credits or to cover the current fiscal deficit, depending on the difference between the current interest rates and the highest interest rates under which the earlier loans were granted.

Claims that electronic control of fiscal receipt issuing will bring in additional tax revenues of highly unrealistic EUR 1 billion lead to confusion as to whether the savings proposed in the fiscal consolidation program are necessary. Such statements made by government representatives cause confusion not only among the decision makers but also among the public. Although the representatives of the Tax Administration probably have no intention of causing confusion, by these hasty statements they send a message that the proposed savings on wages, pensions and subsidies etc. are not necessary, because simply introduction of modern fiscal cash registers can bring EUR 1 billion increase in tax revenues.

Literature:

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Highlight 2. Low Inflow of Foreign Direct Investment: Regional Problem or a Specificity of Serbia?

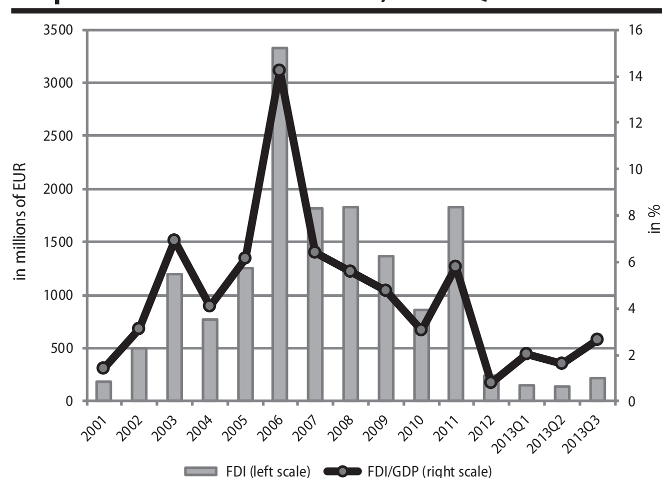
Mirjana Gligorić [1]

This paper is going to compare the trends of foreign direct investment (FDI) in Serbia and the countries of Central and Eastern Europe (CEE) in the period 2001-2012. Even though the analysis covers the entire stated period, the focus of the analysis will be the trends of FDI during the crisis period and especially in the last two years. The latest period is especially analysed from the standpoint of the impact of subsidies on the FDI inflow.

During 2012 and in the first nine months of 2013, inflow of FDI in Serbia have significantly declined compared to the previous inflow levels, especially in the period before the crisis. That is why the focus of this paper is to examine to what extent this phenomenon is specific to Serbia and to what extent it is characteristic of countries in the region and CEE. Graph 1 shows that FDI in Serbia have recorded significant amounts since 2001 (in 2006 they reached 14.4% of GDP). Also, the Graph shows that the FDI inflows have had a downward trend since the beginning of the global crisis, as well as that this trend was stopped in 2011, which means that even after the crisis, although reduced, the average FDI were for the most part kept at a solid level until the end of 2011 (average value of FDI inflow from 2009 to 2011 was 4.5% of GDP).

However, the extremely low inflow of FDI in Serbia since 2012 indicates a potential problem for the local economy from the standpoint of covering the current deficit, as well as considering the impact of FDI on the economic growth. Therefore, the question is whether the current poor inflow of FDI will continue in the coming period as well, which would be especially disconcerting having in mind both perspectives mentioned (balance of payments equilibrium and economic growth), what led to this (general factors or specific characteristics of Serbia and problems that the local economy is currently facing), and what are the possible solutions?

Graph 1. Serbia: Net FDI Inflow, 2001- Q3 2013



Source: NBS, *QM*.

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Since the beginning of 2012, the sudden reduction of FDI inflow, accompanied by deleveraging of the banking and business sector, as well as highly volatile portfolio investments, have caused an unfavourable condition of the capital and financial account of Serbia's balance of payments. In this period, the total inflow of capital (without changes in forex reserves) over three quarters was negative: in Q2 2012, Q2 2013 and Q3 2013, two quarters recorded very low values: Q1 2012 and Q3 2012, while the other two quarters, Q4 2012 and Q1 2013, had a high inflow, but as the result of state borrowing (increase of portfolio investments due to the emission of government bonds). Therefore, FDI inflow is from the viewpoint of achieving equilibrium in the balance of payments the most desirable form of foreign capital, which would secure covering of current deficit and thus avoid a reduction of forex reserves.

Theoretical and empirical findings indicate that there is a positive impact of FDI on economic growth, employment and exports. Several channels have been identified through which FDI accelerate economic growth. Primarily, new investments directly contribute to the growth of GDP, either through increased production of consumer goods, or through a production of production goods – through growth of capital and/or technological progress. Additionally, foreign direct investments, due to transfer of knowledge – efficient management systems or production know-how, or due to the influence on local companies to adopt new technologies, have an indirect, positive impact on economic growth[2].

In the case of Serbia, inflow of such capital could jumpstart currently pretty inactive private sector, which is facing huge financial problems. Empirical research for CEE countries has shown that FDI were an important factor in economic growth – it was estimated that as much as 71% of GDP growth in these countries is owed to the inflow of FDI[3]. Therefore, given the positive effect that FDI could have on Serbia's economic growth, we consider as crucial identifying and removing key problems and weaknesses that foreign investors see as obstacles, as well as finding appropriate measures to make Serbia an attractive investment region.

One of the effects of FDI could be the increase of employment and exports as well. A high positive correlation has been confirmed between the level of FDI *per capita* and the level of foreign trade (measured as a sum of imports and exports in GDP) in CEE countries in the period 1995-2003. Thus, in this region, as anywhere in the world, FDI inflows and foreign trade are complementary[4]. Also, the results of recent empirical analysis show that FDI inflows give developing countries an opportunity to improve their export structure[5] (the so-called export quality, which according to previous research significantly contributes to their future economic growth[6]).It is stated that certain CEE countries who in the first stages of the transition were "driven by domestic demand" and manufactured clothes and furniture, later recorded a significant inflow of FDI and the biggest increase in exports of high value added components and parts they exported for the further production.

Given the positive impact of FDI on economic growth, we feel it is important to stress some of the factors that cause certain countries to be more successful at attracting FDI than others: market size, its dynamic, openness and structure; input costs – labour, energy and raw materials; macroeconomic stability (possibility of depreciating local currency, high inflation, high and rising fiscal deficit); institutional and political stability (absence of capital control and other limitations, market oriented tax system, strict legal regulations[7], low level of corruption, high level of political freedom, high level of price liberalisation, measure and method of privatisation); foreign trade liberalisation and membership in trade organisations, EU integration; subsidies for attracting FDI, agglomeration, quality of infrastructure.

1. Serbia and CEE Countries: FDI Inflow in the Period 2001-2008

Based on the data for Serbia and CEE countries (as well as within them for the surrounding countries – the Region[8]), we will analyse in more details FDI in the period before and after the onset of global crisis. Even though 2008 can be considered both pre-crisis and post-crisis year, we feel that in the case of CEE countries it is more appropriate to consider it a pre-crises year. Therefore, in this part of the paper, we will focus on FDI inflow in the pre-crises period (2001-2008), while in the next part we will focus on the effects of crisis on the level of FDI in the observed countries through the analysis of available data (2009-Q2 2013).

Transition of CEE countries led to their economic integration with Western Europe and bigger openness. This led to an expansion of foreign trade and increased capital inflow, primarily FDI. CEE countries recorded a strong economic growth, through transfer of technology and capital, which put them significantly closer to the

2 Neuhaus, M. (2006).

3 Neuhaus, M. (2006), research was conducted on the sample of 13 countries: Albania, Bulgaria, Estonia, Croatia, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, the Czech Republic, and Hungary.

4 Broadman (2008).

5 Harding and Javorcik (2012).

6 Hausmann et al. (2007).

7 Here Neuhaus, M. (2006) states: transparency of the legal system, law implementation, protection of property rights, repatriation of profit.

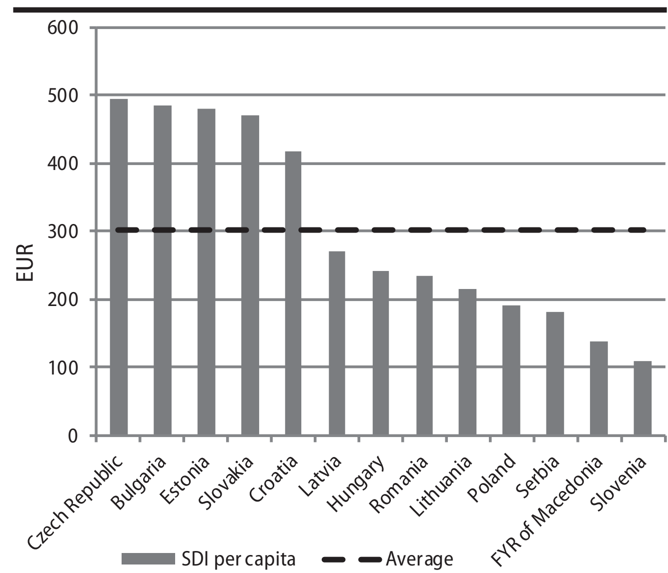
8 Bulgaria, Romania, Croatia, Hungary, Slovenia and Macedonia.

"developed West". During the initial stage of the transition, inflow of FDI in the Czech Republic, Estonia, Hungary, Poland and Slovakia affected the restructuring of their economies, i.e. reorienting production from final products of low level of processing (e.g. clothes and furniture) to components for further production in the automobile and IT industry (so-called network products[9], components and parts). Regarding FDI inflow in CEE, the period between 2000 and the beginning of the crisis can be estimated as extremely heterogenous. It can be divided in two sub-periods: *"normal"* period (2001-2003) and *"investment boom"* (2004-2008). In the latter sub-period, developing countries, including CEE countries, were flooded by an abundant capital offering.

Graph 2 shows average values of net FDI inflows *per capita* in euros, for the period 2001-2008. Countries with an exceptionally high net FDI *per capita* (above average of observed countries and over 400 euros *per capita* a year) were the Czech Republic, Bulgaria, Estonia, Slovakia and Croatia. Below average and with annual inflow of 200-300 euros *per capita* were Latvia, Hungary, Romania and Lithuania. Net inflow of other CEE countries was between 100 and 200 euros *per capita.* Slovenia had the lowest value of net annual inflows of 109 euros *per capita,* primarily due to high outflows of FDI and net outflows realised in 2003, 2005, 2006 and 2007. Such a result in Slovenia is primarily the result of its privatisation model, which left little room for foreign investors, unlike in other countries in the region. In addition, the fact that Slovenia is a small country and has a small domestic market could be one of the reasons why foreign investors do not see it as an attractive location. Also, the service sector in Slovenia (finance, trade, tourism, infrastructure) was relatively developed compared to other countries in the region, which gave a signal to foreign investors that they would have to invest more effort in order to fight the local companies for the same market share that they would get much easier in other countries.

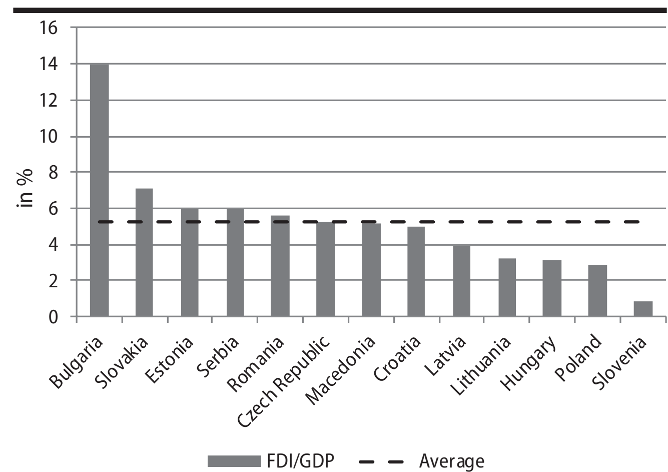
Serbia on average recorded a net inflow of 183 euros *per capita,* which ranks it 11th out of 13 observed countries. Observing the ratio between the net inflow of FDI and gross domestic product of CEE countries, puts countries with relatively low levels of GDP *per capita* (such as Serbia, Macedonia, Romania, Slovakia and Bulgaria) in a much more favourable position. In Serbia, net FDI on average made 6% of GDP. Thus, Serbia is ranked fourth according to this indicator, with realised level that is almost 0.7 pp above its average value in CEE countries in the pre-crisis years (Graph 3).

Graph 2. FDI inflow per capita, Serbia and CEE countries, average for the period 2001-2008



Source: Author's representation based on Eurostat and NBS data (for Serbia).
Note: Average for Macedonia was calculated for the period 2003-2008, due to availability of data.

Graph 3. FDI inflow in % of GDP, Serbia and CEE countries, average for the period 2001-2008



Source: Author's representation based on Eurostat and NBS data (for Serbia).

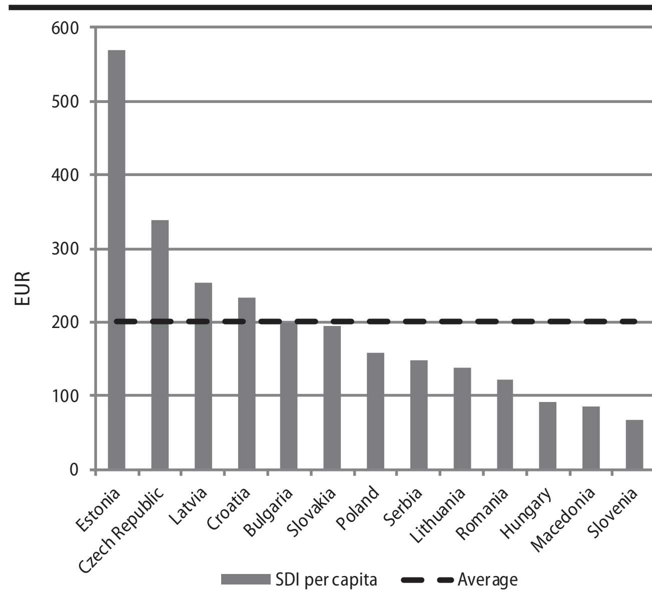
2. Effects of Global Crisis on Inflow of FDI in CEE and Serbia: Is Serbia Specific?

Graph 4 shows that average inflow of FDI in the years after the onset of the global crisis (2009-2012) was 200 euros *per capita,* which is by 103 euros below the average in pre-crisis years (when it was 303 euros *per capita,* see Graph 2). Also, with the exception of Estonia, all other countries recorded a reduction in average inflows in this period compared to the average before the crisis. Serbia still managed to improve its position by 3 spots, i.e. to be ranked eighth in the observed crisis period out of the 13 countries observed. This slightly improved position of Serbia can be assigned to the implementation of several

9 Engl. *Network products*, see Brodman (2008), p.18

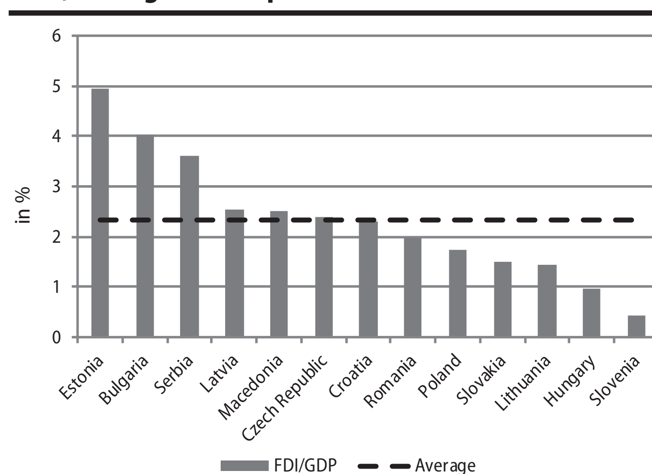
large investments, primarily FAS and NIS. Aside from the investment projects related to these two companies, the especially high level of net FDI in Serbia in 2011 is also owed to the sale of "Delta Maxi". On the other hand, the amount of FDI in Serbia in 2012 can be characterised as specifically low (which is primarily the result of FDI outflows due to repurchasing of "Telekom Srbija" stocks from the Greek telecoms company OTE and withdrawal of part of the Telenor capital, along with low inflow of FDI).

Graph 4. FDI inflow per capita, Serbia and CEE countries, average for the period 2009-2012



Source: Author's representation based on Eurostat and NBS data (for Serbia).

Graph 5. FDI inflow in % of GDP, Serbia and CEE countries, average for the period 2009-2012



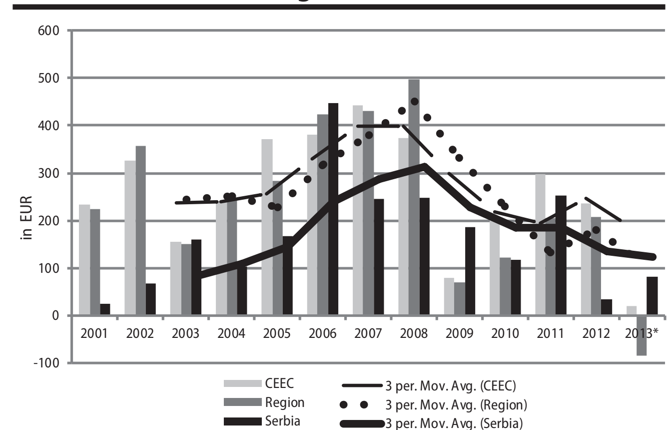
Source: Author's representation based on Eurostat and NBS data (for Serbia).

Also, similar conclusions can be made if we observed the net inflow of FDI as % of GDP for Serbia and CEE countries in the period 2009-2012 (Graph 5). Average value of FDI share in GDP is 2.34%, which is by 2.9 pp below the average for the pre-crisis period. Despite the significantly low inflow of FDI compared to the period before the crisis, Serbia is ranked third after the crisis in the observed group of countries.

If we compare net inflow of FDI *per capita* and share of net inflow of FDI in GDP for Serbia and for the average of surrounding countries (the Region), as well as all CEE countries in the period 2001-2012, we can see that the inflow trend in Serbia was very similar to the trend in two observed groups (CEE and the Region, see Graph 6 and Graph 7). There is a notable increase of net FDI before the crisis, accompanied by their decrease in the crisis period and especially low values since the beginning of 2013. Assuming the recorded values of net FDI *per capita* remain at the same level until the end of 2013, it is our estimate that their "low" level in Serbia will probably be above average of CEE countries and especially the countries in the Region, which recorded a net outflow in the first half of the year. Graph 7 shows a notable decrease of FDI since the beginning of the year, i.e. pronounced net outflow of FDI realised in the countries of the Region and CEE in Q2 2013.

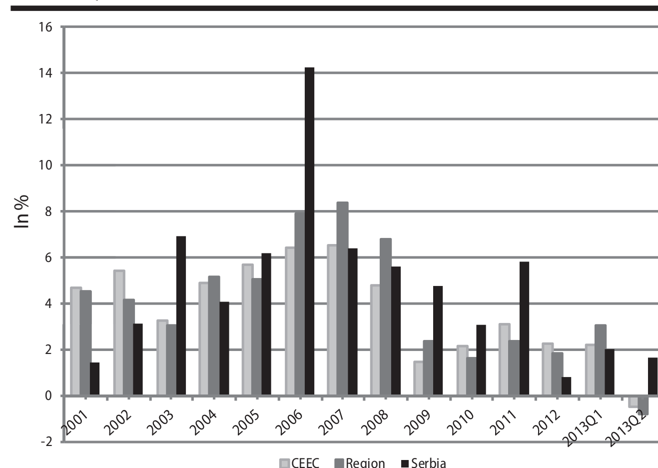
Therefore, the insight into data for FDI *per capita* and FDI/GDP (Graph 6 and Graph 7) indicates that the inflow of FDI in Serbia in the years since the beginning of the crisis (with the exception of particularly low level in 2012) has been quite in line with the trends in comparable countries. Additionally available data suggest that a modest level of FDI in Serbia in 2012 and first half of 2013 is not a specificity of the local economy, but rather the result of unfavourable trend present in the Region and CEE countries.

Graph 6. Net inflow of FDI per capita, average for the countries of CEE, the Region and Serbia, 2001-2013



Source: Author's representation based on Eurostat and NBS data (for Serbia).
Note:
1) *QM* estimate for 2013 (calculated as double value of net inflow from the first half of the year).
2) *CEE*: Bulgaria, the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, Slovakia, Macedonia; *Region:* Bulgaria, Croatia, Hungary, Romania, Slovenia, Macedonia.
3) Net outflows were recorded in 2003, 2005, 2006, 2007 in Slovenia, 2009 in Lithuania, Slovenia and Slovakia, in Q1 2013 in Estonia, Slovenia and Slovakia, and in Q2 2013 in Croatia, Lithuania, Poland, Hungary, Slovenia and Slovakia.

Graph 7. Net inflow of FDI as % of GDP, average for the countries of CEE, the Region and Serbia, 2001-Q2 2013



Source: Author's representation based on Eurostat and NBS data (for Serbia).
Note:
1) *CEE*: Bulgaria, the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, Slovakia, Macedonia; *Region:* Bulgaria, Croatia, Hungary, Romania, Slovenia, Macedonia.
2) Net outflows were recorded in 2003, 2005, 2006, 2007 in Slovenia, 2009 in Lithuania, Slovenia and Slovakia, in Q1 2013 in Estonia, Slovenia and Slovakia, and in Q2 2013 in Croatia, Lithuania, Poland, Hungary, Slovenia and Slovakia.

This analysis leads to a conclusion that Serbia, with a lot more direct incentives for investors, hasn't particularly shined in the inflow of FDI compared to the observed countries of CEE and the Region. In the observed period, Serbia had only slightly higher inflow of FDI compared to certain observed countries, but it hasn't diverted much from the trend dynamic of FDI in the observed countries either, despite the fact that mass privatisation ended in most other countries during the 90s, while inflow of FDI since 2000 in Serbia has primarily been the result of privatisation. So, having in mind past performance, as well as the fact that generous incentives as in the case of FIAT are not fiscally sustainable, it is our opinion that this type of incentive should be an isolated example and a temporary direction, rather than a model for attracting foreign investment.

3. Recommendations and Lessons for Serbia

Based on the observed data, it can be concluded that since 2001, Serbia has had a relatively good result when it comes to amount of annual net FDI inflows, and that the trend of FDI inflow followed the regional trends in the observed period. Still, FDI inflows in Serbia are primarily the result of privatisation, unlike in majority of CEE countries, where privatisation was finalised long time ago and where FDI was primarily targeted to the opening of new production capacities. Even though Serbia has been giving generous direct incentives since 2006, the inflow of FDI was either at the same level or slightly above the level of investments in other observed countries. Having in mind that such incentives are not fiscally sustainable, we feel that they should not be the chosen model for attracting foreign investment in Serbia in the future. Therefore, now that inflows from privatisations have been almost depleted and when the reduction of state subsidies for securing fiscal sustainability is almost inevitable, Serbia should find alternative ways of attracting foreign investors in the future, in order to secure an equilibrium in the balance of payments, get the inactive local economy going, ensure economic growth and increase employment and exports.

We believe there are certain factors in Serbia that discourage foreign investors, such as: macroeconomic instability (high external imbalance: public and foreign debt, current account balance of payments deficit), political risks, business conditions, institutional factors (inefficient regulations and bureaucratic obstacles, poor infrastructure). On the other hand, Serbia has certain advantages over Central European (CE) countries[10] such as cost of labour, good geographic position, relatively low taxes.

Serbia grants high direct incentives to foreign investors in the form of subsidies (4,000-10,000 euros per job created, where average incentive approved so far per job created per foreign company is 4,693 euros[11]). Even though Serbia is not alone in giving incentives to foreign investors, since incentives are a method of attracting FDI in other CEE countries as well, it is evident that it is the indirect incentives that are predominant in other countries, such as tax benefits, giving free land, creating infrastructure on the land, and these are mostly offered to large investors only. Also, Serbia so far approved 289.9 million euros of incentive funds, where approximately ¾ of funds have been allocated to foreign investors[12], putting it at the top of the CEE countries according to the size of subsidies[13].

As a starting assumption of the theoretical and empirical literature, it is stated that fiscal incentives in the form of tax concessions do have an influence on attracting FDI, but that influence is small in the absence of a stable economic environment. It has been confirmed that high incentives should not be a permanent solution, because they are estimated to be a deviation from market principles and thus affect distortions on the foreign

10 We particularly stress here that stated advantages of Serbia are relative compared to CE countries, and they are not valid when Serbia is compared to the Balkan countries, as other Balkan countries have the same advantages.
11 SIEPA.
12 SIEPA.
13 Generous direct incentives in the region in the previous period have been given by Serbia, Romania and Croatia, while Macedonia, Albania and Bulgaria never gave this type of incentives to foreign investors.

capital market and reduction of efficiency[14]. We believe that the model of granting direct subsidies to foreign investors that Serbia is applying should be gradually abandoned, but making sure that business environment is improved at the same time, which primarily means reduction of costs and risks of doing business in Serbia.

That is why Serbia should find alternative ways of attracting FDI, i.e. replace current costly incentives by a more attractive business environment for foreign investments. If only subsidies are abolished, without implementing the reforms, FDI will decline. Reforms include improving business conditions, improving the efficiency of administration and judiciary, managing public finances, and reducing the fiscal deficit and the public debt, upgrading infrastructure, reducing corruption.

Whether or not a foreign investor decides to invest in a country depends on whether it is macroeconomically and politically stable, institutionally developed, market oriented, and open to foreign trade. Therefore, in order to make Serbia an attractive location for foreign investments, a credible monetary and fiscal policy, a favourable business environment, which includes competitive domestic market, anti-monopoly regulations, transparency of the legal system, implementation of the laws, protection of property rights, reduction of corruption, improvement of infrastructure, progress in European integrations, should be emphasised as priorities in the future development of Serbia, that would be based on healthy foundations.

14 Balasubramanyam (2001), p. 2 & 5.

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Highlight 3. Is Privatization First to Blame for Job Losses in Serbia

Milojko Arsić [1]

One criticism that is increasingly appearing in public refers to privatization as responsible for the loss of hundreds of thousands of jobs. According to some estimates privatization is responsible for loss of even 800 thousand jobs, which is approximately equal to total decrease in the number of jobs in the period between 1989 and 2013. Previously said implies, almost unbelievable claim, that bad privatization is solely responsible for the loss of jobs in Serbia, and that other factors such as the transitional recession, the collapse of the Yugoslavian market, the international sanctions, the bombing of Serbia, the current world economic crisis, bad economic environment, mistakes in economic policy, etc, did not affect the loss of jobs. Furthermore, from this claim follows that the reduction in the number of employees in companies that have not yet been privatized, as is the case of public companies or companies in restructuring, is caused by bad privatization!? Moreover, according to this logic a decrease in employment in the original private companies, which started with the beginning of the crisis, is attributed to the bad privatization!?

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