine, Rusije i celog sveta. Ovakva spoljnopolitička pozicija, a potom i strategija obezbediće uslove da Srbija iz pozicije objekta pređe u status subjekta u međunarodnim odnosima.*

Ključne reči: *razvoj, SDI, privredni rast, spoljna politika, mogućnosti, Srbija.*