SEEJE South Eastern Europe Journal of Economics 2 (2004) 101-118

Country Report

ROLE OF DIRECT FOREIGN INVESTMENT IN DEVELOPMENT OF BALKAN COUNTRIES (THE CASE OF SERBIA)

DRAGANA RADENKOVIC - JOCIC
Faculty of Economics, University of Nis, Serbia & Montenegro

Abstract
In the past, Yugoslavia was the only socialist country that allowed foreign investment. Nowadays, Serbia & Montenegro and its Foreign Investment Law allow foreign investors to found their own companies under the condition of reciprocity in almost all of the economic sectors. The law is based on internationally recognized and known solutions which ensure a completely equal (i.e. national) treatment of foreign investors in business dealings in this country and provide investors with full transparency of regulations and practices regarding the status and treatment of foreign investment and foreign investors. Foreign investors are guaranteed full protection of their property rights.

JEL Classification: P2, F21, F23

Keywords: Foreign investment, Reforms, Privatization

1. Introduction

Serbia is striving to create, by passing a number of laws at the federal and republic levels, the essential conditions for cooperation with other countries, and to encourage investment of foreign capital. A continual inflow of foreign capital, particularly from the private sector, is one of the key factors in securing a stable growth of the Serbian economy. Laws were introduced on the basis of the experiences of other European countries. Also, the geo-strategic position of Yugoslavia as one of the countries in the south-eastern part of Europe through which the main European infrastructure corridors pass on their way to the Near East, as well as the abundance of resources, represent a comparative advantage. Back in 1967 conditions were

Corresponding address: Trg Kralja Aleksandra 11, 18 000 Nis, Serbia and Montenegro.
e-mail: draganad@bankerinter.net draganarj@yahoo.com

created for foreign firms to invest through joint venture programs in the Yugoslav economy. At that time, and for many years, Yugoslavia was the only socialist country that allowed foreign investment. Nowadays, the Constitution of Serbia & Montenegro and the Foreign Investment Law allow foreign investors to found their own companies under the condition of reciprocity in almost all of the economic sectors.

2. Serbia & Montenegro's economy

2.1 The 1990's

Notwithstanding the starting position Yugoslavia assumed in the reform process at the end of the 80's, Serbia & Montenegro are now at a double beginning: it is the beginning of the new century, and we are just starting with serious socio-economic reforms. The period preceding October 2000 represents a "black chronicle" in the economic development of Serbia. The beginning of the nineties is characterized by the disintegration of the SFRY and formation of a new state, followed by the economic sanctions that the Security Council imposed in 1992 on our country. These events directly affected the labor market and industrial production. As expressed in numbers, the situation was as follows: during the period 1990-1994, real GDP decreased by 52.2%, and the employment rate declined by 14% (377,000 employees lost their jobs). The economic and social status of the employed was seriously endangered. The research conducted in the period 1989-1998 statistically emphasized certain specificities of the period. Poverty was the reality of everyday life for very many employed people. The earnings from regular work were supplemented with secondary income from activities in the "gray" economy (as well as in the black-market economy: bribery, corruption and so on). It all induced significant stratification of basic social groups. On one side, pauperization of the major part of the population had become massive, while, on the other, a powerful elite consisting of 3-4% of the total population disposed of over 40% of the social wealth. The highly educated found themselves among the worst affected population group.

2.2 The period from October 2000 to the present

The industrial sectors in S & M underwent substantial changes in 2001 and 2002. From Table 1, it can be seen that the observed result of the economic policy was that in 2001 a real gross income increase in the budget and funds was registered and the budgetary deficit was reduced to 2.3% of GDP (while the planned rate was 6%). The *inflation rate* in 2002 was 34.1%, as compared to the previous period of 2000, when the retail price increase was 113%. In the month of July 2002, the business climate in industry was heavily burdened with high fiscal commitments of economic agents. The average net income of the employed increased by 200% during the period of October 2000 - October 2001. However, the actual purchasing power grew by only 10% in the same period. In March 2002, the income of the population, calculated on the basis of the gross earnings of the employed (with taxes and contributions included), other personal receipts and pensions, amounted to 38,285 billion dinars, with nominal growth of only 0.8% and a minor real decrease (0.3%).[2]

Table 1. The predominant economic indicators for the Federal Republic of Yugoslavia. The percentage of increase/decrease related to the previous year.

Year/indicator	1995	1996	1997	1998	1999	2000	I-X 2002
Gross domestic product	+6,0	+5,0	+7,4	+4,6	17,7	7,0	5,0
- industrial production	+3,8	+7,3	+9,6	+5,0	-24,1	+10,9	-1,4
- agricultural production	+3,0	-2,5	+7,0	+1,0	+3,0	-19,7	+30,0
- average net earnings, in real terms	+16,5	-2,5	+21,1	+1,9	-26,0	+6,7	+7,0
- average pension, in real terms	+26,8	+11,1	+19,2	-10,6	-26,0	-1,6	...
Retail prices	174	193	118	130	142	176	206
Industrial producer prices	158	190	120	126	144	206	203
Retail prices*	220,2	158,7	109,3	144,3	150,1	213,3	160,1
Living costs*	217,4	159,9	110,4	145,6	153,9	215,3	156,5

** Indices: December of the current year against December of the preceding year. For the year 2001, the month of October against the previous-year October was applied as the ratio.*
Source: Federal Office of Development and Economic Policy, Federal Statistical Office, Bulletin of the National Bank of Yugoslavia.

In former Yugoslav republics, with the exception of Slovenia, there is high unemployment. The main reason for this is the movement of the workers from the state sector to the gray economy, as well as the liquidation of bankrupt companies. In 2001, the number of employees in Serbia was 1.6 million, including 1,327,233 workers employed with illiquid enterprises. The illiquid enterprises increased in number by one third as compared to the previous year of 2000, while 94.3% of them were engaged in industrial activities. The management of illiquid enterprises continued

2. At the end of 2001, the average net income of the employed was somewhat above 100 Euro, while the average pension in Serbia was 5236 dinars or 85 Euro in October the same year. The actual purchasing power increased by 22% as compared to September 2000. These high percentages of the increase of net earnings and pensions in relation to the previous year illustrate how low they had been before.

trying to evade bankruptcy. At the end of March 2002, illiquid legal entities numbered 25,943 with about 324,000 employees. According to the official estimates, based on the plan of restructuring 39 big companies in 2002, some 59,500 workers will lose their jobs in these enterprises. The social program provides that future redundant labor be informed in advance about all the options. Redundancy is one of the major problems in making arrangements for privatization. Our legislation is based on the experiences of other countries in transition, mainly of the Czech Republic, Poland, Slovenia and Hungary.

According to the White Paper (1995), one of the most important political aspects concerns the reintegration of Serbia & Montenegro (S&M) into Europe, symbolized by prospective membership of the European Union (EU). Economic integration is an extremely important aspect of economic transformation. As Lipsey (2000) noted, foreign direct investments play a crucial role, in terms of fostering accelerated growth, technical innovation and enterprise restructuring.

In Serbia in late 2001 and the beginning of 2002, banking sector reforms and real estate sector privatization changed the dynamics of structural reforms implementation. Verhoeven (1996, p.862) has pointed out that privatization of small enterprises and liberalization of foreign trade are the fields where structural reforms were evaluated positively. In 2001, growth in Serbia was 5.5%.

2.3 Former yugoslav republics

The surrounding countries, which used to be the republics of the former SFRY, have encountered similar problems. The exceptions are Slovenia and – partially - Croatia. Table 2 shows that they have the smallest problem of unemployment, the highest earnings and GDP growth and inflation rates coordinated with the anticipated economic policy.

Table 2. Basic macroeconomic indicators in 2001.

COUNTRY	GDP GROWTH	ANNUAL INFLATION	UNEMPLOYMENT	AVERAGE NET WAGE IN €
Slovenia	3%	8,4%	11,6%	598
Montenegro	5%	26,6%	19,3% (ILO)	107
Serbia	5,5%	41%	26,9%	90
Federation BiH	5,6%	1,7%	39,9%	221
Rep. Srpska	1,9%	8,0%	40,09%	141
Macedonia	-4,5%	5,5%	35% (ILO)	175
Croatia	4%	4,9%	23%	445

Source: ISEE (Institute for South East Europe), 2001.

Generally speaking, the intensity of economic reforms in transition economies, including S & M, can be estimated according to the following criteria:

1. the speed of inflation reduction in a country, and
2. the speed of change in the structural reform index.[3]

The applied criterion is the intensity of change in the structural reform index. The status of structural reforms in the countries of former Yugoslavia has been assessed on the basis of:

a. Success in privatization of medium and small enterprises,
b. Market reforms process, and
c. Financial sector reforms.

Table 3. The EBRD's assessment of structural reforms implemented in the countries of former Yugoslavia for 2001.

COUNTRY			*COMPANIES*		*MARKET REFORMS*				*FINANCIAL INSTITUTIONS*	
	Population (in millions)	The share of private sector in GDP (in %)	Privatization of large enterprises	Privatization of small enterprises	Control and restructuring	Liberalization of prices	Foreign trade and foreign exchange market	Competition policy	Banking sector reform and interest rate liberalization	Capital market and non-bank intermediaries
Slovenia	2	65%	3	4+	3-	3+	4+	3-	3+	3-
Croatia	4,5	60%	3	4+	3-	3	4+	2+	3+	2+
Yugoslavia	8,6	40%	1	3	1	3	3	1	1	1
BiH	4,1	40%	2+	3-	2-	3	3	1	2+	1
Macedonia	2	60%	3	4	2+	3	4	2	3	2-

Source: EBRD, Transition Report 2001.

3. Structural reform index was proposed by Melo, Gelb and Denizer in 1996 and were adopted by the EBRD (European Bank for Reconstruction and Development).

The basis of the structural reform index calculation is the level of the structural reforms in 2000. Different grades were assigned by the EBRD, with the highest grade being 4+. Looking at Table 3, we can argue that Yugoslavia received the lowest grade in 2001 for privatization of large enterprises, privatization of financial institutions, controlling and restructuring of the market system and introducing competition policy. At the beginning of 2002, the reforms in the banking sector and privatization of the real estate sector took place in Serbia. It was a sign that the dynamics of structural reforms were changing.

3. The importance of foreign investments for the host country and how to attract them

Maresceau and Montagui (1995) have argued that national policies are crucial for attracting FDI, increasing benefits from it and allaying concerns about it. Those policies have to be seen in the broader context of the determinants of FDI, among which economic factors predominate. Even where economic factors become dominant, the regulatory regime can make a more or less attractive location for foreign investors and for maximizing the positive development effects of FDI, while minimizing negative ones. As Kenendy and Webb have noted (1993, p.1100), many policies affect FDI.

Thus, the focus for most of the developing countries and economies in transition is to attract inward FDI and benefit more from it. According to the World Investment Report (2003), the FDI inflow in Eastern Europe was only about EUR 23 billion in 2003, following a record inflow of EUR 35.9 billion in 2002.[4] Inflows in the five accession countries amounted to a mere EUR 8.2 billion in 2003, less than the Czech Republic alone had received in the previous year. It turned out that the record-high FDI in 2002 had been an exception related to high privatization revenues. With privatization declining and markets not expanding in Europe, both acquisition and relocation slowed down.

A negative FDI inflow was recorded in Hungary in 2003. However, this result appears to be due to statistical under-reporting, as Hungarian FDI data do not include reinvested profits, as is the rule in the other countries. Hungary was also affected by the volatility of FDI in the form of inter-company loans. But equity investment alone amounted to EUR 1.5 billion, which is more than in the previous year. Hungarian companies that had not been sold to a foreign investor but restructured under local management (for example, the oil company MOL and the OTP

4. The data from the five Central European EU accession countries, now EU members.

savings bank) have been able to use their competence in countries that are more backward in transformation. Bulgaria, Croatia, Romania and Serbia-Montenegro received record inflows. Major inflows were related to the privatization of the oil company INA in Croatia and the DSK bank in Bulgaria (both to Hungarian investors). Greenfield investment went into a great number of small and medium-size projects in the light industry, real estate and the retail sector in Bulgaria and Romania.

The problem of capital deficiency has been present in S & M for quite a long period. For this reason, the significance of FDI has been greatly emphasized. The foreign capital inflow is an essential precondition for a radical and comprehensive transformation of the S & M economy – in terms of property, management, organizational and financial restructuring. It should not be overlooked that the globalization and internationalization processes significantly influence the international economic environment and that they have brought about a remarkable increase in the value of international financial flows. Gligorov (2002, p.45) concluded that the role of FDI in this has been gaining in importance. The FDI is a complex set of investments, containing non-material resources as well as capital: new knowledge, technologies, organizational solutions, marketing and management solutions and techniques.

Increased exports and private investments from abroad are crucial for the recovery of the domestic economy. S & M has become an important factor in south-eastern European regional development. This country has advantages over other European transition countries since it has had the opportunity to observe the mistakes they made on their way towards reform. If we want to comprehend the foreign capital inflow possibilities, we should take into consideration the experiences of the period before the 1990's. During the period 1989-1997, the total foreign investment in the Yugoslav economy was a little less than 4.6 billion DM (where 1.6 billion was obtained by selling the TELEKOM Company). From 1989 until 1991, 2302 contracts on foreign investments were registered. At the end of 1991, there were 1628 enterprises with foreign capital in our country (of these, 357 were firms privately owned by foreign persons and 1217 joint ownership enterprises), while 3046 such enterprises existed in mid-1999. This fact confirms that the interest in foreign investments in Yugoslav enterprises existed even in the unfavorable conditions of sanctions. During the period from January to September 2001, 981 enterprises were founded in FRY. Foreign persons privately owned 498 of them, 464 were joint ownership enterprises, while 19 were based on joint venture. The amount of foreign capital investment in FRY for the first nine months of 2001 was 175 million DM (double the investment of 2000). Table 4 shows the volume of FDI in Yugoslavia for 2002.

Table 4. The FDI in Yugoslavia for year 2002.

	In million US$
Total amount of recorded investments*	**203,112**
In cash	132,298
In kind	63,813
Committed investments**	**117,366**
In cash	62,017
In kind	55,349

** the investment that has been actually realized.*
*** The deals that have been concluded but not yet realized.*
Source: Commercial Court.

According to the Serbian Ministry Report (Table 5), in the first three quarters of 2002 there were 551 foreign investment deals registered, of which 206 deals are 100% FDI. Taking into account these deals, which were not recorded in the statistical data as of September 2002, the total amount of foreign investments into Serbia equals 296.914 million US$.

Table 5. The number of deals by form in 2002 in Serbia.

Total number of concluded deals	551
Foreign investments in existing companies	25
100% FDI	206
Joint Ventures	320

Source: The Serbian Ministry Report.

FDI flows into developing countries help to overcome various problems. The analysis explores options for governments to consider; home-country measures seek to facilitate harmonious relations between investors and the domestic economies and can help advance development. There is a defined list of measures and effectiveness in the UNCTAD World Investment Report (2003, part named *Home Countries and Investors*). From the author's point of view the most important measures are: providing information, encouraging technology transfers, providing incentives to outward investors (various forms of financial and fiscal incentives can be provided to outward investors or to support feasibility studies and environmental assessments), creating employment opportunities and raising the local skills level.

In the WTO Working Group on Trade and Investment, for example, some developing countries raised this issue. It has been argued in the World Investment Report (2003) that "Home governments should undertake obligations: (1) to refrain from policies or measures that influence [TNCs] originating in their territories to have operations or behavior in host members that are adverse to the interests of the host members; (2) to institute measures that influence and oblige [TNCs] originating in their territories to behave and operate with full corporate responsibility and accountability in their operations in host members, and to fulfill their [...] obligations to the host member and government, in accordance with the objectives and policies of the latter."[5]

4. Yugoslav (Serbia and Montenegro) foreign investment law

The Yugoslav Law on Foreign Investment came into effect in January 2002.[6] Having adopted the text of the Law, the legislator took into consideration basic prerequisites of successful investment. The Law confronts complex issues arising from the interaction between national policy making and international investment rulemaking: how to define investment, how to treat the entry of FDI and the subsequent operations of foreign affiliates, how to use performance requirements and incentives, how to encourage the transfer of technology, how to ensure competition, where the dividing line should be between legitimate policy action and regulatory takings, what mechanisms should be used for dispute settlement.

4.1. General provisions

According to the text a foreign investor may, on his own account or jointly with other foreign or domestic investors:
1. Establish a new company;
2. Make an acquisition of stake or shares in an existing company.

5. See FDI Policies for development: Nationa; and International Perspectives; "Investors' and home governments' obligations", Communication from China, Cuba, India, Kenya, Pakistan and Zimbabwe (WTO doc. WT/WFTI/W/152.
6. Official Gazette of the FR of Yugoslavia, no. 3/2002, amended in January 2003.

Legal documents that regulate legal relations in regard to foreign investment are the contract on establishment or the contract on investment that are concluded in written form or decision on establishment made in written form.

A foreign investor, defined as a legal entity established in compliance with a foreign law, whose principal place of business is abroad, or a foreign person (but also a Yugoslav citizen having permanent residence abroad longer than one year), can realize special forms of investment. He may be granted a permit (concession) for exploitation of a natural resource, an asset in general exploitation or for performance of activities of general interest, in compliance with the law, as Djurdjev noted (1995). A foreign investor, also, may build, operate and transfer (B.O.T.) a specific facility, installation or plant, as well as infrastructure and communications facilities (Kopp John Christopher, 1997, 12).

4.2 Guarantees and incentives

The Serbian government has been offering numerous guarantees and incentives for foreigners. First of all, the Foreign Investment Law provides *freedom of a foreign investment*. A foreign investor may establish or invest in a company for performing all kinds of economic activities for profit purposes, Ensign (2001) notes. National treatment and legal security are guarantees for foreign investors. *National treatment* means that the foreign investor enjoys equal status, rights and duties to domestic legal entities and persons unless provided otherwise by this Law. A company with foreign investment enjoys equal legal status and carries on its business under equal conditions and in an equal manner as do domestic companies without a foreign investment. A very important right is *legal security*. A foreign investor enjoys full legal security and legal protection in respect of rights acquired by virtue of the investment. Rights of a foreign investor acquired in the moment of registration of the legal documents cannot be compromised by subsequent alteration of laws and other regulations. Investment of a foreign investor and assets of the companies with a foreign investment cannot be expropriated, nationalized, or subject to other acts of state of equivalent effect, except when the public interest is established by the law or based on the law, and against payment of a compensation. Compensation corresponds to the market value that the investment has on the day of the act of expropriation, nationalization, or other measure. The change in the investment value that may occur due to the fact that the public has learned of the expropriation, nationalization or other measure, shall not have impact on the investment's market value estimation carried out for the purpose of payment of the compensation (Needles, 1992, p.401). Compensation must be paid without delay in convertible currency and the foreign investor may freely transfer it abroad. In the case of a delay in the payment of this compensation the foreign investor has the right to the statutory interest.

The foreign investor may *freely convert domestic currency* into foreign convertible currency as regards each payment related to the foreign investment. A company with a foreign investment is free to perform payments in its international business relations. A company with a foreign investment may keep foreign currency in a foreign currency account with an authorized bank and may freely dispose of those resources.

A foreigner has *the right to transfer his profits and property*. Messmann (1999, p.4) has noted that a foreign investor can, freely and without delay, in the convertible currency, transfer abroad all financial and other resources in relation to foreign investments, especially

1) Profit generated from the foreign investment (profit, dividends, etc.),
2) Property acquired after the determination of the company with foreign shares, i.e. after the determination of the foreign investment contract,
3) Amount acquired from the sales of the shares with foreign contribution,
4) Amount acquired on the basis of reducing the equity of the company with foreign contribution,
5) Additional payments,
6) Contributions from the payment of compensation.

According to Folsom (1997), transfer of the financial and other resources could be implemented after satisfying the obligation on paying the corporate profit tax, tax on dividends and other obligations established by the Law on the basis of public revenues in respect of the amount that is being transferred.

Also, if a foreign investor has *preferential treatment* provided for by an international or bilateral treaty, such preferential treatment shall be applied. This means preferential treatment compared to the treatment provided for by our Law.

5. What we can offer to foreign investors

Serbia - with its social order in chaos, its relations with its neighbors as well as the entire international community severely ruptured, its economy ruined - launched a comprehensive program to transform the country from the major force for regional instability into a democratic, peaceful and free market oriented nation.

Since the beginning of 2001, Serbia has enacted legislation and implemented policies that have laid a solid foundation upon which a free and prosperous nation can be built. However, enormous obstacles and a complex set of challenges are still ahead. The Government is confident that its commitment to comprehensive and rapid democratic and free market reform, with the backing of the international community, is the best course towards prosperity and stability.

Radenkovic-Jocic (1997, 23) have argued that the starting levels of development in Serbia and its neighbor countries are different. FDIs are very important for all of these countries. Basic determinants that influence the position of the host country against the foreign capital inflow are defined in the UNCTAD Report of 2003:

I. Policy framework for FDI
• economic, political and social stability
• rules regarding entry and operations
• standards of treatment of foreign affiliates
• policies on functioning and structure of markets (especially competition and M&A policies)
• international trade and investment agreements
• privatization policy
• trade policy (tariffs and non-tariff barriers) and coherence of FDI and trade policies
• tax policy

II. Economic determinants
• **Market-seeking** (for example, market size and *per capita* income, market growth, country-specific consumer preferences);
• **Resource asset-seeking** (raw materials, low-cost unskilled labor, physical infrastructure);
• **Efficiency-seeking** (cost of resources, other input costs, e.g. transport and communication costs, membership of a regional integration agreement conducive to the establishment of regional corporate networks).

III. Business facilitation
• investment promotion (including image-building and investment-generating activities and investment-facilitation services),
• investment incentives,
• hassle costs (related to corruption, administrative efficiency, etc.),
• social amenities (bilingual schools, quality of life, etc.),
• after-investment services. (UNCTAD World Investment Report, 2003, p. 91)

What is the main reason for investing? Most people have in mind the capital budgeting theory that is represented by the rational investment decision model. But this could be wrong, because the political, social and behavioral factors that exist within the business organization can also influence the decision making. The investment environment is a complex factor representing the country's stability (first of all, political and economic), institutional framework, economic and market capacities, quantity and quality of its natural and human resources, level of infrastructure development and the degree of financial liberalization. In general terms, this problem

is analyzed by Frankel Jeffrey, Stein Ernest and Wei Shang-Jin (1996).
The attraction for foreign investors in Serbia could be:
- First of all, the legal regulation of foreign investments. As stated previously, the new Law guarantees essential rights to foreign investors (national treatment, legal security, protection against expropriation and similar government measures);
- Access to the low-wage labor market, particularly regarding highly educated manpower, which contributes to significant market competitiveness;
- The establishment of a new market position by winning a new market that has long been unattractive to foreigners due to international sanctions and military conflict;
- An exceptional geographic position on the shortest connection between eastern and western, northern and southern Europe, as well as between Europe and Asia;
- A favorable taxation policy enabling numerous concessions to foreign investors;
- An opportunity to buy domestic enterprises of interest to foreign investors at very favorable prices during the process of privatization.

In order to continue its reform agenda, Serbia will require continued donor and creditor support. The Serbian leadership has no intention of becoming dependent on foreign handouts. Indeed, the Government policy does not permit the use of foreign assistance to support regular expenditures such as wages or pensions. However, in order to transform the country the Government requires additional resources to establish a positive environment for foreign investment for an initial transition period. We estimate these resources overall at \$1.3-\$1.6 billion per year for the next three years.

Before we turn to the most important results of the reforms, some of the economic and social measures should be noted, as Kaminski, Wang, Kun, Winter and Alen (1996) reported. The comprehensive and sweeping macro-economic stabilization package brought down inflation from 116 percent in 2000 to 40 percent in 2001, most of it stemming from price adjustments. The forecast inflation rate for 2002 is below 20 percent.

Rapid price liberalization has dramatically cut the state's role in the economy. When the Government took power, over 70 percent of prices were Government controlled. Today only prices of a few items, such as bread and basic utilities are controlled. The fiscal reform program has streamlined the tax system reducing the number of taxes from more than 200 to only 6. Serbia has now completed preparation of a new tax law. From 1 January 2005 we will introduce value-added tax, a completely new kind of tax hitherto unknown in the region.

The ambitious and comprehensive privatization law was enacted in June 2001 and lauded by the EBRD as "the best privatization law in the region." The law prescribes privatization by sale of 70 percent of equity to strategic investors under international tenders and auctions. Privatization will be completed in four years. The successful sale of three major cement producers was completed late last year. Public owned enterprises will be privatized also, immediately after completion of the socially owned enterprises privatization. The Government drafted measures to mitigate the social impact of restructuring. It will offer real market opportunities for SME entrepreneurship.

6. Possible barriers to the investment process

Compared to the results of other transition countries, the beginning of the Yugoslav reform processes has been characterized by comprehensive foreign investments on the level of annual analyses. There are many reasons for a considerably lower foreign capital inflow than expected in the transition countries:

- restrictions present in the existing regulatory rules,
- unfavorable business atmosphere,
- administrative barriers - a complicated procedure of enterprise registration, numerous permits that cannot easily be obtained,
- political risks (political instability, the war-affected environment),
- inadequate resolution of the external debt problem (these countries had hoped for the writing off of their external debts, but the international community did not support such relief).

7. FDI in Serbia for the period January-September 2002

The first step was the democratic changes in September-October 2002, after which everything proceeded more easily. Since foreign investors are guaranteed a wide range of rights, a significant inflow of foreign capital is expected, naturally. The FRY, and Serbia in particular, have anticipated the foreign capital inflow in 2002 from at least three sources: about 300 million dollars from privatization, about 400 million dollars from donations in the form of flexible credits, and 300-500 million dollars from foreign direct investments.

The new foreign investment law was the next step and new initiative for foreigners. Over a few years we have seen several investments which provided an important boost for the market. For example, Alumil Yu Industry a subsidiary of the number-one Greek aluminum producer Alumil Milonas, signed a 10 million Euro contract, in March 2002, with the municipality of Stara Pazova on building an aluminum plant. The construction should be completed within three years.

As one of the major investments, in March 2002, the leading producer of floor coverings in Eastern and Southeastern Europe Sintelon from Backa Palanka, and the leading multinational company Tarkett Sommer signed an agreement on forming a joint venture for development, production, marketing and sale of floor coverings worth 67 million euro.

In cooperation with the domestic company Delta, the French firm Cora signed a deal on building a number of hypermarkets in Belgrade and Novi Sad. Total amount of the investment is 200 million EUR. The amount of the investment in Belgrade is projected to be more than 45 million EUR. Last year the leading producer of automobile tires in the country, Tigar, signed a deal on strategic partnership with Michelin forming a new company Tigar MX. The French Michelin will contribute 10 million EUR of investments, while the third partner IFC will invest 4 million EUR, and allow a credit of 16 million EUR.

Austria's oil firm OMV has planned to invest 150 million euros in Serbia and Montenegro over the next five years. For OMV the Serbian market has a large growth potential and because of that the company has been planning to open a total of 14 retail stations by the year's end.

In March 2002, the SI & SI company from Subotica signed a contract on cooperation with Sidel from France and KHS from Germany. The investment is worth 3 million EUR. This is the first such contract that a company from Yugoslavia has signed without previous guarantees from the foreign financial institutions.

8. Free trade area as a form of investing

The basis for the South East Europe Free Trade Area was laid out in the Memorandum of Understanding on Trade Liberalization and Facilitation signed on 27 June 2001 by the following countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, FYR of Macedonia, Moldova and Romania. Frankel and the others (1996) describe the main points of this agreement as follows: conclusion of bilateral free–trade agreements with all signatory countries by the end of 2002; liberalization of at least 90% of mutual trade by the end of 2008, transparent and non–discriminatory measures concerning public procurement, state aid and state monopolies; harmonization of trade legislation with that of the EU (especially customs procedures, competition law, company law, company accounts and taxes and banking law) and intellectual property protection in accordance with WTO standards.

The effects of the South East Europe free trade area (SEE FTA) are considerable. This area will consist of eight countries covering an area of 647,379 sq. km and a population of 59.6 million people, as we see from Table 6. The strategic location, good growth prospects and abundant human and natural resources make the SEE FTA a location of considerable market, resources and economic potentials.

Table 6. South East Europe Free Trade Zone for the year 2000

Area (in sq. km)	Population (in millions)	GDP (in billions USD)	GDP average Annual growth (%)	GDP (USD per capita)	Average gross (USD per month)
647.379	59,6	87	5,36	1.615	147

Source: Investment Guide for SEE.

The South East Europe region is a good location for the export of goods and services to the European Union, to central and eastern Europe and to western Asia. According to the UN Report (1999) the transport period is typically three to four days from manufacturing locations within the SEE region to the above–mentioned destinations.[7] South East Europe is a rapidly developing market with a considerable potential for growth in the future. Political, economic and social reforms implemented in the region have created a healthy environment for profitable investments.[8] An important contribution to Serbian & Montenegrin trade development is made by the presentation and application of **foreign investment incentives**. *Liberal import* is one of those incentives. Aharoni (1996) reported that import of goods that represent the investment of a foreign investor is liberal, providing such goods satisfy environment protection laws. A foreign investor and a company with a foreign investment also enjoy tax and customs benefits in compliance with the law. Given the market situation in all developed countries, it is clear that customs and their exemption could be the fact of supporting the foreign investing. The Serbian & Montenegrin Foreign Investment Law defines this situation in the following way: imports of (new) equipment on the basis of the investment share of the foreign investor, except for motor vehicles, fun machines and lottery games, are exempt from customs and other import duties.[9]

This right may be used according to the determined investment dynamics up to the time of the completion of the objects being built or the beginning of an activity into which the investment is being made or if the investment is being made on the basis of the profit reinvestment - throughout the validity of the contract or the agreement.

7. United Nations, 1999, World Investment Report: Foreign Direct Investment and the Challenge of Development.
8. All data are prepared and published by Siepa, investigation and marketing agency.
9. Foreign Investment Law, Article 16.

Customs exemption may also be used by a company with a foreign investment to the limit of the foreign investment and for period of two years from the day of the registration of the foreign investment.

9. Conclusion

Serbia and Montenegro is attracting considerable attention from foreign investors, only two years after embarking on its transition and reform program. Although FDI levels are still negligible compared to elsewhere in the region, Serbia and Montenegro could easily overtake other countries in south-eastern Europe. In 2002, foreign direct investment in Serbia and Montenegro amounted to $475 million, according to the National Bank of Serbia. With privatization gaining momentum and more tenders being concluded in Serbia, total FDI for 2003 could approach $500 million, exceeding slightly the 2002 level, and in spite of the assassination of Serbia's prime minister earlier in 2003. In 2004, FDI should increase more than twofold. While the preponderance of capital is expected to flow towards Serbia (given the relative size of its economy), Montenegro is also likely to attract more investor interest.

References

Averett, S., and J. L., Hotchkiss, 1997, Female Labor Supply with a Discontinuous, Nonconvex Budget Constraint: Incorporation of a Part-Time/Full-Time Wage Differential, *The Review of Economics and Statistics,* 79, 461-470.

Aharoni, Y., 1996, *The Foreign Investment Decision Process*, Boston: Harvard

David, K., David, W., 1993, "The Limits of Integration: Eastern Europe and the European Communities", *Common Market Law Review 30*, 1095-1117

Djurdjev, D., 1995, "Arbitration in the concession contracts", *Novi ugovori od znacaja za privredni razvoj Jugoslavije*, Belgrade, 197-210

Dobosiewics, Z., 1992, *Foreign Investment in Eastern Europe*, New York

Ensign, P., 2001, "Cross-border acquisitions in response to bilateral/regional trade liberalization", *The Journal of World Investment, Transnational corporations,* Vol. 10, No.1/01

Folsom, R., 1997, *International Business Transactions*, St. Paul

Frankel, J., Stein, E., Wei, S., 1996, "Regional trading agreements: natural or supernatural?", *American Economic Review*, 86(2)

Frydman, R., Rapaczynski, A., 1994, *Privatization in Eastern Europe: Is the State Withering Away?,* Budapest, London, New York

Gligorov, V., 2002, "Why are the Plans ruined?", *Economist,* 99, 43-45

IMF, 2002, *Global Financial Stability Report-Market Development and Issues*, Washington DC

Jakovcevic, K., 2000, *Struktura i vrednovanje kapitala*, Subotica

Kaminski, B., Wang, Zhen K., Winter, Alen, 1996, "Export performance in transition economies", The World Bank, Washington, *Economic policy*, 10-96

Kopp, J.C., 1997, *Private Capital for Public Works: Designing the Next-Generation Franchise for Public-Private Partnership in Transportation Infrastructure*, Northwestern University, p. 1-47

Levy, H., 1990, *Capital Investment and Financial Decisions*, Prentice Hall

Lipsey, R., 2000, *Interpreting Developed Countries: Foreign Direct Investment*, NBER Working Paper 7810

Maresceau, M., 1997, *Enlarging the European Union, Relations Between the EU and Central and Eastern Europe, "On Association, Partnership, Pre-accession and Accession"*, London and New York, 3-22

Maresceau, M., Montaguti, E., 1995, "The Relationships between the European Union and Central and Eastern Europe: a Legal Appraisal", *Common Market Law Review*, 32, 1327-1367

Messmann, S., 1999, *International Business Transactions,* Budapest

Needles, H., 1992, *Traffic Operations Plans*, Tammen & Bergendorff

Popov, Dj., 1995, "Priliv inostranog kapitala putem koncesija i privredni razvoj", *Novi ugovori od znacaja za privredni razvoj Jugoslavije*, Beograd, 187-198

Radenkovic-Jocic, D., 1997, *Foreign Investments in Countries in Transition*, Belgrade

Robbins, S., 2001, *Organizational Behavior*, New Jersey

UNCTAD, 2003, *World Investment Report*, Geneva and New York

UNCTAD, 1992, *World Investment Directory, Vol. 2, Central and Eastern Europe*, United Nations

Verhoeven, A., 1996, "Privatisation and EC Law: Is the European Commission "Neutral" with Respect to Public Versus Private Ownership of Companies", *International and Comparative Law Quarterly*, 45, London, 861-887

White Paper, 1995, *Preparation of the Associate Countries of Central and Eastern Europe for Integration into the Internal Market of the Union*, Brussels