International Journal of Economic Practice and Policy
Volume XVIII, Issue 2, Year 2021

Professional Article
UDC 339.727.22(497.11)
338.1(497.11)
DOI 10.5937/skolbiz2-36628

THE ANALYSIS OF INVESTMENTS AS DETERMINANTS OF ECONOMIC GROWTH OF THE REPUBLIC OF SERBIA IN THE CONTEXT OF ACCESSING THE EUROPEAN UNION

Dejan Đurić*
Novi Sad School of Business, Novi Sad, Republic of Serbia

Biljana Stankov
Novi Sad School of Business, Novi Sad, Republic of Serbia

Milijana Roganović
Novi Sad School of Business, Novi Sad, Republic of Serbia

Abstract: *Intensifying investment activities, strengthening the institutional sector and improving the competitiveness of the national economy stand out as the most important goals of the economic policy of the Republic of Serbia for proceeding with European integration. In this regard, the main goal of this paper is the analysis of investments as one of the most important determinants of economic growth of the Republic of Serbia in the process of accessing the European Union. Given the fact that the Republic of Serbia, as a candidate for membership in the European Union, has been constantly working on harmonizing its legal, institutional and other pillars with the acquis communautaire, research on this topic has gained special significance. The European Union represent the most important investment partner of the Republic of Serbia, especially in terms of foreign direct investment inflows, as well as one of the leading creators of new jobs in the trade sector. The authors of the paper will pay special attention to the current trends and the achieved level of investments in the Republic of Serbia, as well as to their impact on the dynamics of economic growth. The paper will examine the importance of improving the competitiveness of the economic environment as well as the need to accelerate the process of European integration in order to solve the problem of slow economic growth of the Republic of Serbia and intensify investment inflows in the future.*

*ddjuric971@gmail.com

Key words: *investments, economic growth, Republic of Serbia, European Union*

JEL classification: *F15, F21, F43*

ANALIZA INVESTICIJA KAO DETERMINANTI PRIVREDNOG RASTA REPUBLIKE SRBIJE U KONTEKSTU PRIBLIŽAVANJA EVROPSKOJ UNIJI

Sažetak: *Intenziviranje investicionih aktivnosti, osnaživanje institucionalnog sektora i unapređenje konkurentnosti nacionalne ekonomije nameću se kao najvažniji ciljevi ekonomske politike Republike Srbije u procesu nastavka evropskih integracija. U tom smislu, osnovni cilj ovog rada jeste analiza investicija kao jedne od najznačajnijih determinanti privrednog rasta Republike Srbije tokom daljeg približavanja Evropskoj uniji. S obzirom na činjenicu da Republika Srbija, kao kandidat za članstvo u Evropskoj uniji, konstantno radi na usaglašavanju svojih pravnih, institucionalnih i ostalih stubova sa tekovinama Evropske unije, istraživanje ove teme dobija poseban značaj. Evropska unija predstavlja najznačajnijeg investicionog partnera Republike Srbije, posebno u pogledu priliva stranih direktnih investicija, kao i jednog od vodećih kreatora novih radnih mesta u trgovinskom sektoru. Autori rada će usmeriti posebnu pažnju na dosadašnja kretanja i ostvareni nivo investicija u Republici Srbiji, kao i na njihov uticaj na dinamiku privrednog rasta. Istražiće se značaj unapređenja konkurentnosti privrednog ambijenta i potreba za ubrzanjem procesa evropskih integracija radi rešavanja problema usporenog privrednog rasta Republike Srbije i intenziviranja investicionih priliva u budućnosti.*

Ključne reči: *investicije, privredni rast, Republika Srbija, Evropska unija*

1. INTRODUCTION

Modern market economies operate in conditions of global competition, so the success of every economic actor depends, above all, on his ability to be competitive, innovative and flexible. Due to exceptionally complex competitive relationships that dominate the world economic scene, small economies, such as the economy of the Republic of Serbia, must pave its way to the international market by stimulating investment activities, improving the institutional sector, increasing the attractiveness of the investment environment and strengthening the competitiveness of individual economic entities, as well as the entire national economy.

In the previous period, the economy of the Republic of Serbia has been faced with numerous political and economic problems, which have slowed down the transition process, and together with other negative influences, caused its economic decline and inadequate positioning on the international market. In such circumstances, it is very important to create a stimulating economic environment that will lead to the construction of investment and export-oriented economy, whose economic entities would more easily find their place in the international market. In this regard, the paper places special emphasis on the analysis of investment activities and the quality of the business environment as key determinants of accelerating economic growth and improving the competitiveness of the economy of the Republic of Serbia. Foreign direct investment (FDI) should accelerate the process of economic and political tranformation, as Kragulj (2003) emphasized, should be a promoter of economic growth and development in countries in transition. Special emphasis is given to FDI coming from the European Union, because the European Union is considered to be the most important investment partner of our country.

In order to improve the economic environment and accelerate the process of European integration, it is important to mention that one of the most important factors that significantly slows down economic growth and development of the Republic of Serbia is the low level of investment, especially private sector investment. In the macroeconomic sense, investments represent the use of one part of GDP to replace and increase basic production funds in the economy and non-economic activities, as well as to increase stocks of raw materials, semi-finished and finisheds product in the economy. Investments, in that sense, include purchases of production equipment, stocks and construction facilities. Krugman & Obstefeld (2009) point out that investing in investments can be seen as the part of GDP that is used to increase capital. A higher level of investment leads to higher economic growth through the accumulation of physical capital, that is, through its quantitative increase, but, more importantly, through the introduction of new technologies. New technologies stimulate the growth of productivity and competitiveness, and thus encourage technical progress and technological progress of the economy. In the emerging and developing countries national competitiveness has certainly been a very important determinant of FDI inflows, but it has also been a significant factor in developed countries (Stankov, Damnjanović, & Roganović, 2018).

Examining the relationship between investment and economic growth has been the subject of numerous empirical studies, which as a rule indicate the existence of a significant positive relationship. Thus, Levine and Renelt (1992) show that the rate of investment and openness of the economy are the most robust factors of economic growth that stand out among the 50 analyzed factors. Also, Mankiw, Romer and Weil (1992), based on Solow's extended model, estimate that investments in physical capital explain 1/3 of economic growth. In addition, empirical research indicates that some forms of investment have a stronger impact on economic growth than others. De Long and Summers (1991), examining U.S. investment, have shown that increasing equipment investment by 1% of GDP raises growth rates by 0.33% of GDP, while Munnell (1992) provides an overview of the empirical literature that unequivocally confirms a significant positive relationship between public levels investment and economic growth (Arsić, Ranđelović, & Nojković, 2019, p.45).

In the continuation of the paper, the authors will discuss the unsustainability of the transitional model of economic growth based on high consumption and low investment. Special attention will be paid to the analysis of the dynamics of economic growth and investment activities in the Republic of Serbia in the second decade of the 21st century, emphasizing the low level of investment as one of the key reasons for insufficient economic growth. Researching the movement of foreign direct investment, as the dominant form of investment in the Republic of Serbia, gives the insight into the intensity of investment activities in the period before the global financial crisis, after the crisis and in the period following 2017 when FDI inflows intensified. In addition to the above, the contribution of this paper is reflected in the emphasis on key elements of attractiveness and competitiveness of the investment environment of the Republic of Serbia, among which our country's candidacy for membership in the European Union stands out. In that context, the importance of the European Union for the economic development of the Republic of Serbia and its role as a leading investment, but also a trade partner of our country will be explored.

2. UNSUSTAINABILITY OF THE TRANSITIONAL MODEL OF ECONOMIC GROWTH BASED ON HIGH CONSUMPTION AND LOW INVESTMENT

By analyzing economic trends in the Republic of Serbia in the last two decades, it can be seen that the essential feature of the transition of the Serbian economy in the period before the global financial crisis, was reflected in the large mismatch between production and consumption, i.e. the level of aggregate consumption was constantly higher than national production (about 20%). The structure of GDP use was characterized by a high share of personal consumption and insufficient share of total investments in fixed assets (total investment represents the sum of a number of heterogeneous components:

public investment, public enterprise investment, domestic private sector investment and foreign investment). In addition, the GDP growth of the Republic of Serbia in the period from 2001 to 2008 was mainly based on the rapid growth of the services sector. The consequences of this discrepancy were reflected in insufficient growth of industrial production and intensive growth of the foreign trade deficit.

The global financial and economic crisis indicated to the unsustainability of the previously leading model of economic growth, which was basically based on the growth of domestic consumption and imports and the low share of total investments in the structure of GDP use. It has become clear that such a model must be replaced by a pro-investment and export-oriented model of economic growth. The expansion of domestic demand, on which economic growth was based in the observed period, was financed and encouraged by high inflows of capital from abroad. Growth in demand was not accompanied by a corresponding expansion of production, primarily in sectors such as manufacturing. In such circumstances, economic growth was accompanied by growing foreign trade imbalances, relatively high inflation and rising unemployment. In the period from 2000 to 2008, the economic growth of the Republic of Serbia was at a relatively high rate (economic growth averaged 5.4% per year), but with the outbreak of the global economic crisis, previous economic trends were interrupted and major economic problems arose. The economic crisis has led to a fall in aggregate demand, a reduction in foreign capital inflows, an increase in illiquidity and an economic recession. In the new circumstances, it has became clear that a new model of economic growth must be established, which would enable changes in the structure of creation and use of the GDP in the direction of increasing the contribution of investments financed from national and foreign savings and the contribution of exports to economic growth.

The relatively high GDP growth rates achieved in the first decade of the 21st century were primarily based on the growth of domestic consumption. High economic growth, as one of the indicators of economic success in this period, was achieved with a growing fiscal and foreign trade deficit, high inflation, low domestic savings and high levels of public spending and external debt. On the other hand, economic growth was accompanied not only by internal but also external macroeconomic imbalances. Foreign trade and current account deficits were high, despite rapid export growth. This was due to the strong growth of imports based on the growth of domestic demand due to the large increase in wages and public spending and strong lending activity of banks. Faster growth of domestic consumption (over 7% on average per year) than GDP growth (5.4% on average per year) has led to the emergence of such a situation in which the value of domestic consumption exceeded the value of GDP by more than 20%. The expansion of domestic demand was financed and encouraged, above all, by high inflows of capital from abroad (Đurić, Đorđević, & Tomić, 2012).

Based on the presented assessments of macroeconomic trends in the first decade of the transition of the Serbian economy, it can be concluded that personal and government spending in the mentioned period generated GDP growth, while the growth of investments and exports was insufficient for faster economic growth and employment. Although a more favorable environment was created for business and investment of economic entities, the current investment activity was still at a low level in relation to the development needs of the economy. Considering that investments in fixed assets represent the most important segment of GDP consumption from the point of view of development, no significant economic progress could have been achieved in the described circumstances.

3. THE DYNAMICS OF ECONOMIC GROWTH AND INVESTMENT ACTIVITY OF THE REPUBLIC OF SERBIA IN THE SECOND DECADE OF THE 21ST CENTURY

The rapid economic growth recorded in Serbia in the period from 2001 to 2008 was largely supported by an increase in domestic consumption and led to significant internal and external imbalances, so that it proved completely unsustainable. Serbia has gone through a truly dramatic period of change, adapting to extremely rapid changes in the political and economic environment. It was certainly necessary to continue with the implementation of structural reforms and to pay special attention to public administration reforms, solving problems related to public finances and the transformation of the social sector, while continuing negotiations and making additional efforts in the EU accession process. Some of the goals that should be achieved soon are related to ensuring economic and financial stability, stopping the accumulation of public debt, creating a favorable environment that would support economic recovery and increase economic growth while encouraging employment and raising living standards. These goals will be achieved primarily through the implementation of fiscal consolidation measures and the acceleration of structural reforms. It is very important in the future to complete the initiated and implement new privatizations of state-owned enterprises, create a basis for faster economic growth and create new jobs in the private sector.

The low level of economic growth was the main negative feature of the economy of the Republic of Serbia during most of the second decade of the 21st century. As a result, Serbia lags significantly behind developed European countries, but also behind some Central and Eastern European countries that have achieved faster economic growth in recent years.

Table 1

Republic of Serbia and the countries in the region: GDP growth in the period from 2014 to 2017

Country	2014	2015	2016	2017
Serbia	-1.8	0.8	2.8	1.8
Surrounding countries (average)	2.7	3.6	3.6	4.3
Albania	1.8	2.2	3.4	4.0
Bosnia and Herzegovina	0.3	3.8	3.1	2.3
Bulgaria	1.4	3.6	3.9	3.9
Croatia	-0.5	2.2	3.0	3.2
Hungary	4.2	3.4	2.2	3.7
North Macedonia	3.6	3.9	2.9	0.0
Montenegro	1.8	3.4	2.9	3.9
Romania	3.1	4.0	4.6	5.7

Note. European Commission Statistics, https://ec.europa.eu/info/statistics_en

The data shown in Table 1 refer to a comparative overview of the achieved GDP growth of the Republic of Serbia and the neighbouring countries in the years following the end of the global financial crisis (2014-2017). Observed in the regional context, it is evident that during the analyzed period, the Republic of Serbia seriously lagged behind in terms of economic growth, not only behind the developed countries of the European Union, but also in relation to neighboring countries. Although the economic growth of the Republic of Serbia recorded in 2016 reached the highest level since the outbreak of the global economic crisis, it was still below the regional average in that year. In 2017, the situation was even more unfavorable because there was a reduction in the economic growth rate, whereas GDP per capita, which until then was at about 62% of the average of Central and Eastern European countries, fell to 55%.

In 2018 and 2019, there was a revival of economic activities in the economy of the Republic of Serbia. According to the data of the Statistical Office of the

Republic of Serbia, the growth rate of Serbia's GDP in 2018 was 4.4%, while in 2019 the growth rate was 4.2%. GDP was lower by 1% in real terms in 2020, as a result of economic problems caused by the coronavirus pandemic.

Petrović, Brčerević and Gligorić (2019) state that empirical results show that the economic growth of the Republic of Serbia is below its potential level. The authors point out that Serbia is falling behind by 1.5 - 2% regarding the speed of economic growth, i.e. instead of the current trend of economic growth which is 3 - 3.5%, the medium-term GDP growth should be around 5%. The authors came to this assessment by analyzing the economic development and the trend of economic growth of the Republic of Serbia and other Central and Eastern European countries. Underdeveloped European countries should achieve consistently faster economic growth than economically developed countries, with an annual convergence rate of about 2%. The annual convergence rate of 2% is the result of several different empirical studies, which is why it is also called the ”the iron law of covergence‟. Petrović, Brčerević and Gligorić (2019) point out that it is meaningless to compare the current trend of economic growth of the Republic of Serbia (from 3% to 3.5%) with the growth of developed European countries such as Germany and the Netherlands, whose GDP growth trend is currently about 2% . The fact is that European countries at a lower level of development must achieve significantly higher growth rates. Faster economic growth of these countries is largely based on the transfer of technology and knowledge from developed countries, while developed countries are dependent on their own innovations and technological progress, which leads to slower, but certainly stable economic growth.

The main, though not the only, channel through which new technologies and knowledge enter the economy of less developed countries is investment. These are primarily investments in the tradable sector of the economy, such as the processing industry, because they enable international competitiveness of the economy and thus sustainable economic growth. Investments also affect economic growth by simply increasing capital (capacity), although it is difficult to separate their purely quantitative from qualitative effect. Having in mind the presented conclusions on the comparison of economic growth rates between countries of different economic strength, as among the countries of Central and Eastern Europe, it is certain that the economic growth of the Republic of Serbia had to be faster. Petrović and Gligorić Matić (2021) point out that Serbia's GDP per capita is half the average of CEE countries, and (applying a convergence rate of 2% per year), the GDP growth of the Republic of Serbia should therefore be increased by about 1%. The same authors conclude that since the medium-term growth of CEE countries is currently around 4%, the trend of economic growth of the Republic of Serbia should be around 5% instead of the current 3 - 3.5%.

3.1. LOW INVESTMENT LEVEL – KEY REASON FOR INSUFFICIENT ECONOMIC GROWTH

Based on the type of source of financing, total investments can be divided into domestic and foreign, while domestic investments can be viewed as domestic private and domestic public (state) investments. One of the key causes of insufficient economic growth of the Republic of Serbia is reflected in low total investments, primarily domestic private and public investments. Total investments in the Republic of Serbia in the period from 2014 to 2017 averaged about 17% of GDP.

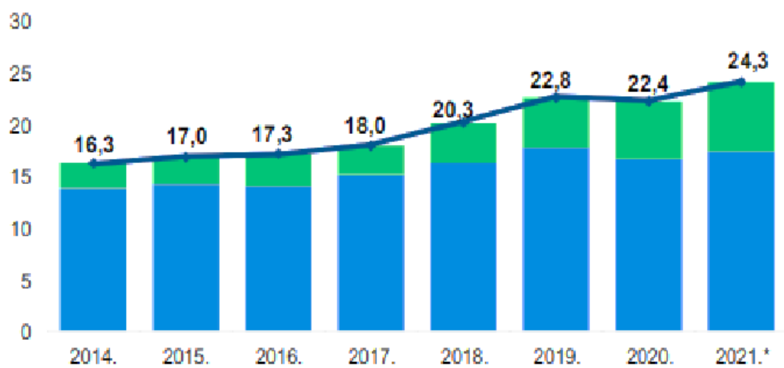

Figure 1. Percentage share of total investments in the GDP of the Republic of Serbia

Note. National Bank of Serbia. *Macroeconomic trends in Serbia*. February, 2022.

The main structural obstacle to the establishment of high and sustainable economic growth is the insufficient share of investments in the GDP structure. The low level of investments does not fully ensure the renewal of production capacities and infrastructure (because their depreciation is approximately the same), and it certainly does not contribute to the sustainability of economic growth. The level of investments in the Republic of Serbia in the period from 2014 to 2017 was significantly lower compared to countries in the region. The average share of fixed investments in the GDP of countries in the region was about 23%, while fixed investments participated in the formation of Serbia's GDP with about 17%. The share of investments in the GDP of Serbia in the observed period was significantly lower than the recommended rate of 25%, which contributes to the achievement of sustainable, long-term economic growth (World Bank, 2008). Simulations according to which long-term GDP growth of the Republic of Serbia can reach 7% annually, imply that the assumption about the total level of investment in the Republic of Serbia of at least 26% of GDP should be met for a longer period (World Bank Group, p.12).

Observed by components, total investments in the Republic of Serbia are lower than in other neighboring countries due to low public and domestic private investments, while foreign investments are at a relatively high level. Public investment in the observed period was lower by over 2% of GDP than the average of the Western Balkan countries. In addition to public investment, domestic private investments, which are the main drivers of economic growth, affecting employment growth, intensifying innovation and increasing productivity, were also very low in this period. Arsić, Ranđelović and Nojković (2019) conclude that private investments in the Republic of Serbia in the observed period averaged only 8.9% of GDP per year, and as such were lower by 3.5% of GDP compared to the national average of Western Balkan countries. On the other hand, net foreign direct investment (FDI) averaged about 5% of GDP, which is about 3.6% of GDP higher than the average of the Western Balkans. The low level of domestic private investments can be explained by the unfavorable business environment and inadequate treatment of domestic businessmen, but also by the low level of domestic savings, which is lower than the average of CEE and EU countries. Low domestic savings in the Republic of Serbia cannot be justified by low levels of income, because countries with similar incomes per capita (Romania and Bulgaria) have significantly higher domestic savings. Possible causes of low domestic savings are found in the long-term inadequate income policy, which was based on faster growth of income from the growth of investments and productivity, as well as in the insufficient development of the financial system of the Republic of Serbia.

Since 2018, in the Republic of Serbia, there has been an increase in the percentage share of total investments in the value of Serbia's GDP, which was primarily a consequence of the growth of state investments. Although public investment has grown in recent years, Serbia still lags behind Central and Eastern European countries in this area, especially when it comes to public investment by local governments. Ranđelović (2020) emphasizes that due to insufficient investments in the long run, the total amount of public capital per capita in Serbia is the lowest in the group of CEE and Western Balkans, which ranks Serbia among the three lowest ranked countries in terms of overall infrastructure quality in the region. According to the World Bank Group, in order to ensure a significant impact of public investment on growth and prevent waste of resources, ongoing public investment management reforms must be continued in order to reduce fragmentation of the investment program, introduce a strategic vision and establish a clear division of responsibilities, their selection, financing, implementation and evaluation.

Petrović, Brčerević and Gligorić (2019) point out that the level of total investments in the Republic of Serbia is 5-6% lower than the level that should exist at the current level of economic development. Insufficient level of investment in Serbia slows down economic growth by approximately 0.7%. Research conducted by these authors shows that public investment in infrastructure should increase by at least 1%, investment by public state and local enterprises by slightly more than 1% of GDP, and domestic private sector investment by the remaining 3-4% of GDP. The government has a direct influence on the increase of public investments and investments of public companies, while the increase of private investments can be influenced indirectly, i.e. by improving the business environment.

One of the main reasons for the low level of investment activities is the inadequate and insufficiently competitive investment environment. In this sense, it is necessary to make permanent efforts to improve the business environment and maintain macroeconomic stability. The greatest threat to macroeconomic stability remains the fiscal side. Although the share of public debt is below 60% of GDP, it is quite a high level for a country like Serbia. With such a high public debt, any new external "shock" and recession, such as the one in 2008, would lead to its accelerated growth and increased participation in the structure of GDP. In this context, the government deficit must be kept low to ensure public debt reduction. Also, a great risk to public finances and thus macroeconomic stability is still posed by the unreformed public sector, primarily large public and state-owned enterprises. Numerous reforms are needed to improve the investment environment which should primarily be directed towards the institutional sector, the judicial system, the fight against corruption and increasing the efficiency of the labor market and goods. Entrepreneurial spirit, available financial resources and qualified workforce in the Republic of Serbia do not mean much in the absence of a competitive business environment. Good governance should support changes aimed at improving the business climate as a whole, which primarily means increasing the transparency of administrative procedures, simplifying overly complex laws and combating corruption. However, Serbia has yet to implement comprehensive reforms in this area. Progress in this area could contribute to GDP growth of 0.9% per year (World Bank Group, p. 4).

3.2. REVIVAL OF INVESTMENT ACTIVITIES AFTER 2017

Looking into the period before the onset of the global financial crisis and the last analyzed year (2016), it can be concluded that FDI inflows were slightly lower. Namely, in the three-year period before the beginning of the FDI crisis, inflows averaged US $ 3413 million per year, while in 2015 they were at the level of US $ 2347 million, which is only 1.4 times less.

Table 2

FDI activity indicators in the Republic of Serbia until 2016

Indicators		2005/ 2007	2013	2014	2015	2016
FDI inflows and outflows in millions of dolars	*Inflows*	3.413	2.053	1.999	2.348	2.352
	Outflows	352	329	356	346	250
Velue of net cross-border in millions of dolars	*Sales*	483	9,3	9,8	12,1	132,4
	Purchases	-348	-	-	16,4	13,5
Number of net cross-border M&A	*Seller*	12	7	9	3	13
	Purchaser	3	-	-	5	3
Velue of announced greenfield FDI projects in millions of dolars	*Destination*	2.510	4.006	1.977	4.470	2.068
	Source	69	91	387	99	110
Number of announced greenfield FDI projects	*Destination*	62	125	79	75	86
	Source	3	11	9	13	8

Note. UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

In 2013 and 2014, almost equal trends in FDI inflows (US $ 2053 million in 2013 and US $ 1999 million in 2014) were also recorded, which were on average 1.7 times lower than FDI inflows in the period before the crisis, i.e. slightly lower than the inflows realized during 2015 and 2016. The values of FDI outflows were much lower in relation to inflows, although outflows recorded a fairly uniform movement observed from year to year without significant oscillations, except during 2016. The number of FDI projects in the form of mergers and acquisitions has not changed significantly, observing the period before the global crisis, when the implementation of 12 of these projects was planned compared to 2016, when the implementation of 13 projects was planned. The situation is much better when it comes to greenfield projects, considering that the realization of 125 such projects was announced in 2013, which is twice as many as the average annual number of projects announced in the period before the crisis began. The realization of 79 of these projects was announced in 2014, 75 in 2015, and 86 in 2016.

Taking into account the value of all FDI projects implemented in Serbia until then, it can be stated that foreign investors were most interested in providing financial services, most often banking and insurance, then telecommunications services, food production, opening retail chains, car and component production for the automotive industry, real estate business, as well as for the implementation of projects in the field of tobacco industry, construction and pharmaceutical production. If the number of realized projects is taken as a criterion for the sectoral distribution of FDI inflows, it can be concluded that until then the most attractive economic sectors were automotive and food industry, construction, textile and electronic industry within which about 50% of all FDI projects were realized. Applying the same criteria, it can be stated that most investment projects were implemented by Italy (16.9%), Germany (13.3%), Austria (11.8%), Slovenia (9.2%), France (5 , 4%), USA (5.4%) and Greece (4.4%). Judging by the total value of realized FDI projects, the largest foreign investors are Italy, USA, Austria, Greece, Norway, Germany and France, which have realized more than 65% of the value of all FDI projects in Serbia.

In the last few years in the Republic of Serbia, there has been a revival of investment and overall economic activities, which has been encouraged by the establishment of macroeconomic stability through successful fiscal consolidation and the application of stimulus measures by the state to attract foreign direct investment. The share of fixed investments in the real GDP of the Republic of Serbia increased from 18% in 2017 to 22.8% in 2019, with the expected continuation of growth in the medium term and with a temporary contraction in 2020 (22.4%) , caused by a corona virus pandemic.

GDP growth for 2021 was expected to be over 6%, but it should be borne in mind that in the previous year there was a decline in economic activity as a result of problems caused by the pandemic, so this growth rate must be viewed in this context. The projected growth of the share of fixed investments in real GDP is 24.3%, and further growth of government investments would amount to about 7% of GDP. It is obvious that the economy of the Republic of Serbia has revived investment and economic activities since 2018, which has resulted in higher rates of economic growth and greater share of investments in the formation of GDP values, especially foreign direct investment. The economic momentum that followed after 2017 was partially interrupted in 2020, but signs of economic recovery were already noticed in 2021.

The inflow of foreign direct investment, both in developed and developing countries, such as the Republic of Serbia, is associated with positive effects, such as: employment growth, technology transfer, investment in infrastructure (Baez-Morales, 2014). Stankov, Damnjanović and Roganović (2019) noted that FDI often represents the driving force of the growth in the developing countries. It is done by increasing capital supplies, decreasing unemployment and bringing modern management skills and new technologies. The said contributions are especially important for the developing countries where GDP and state savings are on a significantly low levelStamenković and Kovačević (2016) emphasize that insufficient domestic accumulation requires the inflow of foreign capital, as the first precondition for permanently translating the rate of economic growth to a higher level. The authors conclude that Serbia is now in a situation where more dynamic economic growth can no longer be ensured without foreign investment, primarily without foreign direct investment.

It is especially important that almost half of the value of the inflow of foreign direct investments realized in 2018, 2019, and 2020, was directed to the tradable sectors, and mainly to the processing industry. The sectors of the processing industry with the largest inflow of FDI (metal industry, auto industry, food industry, tyre industry) recorded strong growth in employment, production and exports in the observed years (National Bank of Serbia, 2021).

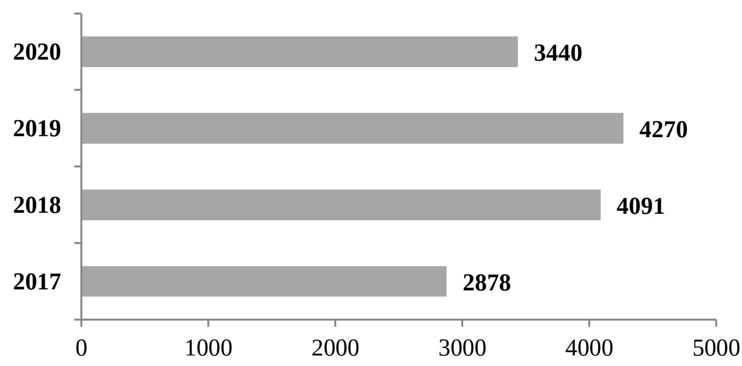

Figure 2. Movement of inflow of foreign direct investments in the Republic of Serbia in the period from 2017 to 2020 expressed in millions of US $

Note. UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

In 2020, FDI inflows remained strong inspite of the coronavirus pandemic. In 2020, the Republic of Serbia attracted more than 50% of the value of total inflows of foreign direct investment in Southeast Europe (World Investment Report, 2021).

Taking into consideration the political and economic situation in the host country, the development and stability of the industry in which he wants to invest, as well as other influential elements, the foreign investor decides on a particular form of investment and the most suitable investment location. In the decision-making process, he is motivated by different motives, guided by individual interests and goals he wants to achieve in business in the future. Some companies want to conquer new markets or take advantage of low start-up costs, while others strive to use scarce and affordable resources or achieve their own strategic goals. When choosing an investment location, investors primarily take into account the expected profitability of the investment venture, which is influenced by various factors specific to a particular country, as well as under the influence of the type of investment motives. Kinoshita and Campos (2002) point out that investors can be attracted by countries with vast and fast-growing markets (*Market-seeking investors*), abundant natural resources (*Resource-seeking investors*) or low costs of transporting products to their home country, or geographical proximity (*Efficeny-seeking investors*). Depending on the motive of the investor, i.e. the strategic goal of the investment, FDI can be classified into market, efficiency, resource and strategic asset seeking investments (Dunning, 1993). In the same way, Dunning and Lundan (2008) explain the activities of multinational companies and explore the motives that drive foreign investors to carry out the production process in another country, i.e. outside their home country. Also, Reiljan, Reiljan and Andersson (2001) mention the same division of FDI in an empirical study on the attractiveness of Central and Eastern European countries from the point of view of foreign investors, all in the context of European integration. This division is also supported by authors such as Brewer (1993), Chudnovsky, Lopez and Porta (1997) and Oxelheim (1993).

3.3. ATTRACTIVENESS OF THE INVESTMENT ENVIRONMENT OF THE REPUBLIC OF SERBIA FOR FOREIGN INVESTORS

The low level of domestic capital accumulation is one of the key features of developing countries, and thus the Republic of Serbia, and creates the need to intensify FDI inflows in order to accelerate economic growth. In order to attract as many foreign investors as possible, Serbia is establishing liberal FDI laws, removing trade barriers and investment bans, and reducing corporate income tax rates. Cheng and Kwan (2000) point out that many countries view the attraction of FDI as a very important element in their economic development strategies because they are considered to be a combination of capital, technology, marketing and management. During the last decade, the Republic of Serbia is often mentioned as an attractive investment destination, attractive to many foreign investors, and a leader in the CEE region in attracting production-oriented FDI. According to EY's European Attractiveness Survey, Serbia is among the top ten European investment destinations in terms of job creation created by FDI inflows.

The benefits available to foreign investors who are determined to invest in the Republic of Serbia relate primarily to the availability of qualified cheap labor, financial incentives, subsidies and incentives, competitive operating costs and duty-free treatment of products provided by signed trade agreements. In order to improve trade cooperation with other countries and encourage foreign trade, Serbia has signed free trade agreements with the European Union, Russia, Belarus, Turkey and Kazakhstan. Serbia's foreign trade with the United States is largely regulated by the Generalized System of Preferences, approved in July 2005, which provides for preferential duty-free treatment for most semi-finished and finished products, as well as certain agricultural products and raw materials. In addition to the above, foreign investors are particularly interested in all other trade benefits and facilitations arising from the signed Free Trade Agreements between Central European countries and the Free Trade Agreement with member countries of the European Free Trade Association. The CEFTA agreement envisages the liberalization of public procurement and the attraction of investments in the signatory countries, and increases the chance of entering European markets under privileged, preferential treatment. At the end of 2009, a free trade agreement was signed with the member states of the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland) and thus another step was taken towards improving Serbia's position in the free trade system. The Decree on the Conditions and Methods of Attracting Foreign Investments in the Republic of Serbia provides for various types of benefits: temporary tax exemption on corporate profits, transfer of losses, avoidance of double taxation, reduction of taxes and contributions on salaries, annual income tax deductions and value added tax exemptions in free investment zones.

In addition to the above, foreign investors can be particularly encouraged to invest by a package of tax incentives that would include low rates of value added tax, corporate income tax and payroll tax or some form of tax credit and other types of tax breaks. Investing in a particular economy can often be motivated by flexible wages, an appropriate employment policy and low layoff costs (Lazić, Markov, & Vapa, 2012). However, the mentioned benefits for investors often take on the opposite character when viewed from the angle of the host country. Stiglitz (2002) points out that firing workers by a foreign investor creates a situation where unemployment can be a major social cost, manifested in its worst form - urban violence, rising crime and social and political unrest, but even if there are no such problems, there are high costs due to unemployment.

Countries that want to attract foreign investors, as Stein and Daude (2001) suggested, must strive to improve the quality of their institutions, because thath is a strategy which, in addition, should generate other positive externalities. According to the research of the World Economic Forum within the Global Competitiveness Report, it is stated that in the Republic of Serbia the most frequent obstacles to unhindered business activities were difficult access to funding, inefficiency of the state apparatus, corruption and instability of public policies. In addition to the above, the modest work ethic of employees, instability of the Government and inadequate infrastructure stand out. There are many authors who deal witn the impact of corruption on FDI inflows including Busse and Hefeker (2007), who argue that lower-corruption is associated with higher FDI inflows.

4. INVESTMENT RELATIONS BETWEEN THE EUROPEAN UNION AND THE REPUBLIC OF SERBIA

Observing investment activities in the Republic of Serbia during the second decade of the 21st century, it can be noticed that foreign investors were especially encouraged by the fact that Serbia was granted EU candidate status in 2012, and that it has been developing economic cooperation and trade relations with the Union. Carstensen & Toubal (2004) conclude that the extraordinary growth of European and American FDI inflows in Central and Eastern European countries can often be seen as a result of the EU integration of these countries as well as the removal of FDI barriers and accelerating transition processes in these economies. By signing the Stabilization and Association Agreement, which entered into force in September 2013, the Republic of Serbia has committed itself to establishing a free trade zone and harmonizing its own legislation with the EU acquis.

At the same time, the Interim Trade Agreement was signed, which envisages the gradual establishment of free trade in industrial and agricultural products over the next six years, with special emphasis on reducing or eliminating customs duties on certain types of products. In this context, it is very important to point out that among all the countries with which the Republic of Serbia has signed free trade agreements, the European Union stands out in terms of the scope and nature of the benefits it has provided. The European Union is by far the most important trade partner of Serbia and participates with about 60% in the total trade exchange of Serbia, while, for example, the participation of Russia is about 9%, and China's approximately 4.4%. According to the data of the Delegation of the European Union to Serbia, as much as 63% of the total trade of the Republic of Serbia in 2019 was realized with the European Union. From 2009, when the implementation of the Interim Stabilization and Association Agreement began, until 2019, the total trade between the European Union and Serbia reached the value of almost 25 billion euros, i.e. during the mentioned ten-year period, it increased by as much as 250%. In the same period, the value of exports from Serbia to the European Union increased from 3.4 billion euros to 11.3 billion euros. During 2019, the Republic of Serbia exported significantly more to the EU, i.e. significantly more imported from the EU, compared to all other candidate countries. In 2019, 66.3% of exports, or 54.7% of imports of the Republic of Serbia were realized with the EU-27. Russia and China are also important foreign trade partners of our country, but with a significantly lower foreign trade share, as much as 10 times lower than trade with the European Union.

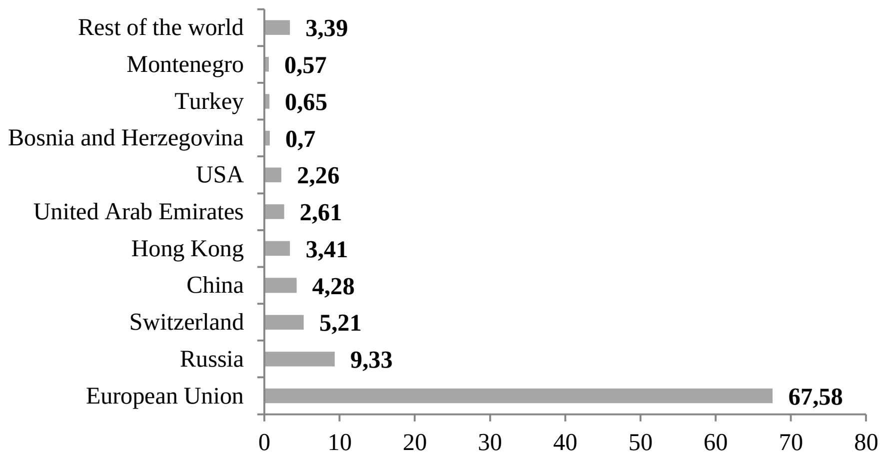

Figure 3. Percentage share of the European Union and other countries in the total value of foreign investments in the Republic of Serbia in the period from 2010 to 2020

Note. EU in Serbia, https://europa.rs/strane-direktne-investicije-2020/

In addition to being the most important trade partner, the EU is also the largest investor in the Republic of Serbia, so the development of intensive economic cooperation and strengthening their mutual relations is of key importance for the future economic development of the Republic of Serbia.

In the total value of foreign direct investments in the Republic of Serbia that were realized during the second decade of the 21st century, the European Union achieved a dominant share of almost 68%. Russia's share was 7 times lower, and China's even 17 times lower. Among foreign investors from the European Union, investors from the Netherlands, Austria, Italy, Germany and Great Britain stand out, who have so far invested the most in the Serbian economy.

The European Union is also considered the largest foreign investor worldwide, as well as the most important investment destination. According to the European Commission, foreign direct investment stocks held in the rest of the world by investors resident in the EU amounted to € 8.990 billion at the end of 2019. Meanwhile, foreign direct investment stocks held by third country investors in the EU amounted to € 7,138 billion at the end of 2019.

In recent years, there has been an evident trend of slowing down the progress of the Republic of Serbia in the process of European integration. As early as 2019, only 2 negotiation chapters were opened, and in the meantime, new chapters have not been opened. The Republic of Serbia has opened a total of 18 negotiation chapters (out of 35), and the opening of only half of the accession chapters, since 2014, when the process began, is considered an unfavorable result. EU officials believe that Serbia has not made the expected progress, especially in the area of ensuring fundamental rights and freedoms, media pluralism and freedom of speech, the fight against corruption and organized crime.

4. CONCLUSION

Insufficient economic activity, reduced share of investments in the GDP structure, low national competiveness, high corruption and weakened institutional sector, are the most important economic problems facing the economy of the Republic of Serbia in the last two decades. The global financial and economic crisis pointed to the unsustainability of the previously applied model of economic growth, which was basically based on the growth of domestic consumption and imports and the low share of investments in the structure of GDP use. It has become clear that such a model must be replaced by a pro-investment and export-oriented model of economic growth. The main structural obstacle to the establishment of high and sustainable economic growth is the insufficient share of investments in gross domestic product. In the forthcoming period of its development, the Republic of Serbia should work on encouraging investments, with an emphasis on national investments, and on improving national competitiveness. The realization of these strategic economic goals implies directing the development processes towards strengthening the factors that raise the level of productivity of the economy, while key measures and activities must be directed towards creating a stimulating and competitive business environment.

Viewed from the aspect of foreign investors and thanks to its many advantages, such as favorable geographical and strategic position, abundance of natural resources, liberal labor laws, friendly FDI laws, low costs of closing business and many others, the Republic of Serbia ranks among the most attractive investment destinations. Also, the benefits resulting from the signed multilateral and bilateral agreements on free trade and the status of candidates for membership in the European Union, have a particularly stimulating effect on foreign investors.

The European Union is the most important investment and trade partner of our country. Its share in the value of imports and exports of the Republic of Serbia, as well as its share in the value of total FDI inflows, is incomparably higher compared to other foreign trade partners. In 2019, 66.3% of exports, i.e. 54.7% of imports of the Republic of Serbia were realized with the European Union, while the foreign trade share of Russia and China was up to ten times lower. In the total value of foreign direct investments in the Republic of Serbia, which were realized during the second decade of the 21st century, the European Union achieved a dominant share of almost 68%. Russia's share was 7 times lower, and China's even 17 times lower. In recent years, there has been stagnation in the negotiation process of Serbia's accession to the European Union, and more decisive steps must be taken in that direction in order to make progress in closing the current and opening new negotiation chapters. Following the mentioned trends in foreign trade and investment relations between the European Union and the Republic of Serbia will certainly affect the intensification of economic growth and encourage employment in our country.

REFERENCES

Arsić, M., Ranđelović, S., & Nojković, A. (2019). Uzroci i posledice niskih investicija u Srbiji. U: *Zbornik radova Ekonomska politika Srbije u 2019. godini* (43-61). Beograd: Ekonomski fakultet, Univerzitet u Beogradu.

Baez-Morales, A. (2014). A panel data analysis of FDI and informal labor markets. *AQR–Working Papers, 2014, AQR14/02*.

Brewer, T., L. (1993). Government Policies, Market Imperfections, and Foreign Direct Investment. *Journal of International Business Studies*, *24*(1), 101-120.

Busse, M., & Hefeker, C. (2007). Political risk, institutions and foreign direct investment. *European journal of political economy*, *23*(2), 397-415.

Carstensen, K., & Toubal, F. (2004). Foreign direct investment in Central and Eastern European countries: a dynamic panel analysis. *Journal of Comparative Economics*, *32*(1), 3-22.

Cheng, L., K., & Kwan, Y., K. (2000). What are the determinants of the location of foreign direct investment? The Chinese experience. *Journal of International Economics*, *51*(2), 379-400.

Chudnovsky, D., Lopez, A., & Porta, F. (1997). Market or Policy Driven? The Foreign Direct Investment Boom in Argentina. *Oxford Development Studies*, *25*(2), 173-188.

De Long, J. B., & Summers, L. H. (1991). Equipment investment and economic growth. *The Quarterly Journal of Economics*, *106*(2), 445-502.

Dunning, J., H., & Lundan, S. M. (2008). *Multinational enterprises and the global economy.* UK: Edward Elgar Publishing.

Dunning, J., H. (1993). *Multinational enterprises and the global economy*. New York: Addison Wesley.

Đurić, D., Đorđević, M., & Tomić, R. (2012). *Nacionalna ekonomija*. Novi Sad: Alfa-graf.

EU in Serbia. Retrieved from https://europa.rs/strane-direktne-investicije-2020/

European Commission Statistics. Retrieved from https://ec.europa.eu/info/statistics_en

Kinoshita, Y., & Campos, N., F. (2002). *The location determinants of foreign direct investment in transition economies.* University of Michigan William Davidson Institute and CERP.

Kragulj, D. (2003). Ekonomska kretanja i strane direktne investicije u zemljama u tranziciji. *Management: Journal for Theory and Practice Management*, *32*(8), 19-27.

Krugman, P., & Obstefeld, M. (2009). *Međunarodna ekonomija – teorija i politika*. Beograd: Data Status.

Lazić, B., Markov, J., & Vapa, B. (2012). Povećanje konkurentnosti zemalja Zapadnog Balkana - šansa za privlačenje stranih investitora i prevazilaženje kriza. In *Drugi talas ekonomske krize – Posledice na privredu regiona i moguća rešenja* (245-260). Sremska Kamenica: Univerzitet Educons Sremska Kamenica.

Levine, R., & Renelt, D. (1992). A sensitivity analysis of cross-country growth regressions. *The American economic review*, 942-963.

Mankiw, N. G., Romer, D., & Weil, D. N. (1992). A contribution to the empirics of economic growth. *The quarterly journal of economics*, *107*(2), 407-437.

Munnel, A. H. (1992). Policy Watch. *Journal of Economic Perspectives*, *6*(4), 189-198.

National Bank of Serbia. (2022). *Macroeconomic trends in Serbia*.

Oxelheim, L. (1993). *The Global Race for Foreign Direct Investment: Prospects for the Futur*e. London: Springer-Verlag.

Petrović P., Brčerević D., & Gligorić M. (2019). Zašto privredni rast Srbije zaostaje?. *Ekonomika preduzeća, 67*(1-2), 17-33.

Petrović, P., & Gligorić Matić, M. (2021). *Konvergencija periferije ka razvijenoj EU i faktori koji je opredeljuju: Empirijsko istraživanje i implikacije za Srbiju.* Beograd: Ekonomski fakultet, Univerzitet u Beogradu.

Ranđelović, S. (2020), Politika javnih investicija u Srbiji usmerena na podsticanje rasta - više i efikasnije. *Ekonomika preduzeća, 68*(1-2), 137-146.

Reiljan,J., Reiljan, E., & Andersson K. (2001). Atractiveness of Central and Eastern Europen Countries for Foreing Direct Investment in the context of European Integration. The case of Estonia. In *Proceeding from 41 st Erse Congress* (3-5). Zagreb.

Stankov, B., Roganović, M., & Damnjanović, J. (2018). Pillars of competitiveness as FDI determinants in host countries: A review of the panel data empirical studies. *School of Business*, *15*(2), 98-116.

Stankov, B., Damnjanović, J., & Roganović, M. (2019). Research of foreign investors' opinions on the quality of workforce education and professional improvement in the Autonomous Province of Vojvodina. *School of Business*, *16*(2), 52-77.

Stamenković, S., & Kovačević, M. (2016). Dinamika BDP, investicija i stranih direktnih investicija (SDI) u Srbiji po izbijanju svetske ekonomske krize. U: *Strane direktne investicije i privredni rast u Srbiji*. Beograd: Naučno društvo ekonomista Srbije, Akademija ekonomskih nauka i Ekonomski fakultet u Beogradu.

Stein, E., & Daude, C. (2001). *Institutions, Integration and the Location of Foreign Direct inestment.* Washington DC: Inter-American Development Bank.

Stiglic, Dž. (2002). *Protivrečnosti globalizacije*. Beograd: SBM-x

United Nations Conference on Trade and Development – UNCTAD. *FDI/MNE database*. Retrieved from www.unctad.org/fdistatistics

United Nations Conference on Trade and Development – UNCTAD. (2021). *World Investment Report 2021*. Retrieved from https://unctad.org/webflyer/world-investment-report-2021

World Bank Group. Nova agenda za privredni rast Srbije – stvaranje nove budućnosti. Retrieved from https://thedocs.worldbank.org/en/doc/579881576613980824-0080022019/original/SRBCEMSynthesisSRPSKI.pdf

World Bank. (2008). *The growth report: Strategies for sustained growth and inclusive development*. Washington DC.

Delivered: 08.09.2021.

Accepted: 29.12.2021.