

INSTITUTIONAL ENVIRONMENT FOR ATTRACTION OF FOREIGN CAPITAL

Zoran KARAVELIĆ¹, Ljubiša GOJKOVIĆ²

¹ High School of Business Economics and Entrepreneurship, Belgrade, Serbia,
E-mail: zkaravelic@gmail.com

² Faculty of Business and Industrial Management, Belgrade, Serbia,
E-mail: gojkovic.ljubisa@hotmail.com

Abstract—Attraction of foreign capital is a major goal of many countries as it is quite clear that it plays an important role in the creation of new permanent workplaces, increase of exports, transfer of technologies and knowledge, increase of competitiveness, improvement of overall production and eventual poverty reduction, throughout the overall economic growth and development. Serbia has no sufficient own funds to finance its own growth and development. The inflow of foreign direct investment in the first decade of this century, was various, viewed by years. The global economic crisis, among others, resulted in a decrease of foreign direct investment, which had a very negative impact on the development trends of the national economy. Inconsistent economic system, unfavourable institutional solutions, as well as a number of other weaknesses of the Serbian economy have not led to a significant influx of capital from international capital markets. The aim of this study is to highlight the need to eliminate all weaknesses, particularly unfavourable institutional solutions in the domestic economy, respectively the need to establish such institutional frames, and other basic prerequisites that despite the economic crisis will enable the rapid privatization of the remaining assets with the social and national character of the property at considerably higher inflow of foreign direct capital as a primary factor in our economic development.

Keywords—foreign direct investment, institutional solutions, export, privatization, market economy, transition, tax system, foreign capital.

I. INTRODUCTION

AREA of foreign investment and inflow of foreign capital in general is one of the most important segments of international economic relations. With respect to the long-standing crisis and chronic shortage of domestic working capital, the future national strategy can not be defined without the significant support of foreign capital. The inflow of foreign capital is needed primarily due to the rapid economic restructuring and its efficient integration into the global economic trends.

Significant inflow of foreign capital can be possibly expected only by creating favourable institutional frameworks in the domestic economy. Institutional strengthening, which involves the establishment of new functions of the state in the conditions of the market economy, should lead to the development of market

institutions, labour markets, liberalization, deregulation, privatization and inflow of capital from international capital markets. This would occur as a consequence of construction and functioning of the economic system with the affirmation aim of market economy, market institutions and mechanisms which are in the function of market liberalization and promotion of competition.

Attraction of foreign direct investment represented one of the main levers of economic development. In the period between 2001-2010, the total foreign direct net investment in Serbia amounted to 13,1 mlrd EUR and the highest level was achieved in 2006, amounting to 3.3 mlrd EUR. In Serbia and other transition countries of southeast Europe, the impact of the crisis to the reduction of inflow on the foreign direct investment were joined by other factors, such as exhausted opportunities in privatization and structural weaknesses of certain economies. The effects of the economic crisis on foreign direct investment inflows in Serbia were apparent during 2010 year. In 2010, Serbia earned 860 mil. EUR of the foreign direct net investment, which is less for 512 mil. EUR than in 2009 year, and nearly 1 mlrd EUR less compared with 2008 year.

In order that such a defined objective of work was achieved, the work is structured in four parts. In the first part of the paper was highlighted the role of donations in so far course of our economic development and the dilemma of donations or investments. In the second part of the paper was highlighted the importance of stimulation and attraction of foreign capital for economic development. In the third part of the paper were highlighted the basic goals and prerequisites for attraction of foreign capital. In the fourth part of the paper was highlighted the categorizing of all foreign investments on various bases.

II. DONATIONS OR INVESTMENTS

Before we go through a broader discussion and analysis of the inflow of foreign capital into our country and creation of institutional environment for it, we would like to point out the role of donations in so far course of our economy development and the dilemma of donations or investments.

And after several years of beginning the transition, in professional public are present the views that Serbia received too little donations and the West, in a way, betrayed the expectations of the citizens of Serbia.

A group of politicians who supported partial reforms many times criticised the West due to insufficient help to the „best reforms“. However, the right question is whether the donations can be a way to overcome the problems with which are faced the underdeveloped countries, or whether there is an example in the history of the developing/transition countries where donations have led to serious reforms that are a prerequisite to the creation of the prosperous economy.

The World Bank and development agencies of Western countries for many years based their doctrine on the view that the gap between savings and needed investments in underdeveloped countries can be filled only by development aid that would led to the fact that the Third World countries move into a phase of self-sustaining growth. „Experience has shown that the development aid, either in the form of grants or loans that have a large share of gifts through non-market interest rates and grace periods, led to endless circles of moral hazard“ [8].

Serbia was a perfect candidate for unproductive spending of development aid. The period of transition that is behind us, clearly indicates that, it is most obvious in the absence of real investments, both local population or foreign countries. If Serbia had used the foreign aid to go to the self-sustaining growth, except the local politicians, that would has been noted even by Serbian citizens and foreign investors. Grants and „favourable credits“ led to the abandonment of fundamnetal reforms.

The direct consequence of such a policy is the absence of significant foreign direct investment. The years of 2001and 2002 resulted in less than 600 million dollars, and in 2003, is recorded a significant growth as a result of market sales of tobacco products, petroleum, cement and some food products, as well as a significant drop in the value of the dollar against euro.

III. STIMULATION OF THE FOREIGN CAPITAL INFLOW

Attraction of foreign capital is the main goal of many countries, since it is quite clear that it has an important role and impact on the dynamic economic growth and development.

Improving conditions for foreign investments in our economy, primarily involves: 1) development of the market economic system with a stable institutional conditions of business, 2) conduct of macroeconomic policies in order to maintain stability of general price level and the exchange rate of the domestic currency.

The stabilize oriented macroeconomic policy represents a necessary starting component for each sustainable economic growth, especially for growth that is substantially based on foreign capital. Macroeconomic

system and policy are very important for foreign investors because it allows them to realistically present the current and future prospects and conditions of stable developmet of a certain country. 3) that a country to be accepted as an active member of the international financial and trade organizations, 4) continuation and accelaration of transition process and privatization of national economy as a condition for a normal functioning of the commodity and financial markets, 5) strict adaptation of the economy and reconstruction of the banking system, 6) clearly defined role of the state in managing of economic trends, 7) creation of favourable institutional frameworks for ensuring the long-term security of capital investment.

Serbia is determined in its intention to speed up the legislative reforms and to launch an initiative and additional activities to strenghten the institutional capacities, solving the problems of competitiveness and improving the understanding of the importance of foreign investments in the country and overseas marketing, in order to provide relief and support to investors in the profitable implementation of their investment plans.

Foreign investors are particularly interested in that a country in transition where you can invest can ensure the guaranteed security of investment capital, repatriation of investment capital, transfer of achieved profit, participation in decision-making in business, respect and protection of property.

It is particularly important that the institutional solutions provide protection of foreign investors against political risks of any kinds, especially the possiblity of radical change in policy that would lead to deterioration of general economic conditions and abandonment of foreign investors from the potential investments in our country.

Therefore, it's obvious that certain institutional solutions can significantly encourage or discourage the foreign investments.

In the globalization conditions of international economic relations decreases the impact of monetray policy, and increases the importance of taxation to foreign investment. In order the inflow of foreign capital was sufficient and proceeded smoothly in a country, the tax system of that country must be in such a way that can be adequately and stimulatingly applied to foreign investors.

The tax system and policies, respectively the taxation, is becoming one of the factors that influence the international investments and is surely taken into account in decision-making on investment in a particular country. The introduction of the value added tax in the tax system of Serbia has already given affects in contributing the promotion of investment activities, especially the influx of foreign investments, respectively the promotion of foreign investment in our region.

The tax system needs to be harmonized with other tax systems in other countries of the developed world in

order to avoid difficulties compared with other countries. It will provide the country's international competitiveness in attracting the foreign investments.

The tax system should be simple and convenient for application, to has an adequate tax structure and moderate tax rates without a large number of tax relief and exemption.

In addition to the above mentioned, the attraction of capital is affected and by other factors, such as:

- favourable foreign trade and customs regime,
- efficient banking system,
- convertibility of the domestic currency,
- creditworthiness and secured access to domestic and international loans,
- the introduction of norms and rules that ensure quality control,
- developed infrastructure,
- simple administrative procedures for company registration and approval of foreign investment, etc.

The results of the late commencement of general economic reforms and programmes of modernization in our country are seen through:

Table 1: The total inflow of foreign direct investments in the period between 2001-2007 years (u mil. USD)

2001.	2002.	2003.	2004.	2005.	2006.	2007.
165	475	1.360	966	1.550	5.474	3.569

Source: National Bank of Serbia.

Experiences from abroad show that the foreign investments have played a major role in restoring of many economies and resolved key national problems in creating new jobs and development of export. Countries that have had limited understanding of foreign capital, with the exemption of a few areas rich in natural resources, made no progress in the growth and development.

Countries around the world have realized these advantages, thus they adopt policies that encourage investments and are looking for ways to improve their investment environment as a sign that they have recognized the benefits that have been brought by foreign capital, especially through: a strong contribution to economic development through increased exports, a large growth of new employment opportunities, positive impact on the change of regulations, human resources, improving the management of companies, a favourable influence on the development of infrastructure conducive to business. The fact is that the foreign capital is a major source of new technologies, management skills and business knowledge, a significant increase in tax revenues to facilitate the new development of infrastructure and social spending.

IV. MAIN OBJECTIVES AND PREREQUISITES FOR ATTRACTION OF FOREIGN CAPITAL

The main goals of stimulating the inflow of foreign capital are related to the increase in exports which will

- relatively low levels of foreign investment, attracting Serbia compared to other neighbouring countries,
- most of the new foreign investment is mainly focused on the domestic market and is reflected in the purchase of companies and assets that are in the privatization programme,
- companies under-invests in business directed towards international markets,
- limited development within the state, limited understanding of the need for a competitive, modern industry and the potential benefits of foreign direct investment,
- low level of exports and the continuous dependence of international aid and private remittances from abroad,
- limitations of institutional capacities and underdeveloped mechanisms for investor's support and implementation of their plans.

In Table 1 is shown the total inflow of foreign direct investments in the period between 2001-2007 years.

be internationally competitive in the field of industrial, service and agro-industrial capacity, solving current problems of uselessness of most existing capacities for modern production and supply of modern markets for years because there were no investments, creating opportunities for new job vacancies, stimulating the reform programme, solving the trade deficit programme and harmonious development of the EU member states, the maximum increasing number of internationally competitive products and services with high added value.

The main prerequisites for attracting foreign capital are:

- acceleration of the programme of economic reforms, modernization of legislation and enforcement of regulations,
- Euro-Atlantic integration processes of our country,
- increase of understanding at public and official levels of the competitive needs of investors and greater understanding of the benefits arising from the presence of modern and internationally competitive industrial enterprises,
- implementation of the stabilization macroeconomic policy,
- development of market-oriented economic system,
- completion of transition and privatization process of our economy,
- structural adaptation of our economy and reconstruction of the banking system,
- ensuring the long-term security of investment capital,
- development of initiatives for promotion of competitive investment environment,

- development of a strong sense of partnership and common visions between all levels of public and private sector,
- development of marketing programme to encourage interest and attract foreign investors.

These principles are expressed in numerous publications of the World Bank (WB), the Organization

for Economic Cooperation and Development (OECD), Investment Compact and other international organizations.

Table 2: The foreign directive investments in the SEE region (1990-2003)
 (in millions of USD)

	1990-1997	1998	1999	2000	2001	2002	2003	Cumulative
Albania	180	45	41	143	207	135	180	988
Bos-Herz.	-1	56	154	147	130	265	381	1153
Bulgaria	671	537	819	1002	813	905	1419	5082
Croatia	1187	932	1467	1089	1561	1124	1713	11351
Serb-M.N.	822	113	112	25	165	475	1360	3319
Macedonia	45	118	32	177	442	78	95	1024
Moldova	134	76	38	129	156	117	58	789
Romania	1640	2031	1041	1025	1157	1144	1566	12693
TOTAL	4678	3908	3704	3737	4631	4243	6772	36399

Source: UNCTAD, World Investment Report 2004.

The main identified obstacles to foreign direct investments in Serbia are:

- legal problems, ie. unresolved ownership relationships and non-market use of urban construction land,
- infrastructural deficiencies in comparison with neighbouring countries,
- slow reforms, due to their late commencement, compared with the competition and overall poor quality of implementation,
- limited institutional capacities for strategic planning, marketing as well as adoption of medium-term and long-term standpoints,
- inexistence of clearly directed national programme for promotion of investments opposed to previously established negative image of Serbia abroad.

V. CRITERIA OF FOREIGN INVESTMENT

All foreign investments in Serbia are categorized by

Table 2: The largest greenfield investments between 2002-2006 (u mil Eura)

Origin of the country	Sector	Company	Amount of investments
Austria	Telecommunications	Mobilkom	570
USA/Hungaria	Bioethanol	Biotech Energy	380
Slovenia	Retail	Merkator	240
Austria	Gas station	OMV	150
Israel	Business center	Africa Israel Corp/Tidhar Group	120
Austria	Real estate	Hipo Alpe-Adria Consultants	66
USA	Cans	Ball Corporation	60
Sweden	Packaging	Tetra-pak	60
Slovenia	Retail	Merkur	60
Germany	Technical gas	Messer	59

Netherlands	Real estate	GTC International	58
Greece	Gas station	Hellenic Petroleum	50
France	Retail	Intermarche	44
Greece	Retail	Veropoulos	34
Austria	Insurance	Grawe	30
Germany	Real estate	Phiwa	25

Source: MFIN, Public Finance Bulletin, Belgrade, 2008, nr. 4.

When the wave of privatization completed, the new foreign investments (uz strana portfolio ulaganja) will be the only forms of foreign direct investments. The level of the foreign capital will depend solely on the quality of the business environment.

Thus, the investments of private domestic companies out of Serbia are still relatively low, although they are very useful and desirable. In the first step, it represents the outflow of capital, but then followed by gains on investments.

Only 13-16% of Serbia's GDP is going to investments, which is one half of the level of investment in successful transition countries. Serbia will hardly experience the strong growth in foreign capital inflow prior to significant improve of domestic investments, as the domestic entrepreneurs are the first to test the quality of the business environment.

According to the data of the Republican Institute for statistics and analysis of the main indicators of socio-economic developments in the Republic of Serbia for 2004 year, domestic investments are important because they are usually higher than foreign investments. Thus, the participation of investments in gross domestic product (domestic investment) in 2003 year, in the Republic of Serbia is 14,1%, and in 2004 year is 19,2%.

According to the data of the National Bank of Serbia, the inflow of foreign capital in 2003 amounted to 1,36 billion of USA dollars (calculated at the average exchange rate of 53,98 dinars) and amounted to 7,1% of the GDP, while in 2004 was at the level of 9,66 mln. USA dollars (at the exchange rate of 58,38 dinars) and amounted to 4,3% of the GDP. In 2005, the inflow of foreign capital amounted to 1,55 billion of USA dollars, in 2006 was 5,47 billion of USA dollars, while the inflow of foreign capital in 2007 was reduced compared to previous year and amounted to 3,60 billion of USA dollars.

VI. CONCLUSION

Based on the above it can be concluded that the national strategy of foreign capital inflow at a high degree would have to be flexible, respectively to be capable to changes and adaptable to amendments in the structure of foreign capital supply from other countries, as well as changes on the demand side in terms of aggregate needs and preferences of conditions by our companies and financial institutions.

Solely changing the institutional environment, the strict execution of accepted financial obligations and reasonable rates of return can be expected upward trend in net foreign capital inflow. This must be followed and well-planned by an aggressive and continuous promotional programme at the macroeconomic level.

Since our country has insufficient own capital for intensive economic growth and the development in the future period will depend mainly on the inflow of FDI. Serbia should base its FDI inflow strategy primarily on the experience from abroad, which showed that FDI has played a major role in the reconstruction of its economy and tackling with the key economic problems of the country that had a limited understanding about it that made no progress in the growth and development.

Greater inflow of FDI in Serbia will have to occur as a result of integration of our economy into the all European economy trends with the membership in the EU, the acceleration of the programme of economic reforms, ensuring long-term security of capital investment, completion of transition and privatization process of our economy, the development of market-oriented economic system, development initiatives to promote competitive investment environment and above all, the establishment of an institutional framework for more intensive inflow of the FDI.

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