FOREIGN DIRECT INVESTMENTS - A CHANCE OR A CHALLENGE FOR THE LOCAL BUSINESS COMMUNITY

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Summary

Foreign direct investment is a key driver of global economic integration and enables the transfer of capital, knowledge, technology and managerial skills between countries. In addition to all the benefits they bring, they have a great impact on the progress and survival of domestic companies. This means that domestic companies face numerous challenges such as: lack of incentive measures, double standards, difficult possibility of establishing cooperation with foreign companies, lack of interest of local authorities, insufficient development of domestic companies as well as the existence of a low level of technology transfer. In order to overcome these challenges and create a more inclusive business environment, it is necessary to actively work on improving the position of domestic companies. Accordingly, the recommendations refer to the establishment of clear communication mechanisms, compliance with national legislation, research on the profitability of FDI, a more active role of local self-government, programs of incentive measures, dual education, overcoming the "glass ceiling" for domestic employees in foreign companies, establishing a unique representation mechanism for local companies, improvement of the supply chain, the minimum involvement of domestic suppliers in the supply chains of foreign companies, as well as the creation and improvement of the Local Community Development Plan.
Methodology

Data collection and recommendations are based on inputs received from local debates organized in four cities. Local debates were organized in the form of one-day events in Zrenjanin, Čačak, Pirot and Šabac. These cities were chosen based on three criteria: they represent regional centers with a significant number of people and businesses gravitating towards them, they have a significant number of foreign companies operating and they have several active business associations.

The focus of this research was to examine the impact of foreign direct investments and foreign companies on the business community in Serbia, with a special focus on the local level. The idea was to examine and define the impact that foreign direct investments have on Serbia's economy in a broader sense, but also on specific economic subjects, such as small and medium-sized enterprises and large economic systems, through mapping needs and challenges.

To that end, as participants in local debates, BFPE targeted the most relevant actors who can significantly help achieve the previously defined goal with their input. These are: representatives of business associations, chambers of commerce, local communities and local governments, representatives
of domestic companies, representatives of foreign companies present in the mentioned regions and other relevant actors at the national level.

The goal of this publication and project is to review the impact of foreign direct investments on the local business community, identify the needs of domestic business entities, consider ways to overcome challenges arising from the activities of foreign companies at the local level, as well as review the strategic importance of foreign direct investments.

The role of foreign direct investments

Foreign direct investment is a key component of the contemporary global economic landscape. Through globalization, countries have become more interdependent and economies more connected. The Republic of Serbia is no exception. With the appropriate policy framework, foreign direct investments contribute to financial stability, economic growth and improve the general prosperity of a society. There are numerous definitions of foreign direct investment. According to the definition of the Organization for Economic Co-operation and Development (OECD), foreign direct investments are "a category of cross-border investments made by a resident of one economy (direct investor) with the aim of establishing a permanent interest in an enterprise (direct
investment enterprise) that is resident in an economy other than the economy of the direct investors."

Therefore, it can be said that foreign direct investment serves as a means of creating direct, stable and long-lasting links between economies. Driven by long-term profit-making objectives, foreign direct investment is a relatively stable source of external financing. For countries that are capital importers, foreign direct investments represent the most favorable form of international financing. Although they carry a certain degree of risk as the riskiest form of international capital, transnational companies, which are carriers of foreign direct investments, still prefer this type of investment because of the potential for high profits.

Foreign direct investments have a significant role for an economy from multiple perspectives and have great potential to become key drivers of economic, technological and social transformation in a country, providing long-term benefits for both investors and the local community. Here are some key benefits:

- Economic Stimulation – FDI provides a strong boost to a country's economy as it leads to increased investment, new businesses, job creation and general economic growth.
• Transfer of technology and know-how – foreign companies investing in a country usually bring advanced technologies, innovations and business know-how. This one technology transfer can improve domestic industry, encourage the development of new skills and increase competition.

• Job creation – investments by foreign companies often result in job creation, which reduces unemployment and improves economic conditions in the community. This contributes to the increase in income and living standards of the local population.

• Increase in exports – FDI can increase exports of domestic products because foreign companies often use local resources and labor to produce products for export.

• Access to international markets – investments by foreign companies can provide local businesses with access to international markets through global supply chains and distribution networks.

• Improving the business environment – in order to attract foreign investment, countries often implement reforms to improve their business environment, which in the long run contributes to more efficient governance and reduction of bureaucracy.
While foreign direct investment (FDI) brings significant benefits, there are several challenges with that countries face when attracting these investments. Some of the key challenges are:

- **Maintaining sovereignty** – there is great concern that the arrival of foreign investment may lead to a loss of sovereignty, especially if foreign companies have too much influence over key sectors of the economy and political decisions.

- **Lack of technical and technological readiness** – in some cases, domestic industries may be insufficiently prepared for the technological and technical requirements of foreign investors, which may lead to difficulties in integrating into global value chains.

- **Social and cultural impact** – foreign companies often bring with them different business cultures and values. This cultural chill can cause tensions with local communities and workers.

- **Negative impact on the environment** – foreign investments can have a negative impact on the environment if they are not carefully selected and regulated. Damage to natural resources and pollution can cause concern for local residents.

- **Dependence on certain sectors** – if a country
becomes too dependent on foreign direct investment in certain sectors, it can increase the vulnerability of the economy in case of changes in the global market or in political relations.

- **Working conditions and labor rights** - foreign companies sometimes face criticism for inadequate working conditions and insufficient respect for labor rights.

- **Corruption and lack of transparency** - in some cases, corruption and lack of transparency in the country can make it difficult for foreign investors to do business, at the same time contributing to poor governance and endangering the position of local economic entities.

- **Countries that attract foreign direct investment must balance attracting capital and managing these challenges to ensure sustainable and long-term economic development.** The question arises, what is the situation in Serbia?

**Foreign direct investments in Serbia**

In recent years, Serbia has attracted a significant amount of foreign direct investment, becoming a prominent investment destination in the Central and Eastern Europe region, which has had a positive impact on the country's economy. Serbia stands out
for its liberal foreign trade and investment policy towards foreign investors. For a long period, the country implemented a policy of encouraging foreign inflows direct investments, especially through the provision of financial incentives to investors based on the creation of new jobs. Thanks to numerous free trade agreements, Serbia has become even more attractive for investments, and the country's regional connection with the European Union and within Southeastern Europe additionally contributes to an attractive investment environment. *1

At the top of the list of successful companies on the Serbian market are Bosch, Michelin, Siemens, ZF, Panasonic, NCR, Microsoft, Gorenje, Brose, Continental, Magna, Cooper Tires, Johnson Controls, Johnson Electric, Leoni, Fiat Chrysler Automobiles, Yazaki, Eaton, Stada, Swarovski, Aunde, Calzedonia, Mei Ta, Schneider Electric, Geox, Tarkett, Ling Long, Adient, Minth, Toyo Tires, MTU, Barry Callebaut, and many others. For the fourth year in a row, the Republic of Serbia is the world leader in terms of the number of jobs created through foreign direct investment projects, according to the "IBM Global Location Trends 2020" report. Also, according to the criterion of the number of new jobs, regardless of the size of the population, Serbia is highly positioned in fifth place among European countries, considering the foreign direct investment projects started in 2019. In 2020, Serbia was the first in Europe in terms

*2 https://ras.gov.rs/uspesne-price
of the number of foreign direct investments in relation to the size of the economy, according to the annual report published by fDi Intelligence, which is part of the British newspaper "Financial Times".\(^*2\)

There is no doubt that Serbia attracts the attention of foreign investors with its extensive potential. Key areas that stand out as extremely promising for foreign direct investment in the country include the aerospace and special purpose industries, the automotive industry, IT technologies and international business services, the textile industry, the food industry, the wood and furniture industry, as well as the metal and machine industry.\(^*3\)

On the other hand, in addition to the mentioned numerous potentials that Serbia has, in order for the country to succeed in attracting foreign direct investments, it is necessary to create a favorable environment for investors. Bearing this in mind, Serbia offers numerous benefits for investors, namely: reduced burden on wages up to 75%, temporary tax exemption on the profits of legal entities (depending on the amount of investment and the number of jobs created), avoidance of double taxation, the possibility of duty-free imports raw materials and semi-finished products, duty-free import of machinery and equipment, exemption from value-added tax in free zones, financial support for investment projects in the

\(^*3\) https://www.srbija.gov.rs/tekst/329922/pogodnosti-za-investitore.php
manufacturing sector, the international trade services sector and the hotel accommodation services sector, additional benefits at the local level (exemptions or reductions in rental fees of urban construction land, facilitation of fees for the arrangement of urban construction land, exemptions or reductions of other local fees.).*4 It is precisely for these reasons that Serbia has proven to be a good destination for foreign investors, as evidenced by statistical data.

Overview of foreign direct investments in Serbia

Out of a total of 18.6 billion euros of FDI in the period from 2018 to 2022, more than 10 billion euros were directed to exchangeable sectors, of which almost 6 billion euros were directed to the manufacturing industry. The sectors of the manufacturing industry with the largest inflow of FDI (metal industry, automobile, food, rubber and plastics) are recording strong growth in employment, production and exports. Serbia attracted more than half of the total FDI in the Western Balkans region in the period from 2018 to 2022. The inflow of FDI in 2022 was 4.4 billion euros (net 4.3 billion euros). In nine months of 2023, the total inflow amounted to 3.2 billion euros (net 3.0 billion euros), which still represents a higher level compared to the same period last year. FDI is also geographically diversified, with a growing

When it comes to the current year, according to preliminary data of the National Bank of Serbia collected until June 30, 2023, when we talk about individual countries, the largest inflow of foreign direct investments came from China (592.6 million euros), the Netherlands (414.7 million euros), Romania (124.5 million euros), Great Britain (122.5 million euros), and Germany (117.1 million euros). The total number of foreign direct investments coming from the European Union is 1110.3 million euros.

Based on the above data, we can conclude that the European Union and China are the dominant actors in Serbia when we talk about foreign direct investments. According to the National Bank of Serbia, free trade agreements play a significant role in attracting foreign investments. The most
important in terms of trade volume are those with the European Union and within CEFTA. The agreement with the Eurasian Economic Union (EAEU) led by the Russian Federation was signed in October 2019. Serbia has agreements with Turkey and Great Britain, as well as with the countries of the European Free Trade Association - EFTA (Iceland, Liechtenstein, Norway and Switzerland).

Foreign direct investments coming from the EU accounted for almost 59% of total FDI coming to Serbia during eleven years, from 2010 to 2022, and reached 20.3 billion euros in the past years. EU companies were the leading investors in Serbia during the previous decade. These companies brought efficiency, modern technology and knowledge to the Serbian economy, providing jobs for a large number of people. This in turn significantly increased the productivity and competitiveness of the Serbian economy, increasing its export potential, increasing budget revenues and generating economic growth. Finally, the opening of the Serbian market to EU companies led to different choices and lower prices for consumers.

When it comes to Hollandia, it should be kept in mind that here one should be careful with the interpretation of the origin of investments in this country because it is considered a kind of "tax haven" because of its tax regulations, so investors
from different countries establish companies there. It is interesting that in terms of investments, Romania is ahead of Germany, which is the largest investor in Serbia. In the last ten years, local companies have invested more than four billion euros here and employed around 80,000 people. But apparently because of the recession, they invested less this year.

When it comes to China, in recent years there has been a noticeable growing trend of investments coming from China, because due to the fact that Serbia is not a member of the EU, and that it has free trade agreements with the EU and Russia, it has the opportunity to export from Serbia to the EU market, which is its ultimate goal. China is rapidly expanding its economic influence in Serbia. This would not be problematic if China's greater economic influence was not associated with the decline of legal standards and the degradation of democracy. Thus, the more closely a country is tied to China and the larger its GDP is Chinese investment, the more likely it is that China has exploited its rule of law problems to expand its economic and political influence. This can be seen from the way of doing business of the Chinese company Zijin Minig in Bor, the Chinese foreign direct investments in the Smederevo steel plant that was bought by the Chinese Hesteel Group, the construction of the car tire factory in Zrenjanin by
the Chinese Linglong, the Chinese company "Xing Yu" in Nis and others. However, Chinese investment is not necessarily a bad thing. But in order to achieve this, it is necessary to ensure compliance with all legal regulations, increase the transparency of Chinese companies' operations, protect the local interests of residents, as well as set clear environmental standards.

Therefore, regardless of the country of origin of foreign direct investment, the state should encourage investments in high-tech sectors that require highly qualified labor and use modern equipment, which results in increased export potential and higher incomes for employees. Through these investments, the host country benefits by placing high-quality products on the international market. In contrast, investments in labor-intensive sectors such as the leather, shoe or textile industries require less qualified labor, are not technologically demanding and do not generate higher added value. In addition to all that, the state should take advantage of the opportunities available to foreign companies in order to improve the position of domestic businessmen.

**Challenges of foreign direct investments at the local level: Zrenjanin, Čačak, Pirot and Šabac**

There are numerous trends when it comes to the relationship between foreign direct investment and
SMEs at the local level. Some of the key questions in this relationship are: how does a small or small company manage in a situation when a large investor comes? Are there any benefits for small and medium-sized companies or domestic entrepreneurs in that case? And who can say what are the benefits and what are the challenges of doing business of foreign companies at the local level?

In order to see that relationship, we need to have an overview of the total number of local companies. The total number of business entities in the domain of entrepreneurs in 2019 is 288308, in 2020 298279, in 2021 303300. In the domain of micro enterprises in 2019 we had 89190, in 2020 90106, in 2021 89655. In the domain of small enterprises in 2019 we had 11537, in 2020 12187, in 2021 12607. In the domain of medium enterprises in 2019 we had 2646, in 2020 2716 and in 2021 2800. So, in the group In 2019, we had 391,681 SMEs, in 2020, 403,288, and in 2021, 408,362. This means that in addition to the growing trend of foreign direct investments, we also have a growing trend in the field of small, medium, and large enterprises from year to year.

Pirot was chosen as one of the cities for analysis because it is an excellent address for trying to find answers to the previously mentioned questions, since it has decades of experience in the presence of large investors and has a specific geographical
location. One of the important reasons why Pirot is a leader in the business of foreign companies is the existence of Slobodna zave Pirot, which was founded in April 1998. It provides the possibility of efficient business and significant savings by centralizing all advantages for investing and doing business in one place. According to the Law on Free Zones, users are exempted from local taxes and taxes for the construction and exploitation of facilities. In 2018, the Pirot Free Zone was declared the best in Europe and 3rd in the world, while in 2019 it received 4 awards for support of surrounding areas, connectivity, expansion and for encouraging investors. 25 manufacturing companies and about 100 trade companies operate in the regime of the Pirot Free Zone, among which there are large, small and medium-sized companies employing about 6,000 workers. Therefore, there is no doubt that in the territory of Pirot there are foreign companies that do well and that they provide certain benefits, but they also impose certain challenges that domestic companies face.

Šabac was on the list of one of the top ten cities in Europe in 2020 for attracting foreign direct investments according to the Financial Times magazine thanks to the good development plan of the city. The reasons for such a good positioning of Šabac are as follows: the presence of waste water treatment (the only functional one in Serbia), a
regional landfill and an organized system for waste removal, a Free Zone and a regime of functioning in the Free Zone for all companies that want to export. In addition, there is a customs terminal, organized parking for all companies, a completely organized infrastructure, but also a training center as a special service available to companies. By purchasing land, investors get a plot with complete infrastructure - this means connection to water, electricity, gas, optical cable, a well-maintained road and water treatment. By purchasing land, investors get a plot with complete infrastructure - this means connection to water, electricity, gas, fiber optic cable, an organized road and water treatment. On the territory of the city, there is a Business Council that meets once a month and an Investment Monitoring Commission that meets every Monday in order to review each investment and eliminate problems. Some of the foreign companies operating in Šabac are Fox-pak, Seletra, Refrion, Nepi, Metal Investments, Vopachel, ODS, Pasubio. From domestic companies there in Set, Saturn Electric, Mašinkop and several small companies that bought plots in the industrial zone.

Zrenjanin has been recognized by the Center for evaluating foreign direct investments in the world and FDI Intelligence placed the city in third place in terms of investment profitability in the category of European cities of the future for the period
2022/2023. The industrial zone "Southeast" was formed on 72 hectares of land and in 2018 it was expanded to 550 hectares, which is the largest zone for direct economic investments in the territory of Serbia. About 30 companies operate, build production plants or have bought land in the zone, among which is the largest investor ever in Zrenjanin and the largest direct foreign investor in Serbia, the Linglong company with a production complex worth almost one billion dollars.

Čačak is specific as a city where the economy, which is significantly more developed than in many other cities in Serbia, has a great influence on all social trends. The development of the economy in the city rests on two main pillars. The first pillar is an institutional network for supporting the economy, which on the one hand has a foothold in local self-government and the existence of a scientific and educational institution with a Science and Technology Park. The second pillar is the very important participation of the economy in the decision-making processes of local self-government, through the City Council for the Economy, which is made up of representatives of business associations.

So, it is without doubt that these cities provide numerous benefits when it comes to foreign investors and often city administrations improve the business environment to make it adaptable and
attractive for foreign investors. So one gets the impression that the national and local authorities are not doing enough to create a suitable investment environment for domestic companies as well. Below are the key challenges facing domestic businesses at the local level.

Key challenges:

- **Insufficient incentive measures for the development of domestic enterprises** - The result is a challenge for sustainable business, primarily micro and small enterprises. This is most pronounced for entrepreneurs who do business with 5 to 10 employees. A review of the system approach to incentives for this group of entrepreneurs is needed, whereby attention should be paid to those who have been in business for a certain number of years and not only to beginners.

- **Existence of double standards for foreign and domestic companies** - Foreign companies operating locally often have a privileged position compared to domestic companies. Often, national legislative and normative frameworks are ignored in favor of the foreign investor. Whether it's environmental standards, enforcement of human rights or subsidies specifically created to attract a certain type of
investor from abroad. And while some of the mentioned measures to attract FDI can be considered positive, these measures should not be implemented contrary to the needs of the business community both at the local and national level.

- **Difficult possibility of establishing cooperation with foreign companies** - The arrival of large systems through the investment process is often accompanied by an insufficient level of communication about the potential of the local business environment. Additionally, domestic companies do not have enough information on how they can establish cooperation with foreign companies operating in their environment.

- **Lack of interest of local authorities in improving the position of domestic companies** - The reason is the insufficient activity of local management levels to help and contribute to the improvement of the position of domestic companies in their relationship with foreign companies. Decisions regarding foreign investment are made at the national level, which means that local governments have little or no influence on decisions that directly affect them.

- **Insufficient development of domestic companies** - domestic companies often do not have enough financial, human or technological resources to
meet the needs of foreign systems operating in their environment. Limited capacities may limit their ability to innovate, expand markets or invest in new technologies.

- **Low level of technology transfer** - One of the direct benefits of foreign direct investment in developing countries is technology transfer. In the case of Serbia, this is tentatively true, but there is room for improvement. A certain number of companies are importers of so-called "dirty technologies" that not only do not contribute to the transfer of new technologies, but also contribute to the development of corrosive capital in the local community.

**Recommendations for improving the position of domestic companies**

- **Establishing clear mechanisms of communication between foreign investors, representatives of local self-government and the local business community.** Although certain mechanisms exist - such as economic (business) councils, it is necessary to define communication methods that will not depend solely on the will of the relevant actors. The process of communication must circulate even before the arrival of the investor in a certain local community. Relevant institutions and organizations such as the
Chamber of Commerce of Serbia, the Development Agency of Serbia, and local business associations also play an important role in establishing this type of communication.

- **Compliance with national legislation** - It is necessary to ensure consistent compliance with all laws, regardless of whether it is a foreign investor or a local business company - compliance with the law must apply to everyone equally and without exception.

- **Research (cost-benefit analysis) on the profitability of a certain foreign direct investment** - It is necessary to conduct research on the justification and profitability of a potential foreign investment on the local economic community and create a set of measures for further action. As a candidate country for the European Union, Serbia will have to adopt a screening mechanism that will assess the impact of the inflow of foreign capital that goes beyond purely economic motives. The strategic importance of investments in certain sectors derives from benefits that will be wider than the profits of the company operating in the territory of Serbia, and it is necessary to take into account the wider impact that each of the investments represents.
• **Active role of local self-government units** - Offices for local economic development at local self-government units, as well as economic councils (considers topics, makes recommendations but does not influence the creation of public policies) should play a greater role in better positioning of domestic companies. The function of economic councils (business councils, socio-economic councils) is defined by law. The advisory role of this body is indisputable, however there is a necessity to review the essential functionality. In order to improve the position of local representatives of the business sector, it is necessary to map and evaluate the work of economic councils, and raise the importance of their functioning by formulating an advisory role as mandatory for consideration by local self-government representatives.

• **Establishing a program of incentive measures for domestic companies** - The treatment of foreign and domestic business entities must be in accordance with principle of equal treatment and fair business. It is necessary to work on the creation of a set of incentive measures for domestic economic entities so that they are not in a subordinate position in relation to foreign investors.
• **Dual education** - The arrival of new foreign investors, the changing economic and political environment, the development of technologies and the progress of humanity have greatly influenced the needs of the labor market. The current educational system does not fully meet the needs of the labor market, both foreign and domestic companies. Therefore, it is necessary to work on the introduction and improvement of the dual education system in order to adapt the workforce to the needs of companies at the local level.

• **Overcoming the "glass ceiling" for domestic employees in foreign companies** - A trend has been mapped that shows that foreign companies operating on the territory of Serbia often have informal limits for the inclusion of domestic citizens in the advancement and development of their companies. The shared experiences of employees in foreign companies at the local level show that they face a "glass ceiling" when trying to advance and be part of higher and top positions within the companies they work for. It is necessary to develop mechanisms and measures in order to overcome this problem.

• **Establishing a unique mechanism for the representation of local companies** - Communication and inadequate representation...
between foreign investors and domestic companies stands out as one of the key problems in their relationship. It is necessary to establish a unified mechanism for representing local companies so that they can get involved and maximize their benefits from the arrival of a foreign investor in the local community. This can be achieved through the establishment of a single catalog or database of domestic companies with all the advantages represented by municipalities in Serbia.

- **Improving the supply chain to include micro and small enterprises** - Optimizing the supply chain is a key initiative in supporting the sustainable development of micro and small enterprises. Traditionally, these businesses face the challenges of accessing larger markets and competing with large corporations. Developing an efficient supply chain that facilitates the integration of micro and small enterprises not only helps improve their competitive position, but also contributes to the overall development of the local economy.

- **Minimum involvement of domestic suppliers/service providers in the supply chains of foreign companies** - In the negotiation process, it is necessary to establish the minimum that a foreign investor must meet when establishing supply chains, and in accordance
with the possibilities and capacities of the local business community.

- **Creation and improvement of the Local Community Development Plan** - Local community development planning is an essential initiative that enables the strategic direction of resources, initiatives and investments in order to achieve sustainable and comprehensive development. Through the joint work of local authorities, business, civil society and citizens, a Development Plan can be formed that reflects the real needs and ambitions of the community and thus improve the local community.
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