Chapter 19.

FOREIGN DIRECT INVESTMENT AND ECONOMIC TRENDS IN SERBIA[1]

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Abstract

The suspension of economic sanctions and the liberalization of Serbian economic system after the year 2000 led to free space for foreign direct investment. The delay, caused by economic sanctions, in opening the country towards the environment for more than ten years have a great impact to modest growth of foreign direct investment in the period 2001-2007. The presence of financial and global economic crisis in mid-2008 was decelerating, and particularly in future would influence on, the poor intensity of investment inflow in Serbian economy. The total foreign investments were dominantly realized through buying off state-owned and social companies. Therefore, the investment growth effects were not noticed considerately in export growth, employment rate increase, and trade deficit decrease. The expectations that the privatization economic policy, as one of the key economic policy factors, together with deregulation and liberalization, will assure the overall economic prosperity were unreal.

Key words: Liberalization, Foreign Investment, Economic Growth,Eemployment, External Debt.

1. Introduction

The economic strategy and the concept of structural harmonization from early eighties of the past century, also called Washington consensus, coined by John Williamson [3], was applied as a receipt for the transition countries. This concept is mainly synthesizes in ten postulates; thereby some authors describe it as economic policy *Ten Commandments*. Briefly, it should be remarked some essential elements of structural harmonization models. The standard, original model of Structural harmonization program, implemented by IMF and World Bank comprises the following elements:

- Abolition of restrictions related to foreign investments in national industry, banks and other financial institutions;
- Privatization and constitution of overall and secure property rights over companies and resources together with withdrawal of the state from the property rights domain;
- Import duties and other import restrictions reduction;
- Industry redirection towards greater export and maximizing the use of local comparative advantages – exploitation of natural resources and cheap labour force, all together aiming to assure the payment of foreign debts and increase these countries dependency rate of developed countries economies;

[1] This chapter is a part of a research project No. 159004, financed by the Ministry of Science and Technological Development of the Republic of Serbia, named: “The Integration of Serbian Economy into the EU - Planning and Financing of Regional and Rural Development and Enterprise Development Policy” and a part of a survey within a research project called “Integration of Financial Services Sector of the Balkan Countries into European Financial System.” as part of interstate programme of co-operation of „Pavle Savić” between the Institute of Economic Science from Belgrade and the University of Nice - Sophia Antipolis from Nice, France.

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[3] Stigliz J. i N.Serra (2008), The Washington Consensus Reconsidered, Oxford University Press. See also: Miomir Jakšić (2009), Svetska ekonomska kriza i ekonomska politika Srbije u 2009.godini, Economic Faculty, Belgrade.

- A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, radical decrease of salary expenditure, social expenditure and education.
- Exchange rates control of local currency and adjustment of their value according to Currency Basket, aimed to export competitiveness:
- Liberalization of trade and interest rates, that is liberal capital price defining aiming to create positive environment for inflows of foreign direct investment
- Fiscal discipline and budget equilibrium in order to decrease deficit;
- Deregulation (to abolish barriers to entry and exit), in sense to maximize the free economic activities of multinational companies on developing countries markets. Deregulation's consequences are restriction in labour force protection level, uncontrolled and free multinational companies access to developing countries natural resources;
- State – owned companies privatization, and growing foreign companies influence on developing countries economic activities.

Transition economic policy in Serbia, as well as the one in all previous in Eastern Europe countries, was developing based on key principles of structural harmonization, aiming to realize the ideal of Smith's market "invisible hand" system.

2. Foreign direct investments

The open market economy of liberalization and deregulation comprises the free financial capital inflow from areas with fewer yields (profits and interest) to the countries with lower row material, semi finished products, energy and labour force prices. The plenitude of free financial capital after 1990 flew out from developed towards countries in transition from socialism to capitalism. The expectations of the countries receiving the direct foreign investment were that those investments would ensure their stable development. Unfortunately, those expectations did not come true, particularly in Hungary, Ukraine, Baltic and other East Europe countries.

The direct foreign investment growth in Serbia in the period 2001-2008, observed in nominal amount is extremely dynamic. This fast growth has its mainstay on low initial basis of sole **US$** 50 millions in 2000, on one side, and intensification of social companies' sale off after 2001, on the other side.

Table 1. Foreign Direct Investment(FDI)
Total in million. $

	FDI	BDP	FDI/BDP u %
2000	50	8.651	0,6
2001	165	10.269	1,6
2002	475	14.282	3,3
2003	1.360	19.094	7,1
2004	966	22.124	4,4
2005	1.481	23.900	6,2
2006	4.387	33.143	13,23
2007	2.195	43.356	5,06

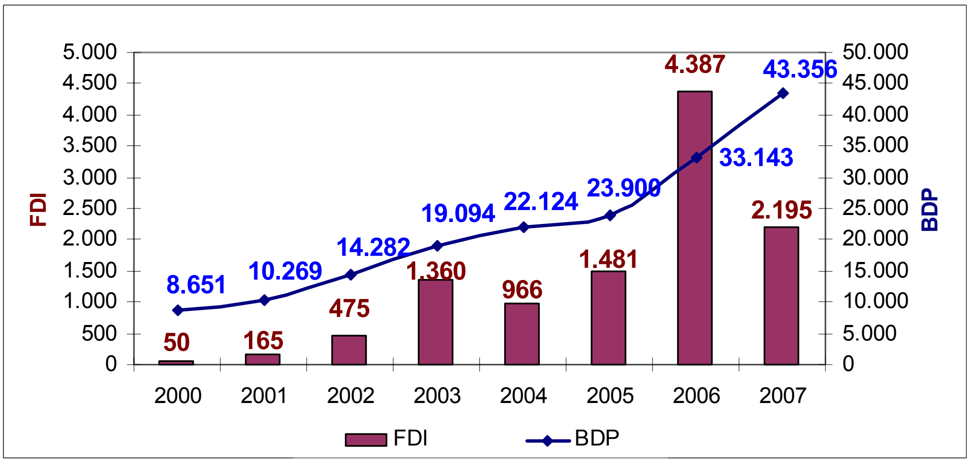
Source: MAP No.11-12, 2005 Institute of Economic Sciences and NBS

Foreign direct investment ratio per gross domestic product in the monitoring period was growing from 0.6% in 2000 on 13.23% in 2006, while in 2007 was decreased on 5.06%. In case that in future period the world economic crisis would be deeper, the foreign direct investment would not only be stopped, but the earlier invested capital would be withdrawn.

If we exclude from presented data on foreign direct investment those referring to companies and banks capital sale off, the position of foreign investment will be more than unfavorable.

The stage of state owned and social capital, as well as the one in banks and big state companies is finished by the year 2008. The new capital inflow will be drastically decreased both because of completed the privatization process and occupation of real and financial sector free market space. The issue will be additionally complicated by the pressure on country's currency reserves as a result of drawing the previously invested capital into domicile countries.

Graph 1. FDI (foreign direct investment) and GDP (in millions. $)



Greenfield direct foreign investment was marginal in Serbia. The economic policy priority was to maximize the companies' sale off budget income. The current state income of social capital sale off to national and foreign entities in the period 2001-2008 is only 2.9 billions €. The Petroleum industry of Serbia (NIS) was sold to the Russian company at the beginning of 2008 for € 400 millions, while its market value is € 784.31 millions, estimated based on the fact that 51% shares had been sold per the mentioned money value. From the total amount of about 11 billions Euro foreign direct investment in real sector, about €2.1 billion, or approximately 19% of all foreign investments, was engaged in telecommunication system, not counting the banking sector. The banks with foreign capital in Serbia have 76.32% of overall balance sheet assets and are acting with profit.

3. Consequences

It would be worth to mention that the complete privatization concept and the strategy how to attract the foreign capital had the key hypothesis translated into axiom, and that could be reduced on conclusion that the privatization of social and state sector will on its own solve all developing, social, and consequently, all economic, or social problems. Opposing this axiom was a real blasphemy. The privatization together with liberalization and deregulation targeted to achieve the results of economic and monetary stabilization, and further to ensure the prerogatives for fast economic recovery. It has passed more than eight years of established macroeconomic, even marketing goals – "Home for the property"[4].

In very brief form it will be presented the economic policy effects on domestic product growth, deficit and external indebtness increase, employment and unemployment.

[4] Marketing motto placed from the Ministry of Privatization from the beginning of the privatization program 2001.

3.1. GDP growth

Besides the monetary stability, the positive results of implemented economic policy liberalization and attraction of foreign direct investments are the GDP growth in the period 2001-2007. Nevertheless, the first question to put here, in addition to explicit data on gross domestic product growth, is the GDP low basis values in the period to 2000. The second one is the issue of its structure, in order to asses this economy indicator as positive one.

Table 2. Real GDP growth for the period 2001-2007.

	2001	2002	2003	2004	2005	2006	2007
BDP real growth in %	5,4	3,6	2,8	8,2	6,0	5,6	7,1

Source: MFIN data based on RZS data

The previous table indicates the highest GDP growth for 2004, owing to real GAV[5] growth in agricultural sector. However, the industry and construction had negative real rates in 2001-2003, followed by considerable growth in 2004, and then decrease of 1.8% in 2005. In the monitoring period only service sector marks the stable growth. GDB growth in 2006 and 2007 is stable. The presented GDP growth rates, in monitoring period, are based on state owned and social companies sale off, inflow of foreign direct investments and public and private sector foreign indebtness, what in general, initiated the dominated domestic consumption, and far away lower investments and long term development.

3.2. Current transactions deficit and foreign indebtness growth

The relative economic and monetary stability in 2001-2008 is followed by the constant growth of trade deficit, as well as country's indebtness growth from 10.8 billion dollars in 2000 to about 28 billions dollars in 2008. The indebtness growth dynamics would have been far higher if it the old debt had not been written off towards the Paris and the London Club creditors. After 2000, trade balance of goods and services marks permanent negative growth with over 2 billion dollars from 2001 to 6.4 billions in 2004, and 5.3 billions in 2005, that is 6.7 in 2006 and 9.7 billions in 2007.

Table 3. Export and foreign balance towards foreign debt in mil. $

Export of goods and services	Import of goods and services	Trade balance of goods and services	Current balance of payment	Foreign debt TOTAL	Foreign debt towards export in %
2.066	3.507	-1441	-350	10.829.7	524.2
2.435	4.499	-2064	-648	11.124.8	456.9
2.961	6.059	-3098	-1731	11.229.5	379.2
3.958	8.054	-4096	-1928	13.574.9	343.0
5.181	11.637	-6456	-2873	14.099.0	272.1
6.424	11.810	-5386	-2088	15.467.0	240.8
6.428	13.172	-6744		19.605,7	
8.825	18.554	-9729		26.235,4	
				27.986,9	

Source: NBS data (Internet site and Statistical Bulletin), 2008. data concluded by November.

[5] Gross added value (GAV) is the difference between the production value as the output and interphase consumption.

In the same period, besides the part of debt written off towards Paris club of creditors, the total foreign indebtness of the country presents constant growth rate, indicating that Serbian economy, in the condition of economic crisis, can easily be enable to pay off due debts without additional indebtness with IMF and World Bank, which is proclaimed in the new economic policy forecast for 2009. Thus, Serbia is jeopardized by debt bondage because of the overall sale of its companies in the previous period, its additional indebtness presenting at the same time the constant growth of the trade deficit. Serbia has to get into debt additionally for servicing a part of its due debts and keeping the exchange rate stability.

3.3. Employment and unemployment

The total employment rate[6] (active rural population excluded) in 2000-2008 had decreasing trend of the number of employees from 2102 thousands in 2001 to 1991 thousands in 2007. In the same period the traders and entrepreneurs mark the employment rate growth from 349 thousands in 2001 to 522 thousands in 2005. So, the employment structure notices the transfer from the companies' to traders sector, which alleviated the employment rate in companies. The structural changes in 2001-2005 caused the minimal decrease of employment rate from 2,103 thousands to 2,069 in 2005.

Table 4. Employed and unemployed in Republic of Serbia, 2001-2008.

	Total employees	Persons searching for job. Unemployed	Unemployment rate in %
2000	1.908		
2001	2.102	769	26,79
2002	2.067	843	28,97
2003	2.041	947	31,69
2004	2.051	945	31,54
2005	2.069	992	32,41
2006	2.021	1.005	33,21
2007	1.991	850	29,92
2008*	2.013	782	27,98

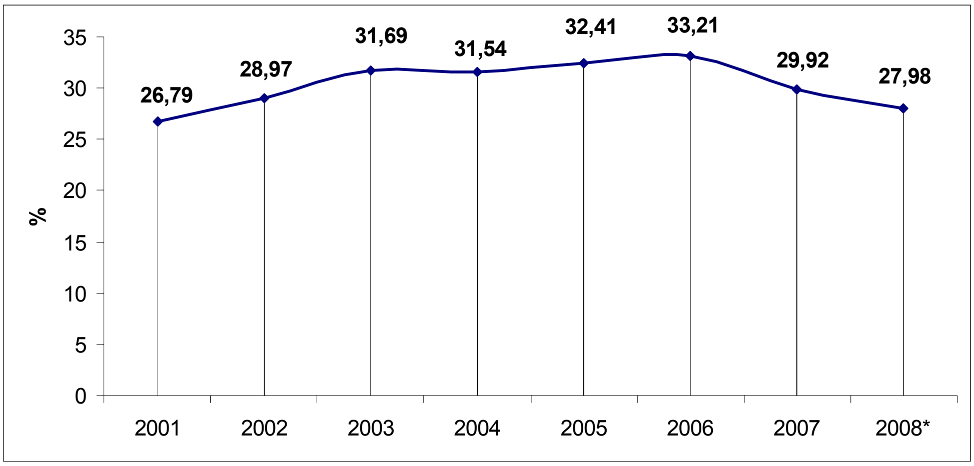
Source: Data up to 2005, Institute of Economic Sciences, Belgrade, MAP no. 11-12/2005 and Bulletin MIF and NBS

The conclusion is that privatization trends caused the decrease of employment rate in companies in the monitored period, from 207 thousands or 11.8%. However, this negative trend was alleviated by employment rate growth with private entrepreneurs for 173 thousands employees.

The slow structural adjustment of economic system in Serbia and noticed labour force surplus in privatized companies, on one hand, and insufficient investment growth on the other, caused the stable unemployment growth rate tendencies.

[6] The term *employed* covers all the entities having work relation with their employers. The entities working under contract on additional work, temporary and occasional jobs are not considered as employed. The Survey on labour force regarding employed entities encompasses all the persons that at least one day in week of survey investigation, were engaged in any business aiming to assure the living sources. (Source: MAP, Institute of Economic Sciences, Belgrade, no.11-12/2005)

Graph 2. Unemployment rate trends



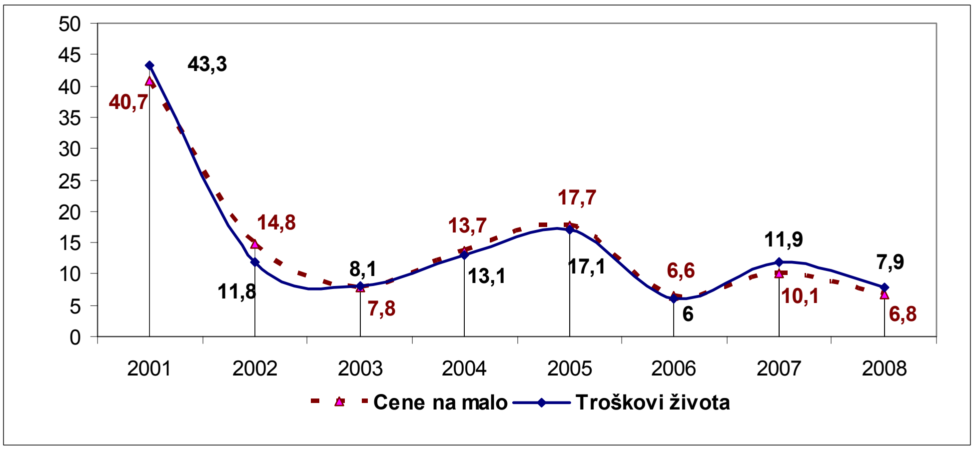
3.4. Inflation

The inflation trends in 2001-2008 are marked by cyclic flow. The retail price growth in 2001 was 38.7%, presenting a drastic interruption in relation to inflation trends in 2000, when the inflation rate was 113.3. In 2002 the inflation further decreased to 14% and 7.6% in 2003. Following the decrease in the previous period, in 2004 and 2005, the contrary trends occurred, when the inflation increased to 13.7% in 2004, and 17.7% in 2005.

Table 5. Inflation rates and costs of living for period 2001-2008.

Year	Retail prices	Costs of living
2001	40,7	43,3
2002	14,8	11,8
2003	7,8	8,1
2004	13,7	13,1
2005	17,7	17,1
2006	6,6	6,0
2007	10,1	11,9
2008	6,8	7,9

Graph 3. Comparable review of retail prices growth and cost of living



In the period 2006-2008 the inflation was maintained under control on one digit number, except the year 2007, when it was a bit over 10%.

A certain correlation between inflation trends and social enterprises sale off income growth trends could be established. As it is mentioned above, in monitored years, a considerable growth of real earnings was not noticed. However, the demand increase and the pressure on prices come from external economic trends (price increase of crude oil during 2008), as well as from the internal economic trends (price growth of utilities sector, expansion of credit for mass consumption financing) and demand creating of one part of population, based on capital sale income (shares and contribution).

4. Conclusion

The foreign direct investments and privatization did not confirm the expectations that the transition would lead to economic growth, development, and employment rate growth. The expectations that privatization economic policy, as one of key factors of de-regulation and liberalization along with stimulating foreign direct investments inflow, according to IMF would provide overall economic progress, proved to be too optimistic. The positive results were realized in the sector of monetary stability, while the banking sector became attractive and economically profitable on one side, whereas the real economic sector, in spite of privatization, did not notice significant results.

The forthcoming economic crisis, which will first hit the most developed countries and then, at the beginning of 2009, the developing countries and countries in transition, will cause the investments withdraw, export-import decrease. The indebted countries will have the problem to pay off the debts. For small and undeveloped countries, the complete liberalization, de-regulation and privatization present the magic circle of economic and social problems generating. Another problem is that the runaway from market fundamentalism into state interventions in the circumstances of irresponsible party governments leads not towards the development but to further social wealth re-distribution trends. The opinions that the foreign direct investments would bring Serbia accelerated development, stability, technological advancement proved to be unreal.

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