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Impact of FDI on the Economic Development of Serbia and Poland

Introduction

Investments lays the groundwork for improving and expanding production. It is a means of expanding and sustaining the capital of a firm. Rational usage of investment assists economic growth and the expansion of national wealth and GDP. Investment is beneficial for technical progress – it is used for upgrading equipment and technologies so that unused resources can be put into production. Investment in science, and research and development stimulates development, innovation implementation and efficient usage of production capacities[1]. Investment contributes to the spreading of scientific and technical achievements from company to company and from state to state. New skills, organisational entities and management methods are being adopted.

FDIs influence economic growth and interact with other factors: labour force, capital, foreign economic relations, natural resources. There are mutual benefits. The country from which the investor receives income taxes and the country where it is invested improves its financial potential and the welfare of the citizens. The flow of Foreign Direct Investments are calculated when the outflow of capital, including amortization and damages, is subtracted from the investment mass.

Foreign Direct Investments are long-term holdings mostly in the scope of production e.g. building factories, buying equipment, developing raw material deposits, mines and, most recently, IT outsourcing. They are characterised by the long-term use of the facilities and long-lasting income. FDIs are an act of entrepreneurship and sustained commitment from a foreign investor. According to the UN, the purpose of FDIs is to acquire a lasting share or effective

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1 STOYKOV I., *International investment policy*, SA D.A. Cenov, Svishtov 2005, p. 11.

control over a company that is functioning outside the investor's country[2]. Foreign Direct Investments are needed when:

- ❑ building new capacity;
- ❑ developing new production facilities;
- ❑ developing economic infrastructure;
- ❑ setting up joint ventures with multinational companies;
- ❑ implementing new technologies through buying patents, licenses and know-how and
- ❑ creating business clusters.

To put it in a nutshell, FDIs take place when an investor sees better conditions for doing business abroad. Reasons vary depending on the business models but the goal is to make profit in the long term. It is widely agreed that foreign direct investments (FDIs) take place when three sets of determining factors coexist at the same time (Dunning, 1993a): the ownership of specific competitive advantages in a transnational corporation (TNC), advantages about location in a host country, as well as the presence of benefits in according to benefits about arm's-length transactions[3].

First of all, the ownership-specific advantages (e.g. proprietary technology) of a firm, if exploited optimally, can compensate for the additional costs of establishing production facilities in a foreign environment and can overcome the firm's disadvantages compared to local firms. Then, the ownership-specific advantages of the company should go hand-in-hand with the location advantages of the host country (e.g. large markets or lower costs of resources or a better infrastructure). Finally, companies find bigger benefits in exploiting both location and ownership-specific advantages by internalisation: through FDIs rather than arm's-length transactions.

By choosing to invest abroad, companies develop a wider variety of instruments to shrink costs and thus increase income. As a mutual benefit, the recipient country receives income in the form of taxation and, as we will see in the case study, a better standard of living. Lately. governments have been advertising the advantages of choosing to invest in their countries whichis why Serbia and Poland have created policies to attract FDIs. According to EY's 2016 European FDI attractiveness ranking, Europe's manufacturing appeal remains intact, accounting for 49% of FDI projects and 62% of FDI jobs. In manufacturing industries, investment in Poland (117 projects, +34%) andSerbia (51 projects, +76%) drove FDI growth. The automotive sector drove manufacturing growth in Poland, while machinery and equipment were dominant for Serbia[4]. The same source (EY's Global Investment Monitor, 2016) shows figures

[2] http://www.un.org/esa/sustdev/natlinfo/indicators/methodology_sheets/global_econ_partnership/fdi.pdf.

[3] http://unctad.org/en/Docs/wir1998_en.pdf p. 89.

[4] http://www.ey.com/gl/en/newsroom/news-releases/news-ey-foreign-direct-investment-in-europe-at-an-all-time-high-despite-uncertainties-posing-risks.

regarding the top 10 European countries by FDI projects and by job creation. Poland is highly positioned in second place for job creation. The same scale put Serbia as 9th of the top ten countries by same criteria and while Serbia is not in the top ten list by FDI projects, Poland is ranked at number seven.

Figure 1. EY's 2016 European attractiveness survey rankings[5]

Top 10 countries by FDI projects

	2015	2014	% change
UK	1.065	887	20%
Germany	946	870	9%
France	598	608	-2%
Spain	248	232	7%
Netherlands	219	149	47%
Belgium	211	198	7%
Poland	211	132	60%
Russia	201	125	61%
Turkey	134	109	23%
Ireland	127	106	20%
Others	1.123	1.032	9%
Total	5.083	4.448	14%

Top 10 countries by job creation

	2015	2014	% change
UK	42.336	31.344	35%
Poland	19.651	15.485	27%
Germany	17.126	11.890	44%
Russia	13.672	18.248	-25%
France	13.639	12.579	8%
Romania	12.746	10.892	17%
Hungary	11.741	4.868	141%
Ireland	10.772	7.306	47%
Serbia	10.631	5.104	108%
Slovakia	9.564	8.012	19%
Others	55.788	60.620	-8%
Total	217.666	186.348	17%

Source: EY's Global Investment Monitor, 2016

Methods and statistical material

Data for this paper was obtained from the database of The World Bank, UNCTAD and other relevant research papers. The analysis also included figures about FDI inflow and outflow for Poland and Serbia, which were examined from 2005–2015.

Discussion of results

The purpose of the analytical part of this research is to examine the impact of FDIs on the economies of Serbia and Poland for the period from 2006 to 2015. To determine whether there is a connection between the amount of FDI and the wellbeing of the citizens, the most appropriate macroeconomic indicator is GDP per capita, because it shows the average wealth of the citizens of

5 http://www.ey.com/gl/en/newsroom/news-releases/news-ey-foreign-direct-investment-in-europe-at-an-all-time-high-despite-uncertainties-posing-risks.

a country for a period of a year. As FDIs have a long-term effect on a country's economy,it is reasonable to include them in the whole amount, accumulated in the economy for the period of the case study. Dunning's (1993) contribution is worth mentioning because it constitutes the starting point for all following elaborations on this issue[6].

Benefits of FDIs in Serbia and Poland
Benefits of investing in Serbia

Over the past four years the Republic of Serbia has taken steps to further improve political and economic stability. To reverse Serbia's trend of economic growth driven by import and consumption, and to put the former Yugoslav Republic on a dynamic and sustainable growth path, economic reforms were carried out. Their purpose was to stabilise the macroeconomic variables and improve the business climate.

Then, since 2014, the Government of the Republic of Serbia has taken steps towards reducing the government debt and fostering a greater fiscal responsibility. Reforms of the public administration and of state-owned enterprises were undertaken. The past few years are also marked by an overall increase of productivity in the public sector.

Serbia has a very favourable tax regi. Corporate income tax rate is 15%. Personal income tax is 10%, flat rate. According to *EUROSTAT*, Serbia has the lowest costs of electricity, gas, other fuels and landline telephony among 37 European states. Depreciation time for computers and new manufacturing equipment is two years. Serbia has one of the most competitive costs for labour in Central and Eastern Europe. The average gross monthly salary is 506 Euros[7].

Corporate Income Tax Relief: A 10-year Corporate Profit Tax Holiday is available for investors who hire more than 100 employees and invest more than 8.5 million Euros. The tax holiday begins once the company starts making a profit[8]. When a firm decides to resort to FDI in order to take advantage of a foreign market, the problem of choosing the host country might be still unsolved. Indeed, the firm can actually invest in a country which is different from the market it wants to exploit, as in the case of „export platform" FDI[9].

Location is another strategic benefit. Serbia is located at the heart of the Balkans, with good transportation links for cargo provided by two Pan-

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6 DUNNING J. H. (1993), *Multinational Enterprises and the Global Economy* (Harlow: Addison-Wesley).

7 The Vienna Institute for International Economic Studies, 2015.

8 http://ras.gov.rs/uploads/2016/06/why-invest-may-16-1.pdf.

9 Ekholm K. et al. (2003), Export-platform foreign direct investment, Working Paper 9517, NBER.

European corridors which pass through the country, and two major airports: Belgrade and Nis. Belgrade Airport Nikola Tesla and the Danube River connects Serbia with the other countries of the Danube Region. Due to its location, Serbia provides direct access to the following key markets[10]:

- ❏ European Union – zero tariff market with 500 million consumers, 66% of total exports;
- ❏ Russia, Kazakhstan and Belarus – 171.1 million consumers, 5.9% of total exports;
- ❏ Turkey – zero tariff market of nearly 80 million population, 1.9% of total exports;
- ❏ CEFTA – 20.1 million consumers, 18.6% of total exports;
- ❏ US – 321.4 million consumers, 1.9% of total exports.

Transport costs can be described as direct and indirect. The former refers to freight charges and the relative insurance on shipments. The latter includes holding, inventoryand preparation costs. While transportation costs have a significant impact on the level of tradability of goods, communication costs impact more on the extent of tradability of services[11].

Macroeconomic factors are a very important motive for FDI. For example, the exchange rate is crucial in the decision-making process for FDI and the transfer of capital. The current literature usually identifies a positive relationship between depreciation of the local currency and FDI (Froot and Stein, 1991; Klein and Rosengren, 1994; Barrel and Pain, 1998)[12]. MNCs look for countries which have stable macroeconomic variables and stable exchange rates as well. In last few years Serbia has had a relatively stable exchange rate.

On the other hand, human resources are another benefit for investment of international companies. The work force is well-educated with 243,000 active students studying in five university centres across Serbia. Human resources in Serbia are highly skilled and multilingual, with about 62% (appr. 4.6 million) of the total population of working age and, based on 100K+, 86% of the population has good English language proficiency, 12% Russian and German, 6% French and Spanish, and 4% are proficient in Italian[13].

Rating agencies, organisations like the World Bank and business magazines rate countries according to the conditions for doing business in them. This measure can help potential investors analyse even further their perspectives when choosing a recipient country for FDI. According to the World Bank[14],

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[10] Statistical Office of the Republic of Serbia, 2015.

[11] HUMMELS D. (2007) *Transportation costs and international trade in the second era of globalization*, The Journal of Economic Perspectives, 21(24), pp. 131–154.

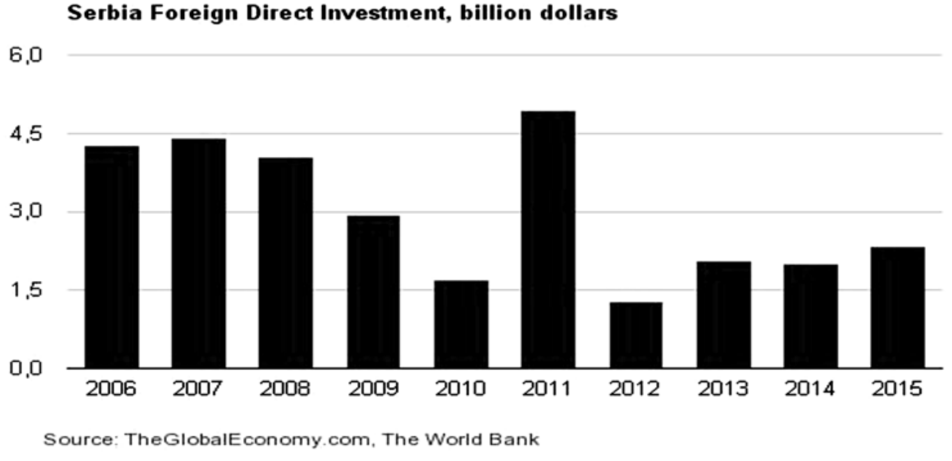
[12] *Why do firms invest abroad?* An analysis of the motives underlying Foreign Direct Investments, Chiara Franco Francesco Rentocchini Giuseppe Vittucci Marzetti August 2008 *The ICFAI University Journal of International Business Law*, 9, (1–2), pp. 42–65.

[13] InfoStud indication of knowledge of languages, based on 100K+.

[14] http://www.doingbusiness.org/rankings.

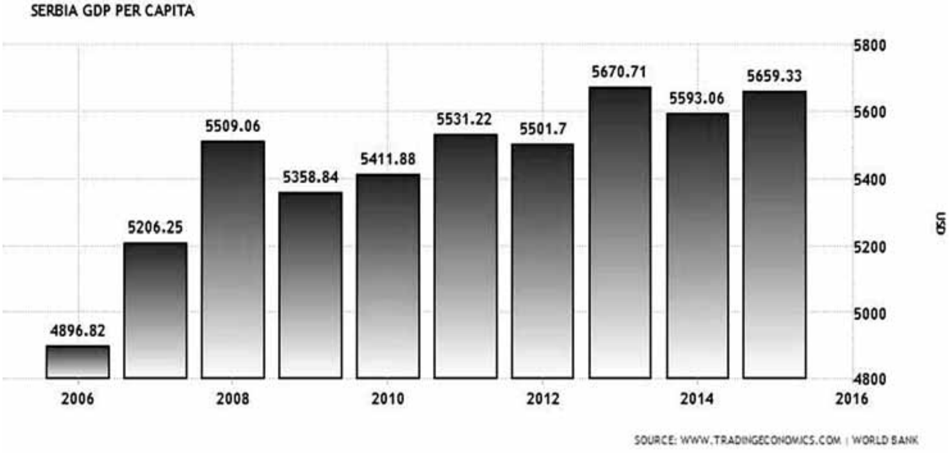
for 2016 the top location for FDI in Europe and Central Asia was Macedonia, ranking 10th worldwide, while Serbia is ranked as 47th. A favourable business climate is crucial for attracting investments including FDI. This is why continuous efforts for improving and maintaining the image of our economies are needed.

Figure 1. The Value of FDI in Serbia



The amount of FDI in Serbia varies yearly. Before the financial crisis, for the years 2006 and 2007 it was about 4 billion USD. Following the crisis, the value gradually reduced from 2008 to 2010 to 1.6 billion USD yearly. In 2011, there is a spike and the total amount was almost 5 billion USD. From 2012 to 2015 investments have gradually increased and for 2015 the amount is about 2 billion USD.

Figure 2. GDP Per Capita in Serbia



GDP per Capita in Serbia was steadily growing in the period 2006–2008, from 4897 USD to 5509 USD. This was an increase of 12.5% for the whole period and about 4% annually. In the years after 2008, the index steadied to around 5500 USD and in 2015 it amounted to 5659.33 USD. In order to establish a statistical correlation between the two total amounts of FDIs for the examined period, we need two total amounts of the GDP.

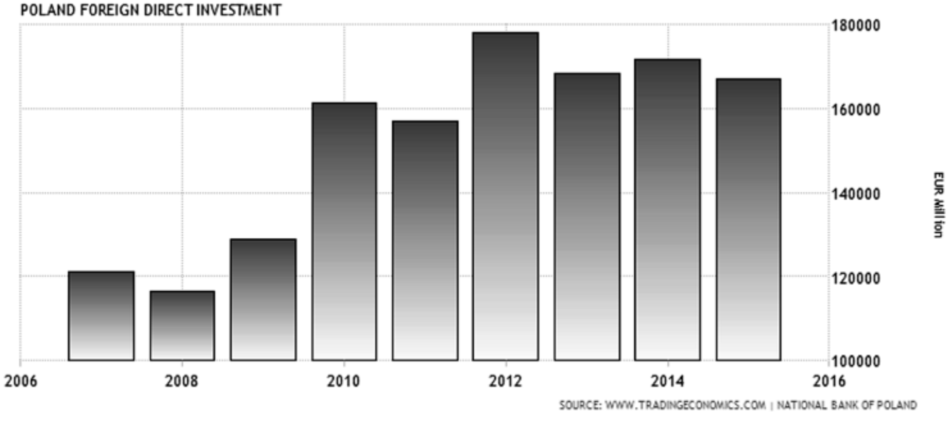
When comparing the tendencies of movement in the amount of FDI and amount for the period 2006 to 2015, a coefficient of positive correlation of 93.2% is calculated. This is a strong positive correlation that indicates a positive connection between those two variables. In next section, we will test correlation between the same variables in Poland.

Benefits of investing in Poland

The investment environment in Poland is specific because of the great disparity in terms of economic development between the eastern and western parts of the country. In order to overcome this problem, the Responsible Development Strategy anticipates and defines the measures of social and economic development of every region. The main fundament is reflected in the assembly of a number of smaller municipalities and smaller regions to make a larger region. In order to harmonise the socio-economic development of the Poland provinces, it is necessary to stimulate the macroeconomic environment to make it more attractive in order to attract foreign investments.

Diagram 3 indicates that there is a relatively stable FDI value in the past three years with an indicated fall from 2012. Analysing the data and the value of FDI in 2015 it is noted that the largest number of investments are coming from the most developed EU countries: Great Britain, Germany, Austria and others. It is expected to have an inflow of foreign investments to Polish economy.

Figure 3. The Value of FDI in Poland



Further analyses of FDI indicates that most of the investments are concentrated in the manufacturing sector, followed by scientific and technological developments and companies in the field of information and communication technologies. Data shows that a significant presence in the manufacturing sector compared to the service sector is because of an adequate country investment strategy. In other words, investing in production contributes to the growth of the employment rate, because only the manufacturing sector can become a strong input for the economy in the future.

This is supported by data from the National Polish Bank indicating that in 2015 the number of unemployed fell by 260,000. Furthermore, in November 2016, also according to the data of the National Bank of Poland, the unemployment rate was 8.2% which is the lowest rate since 1991. This is the result of long-term strategies to reduce the unemployment rate and the increase of trained workers with appropriate skills.

Conclusion

Given the collected and analysed data and theoretical developments in the field of FDI the basic assumption in the paper is presented. It is confirmed that the degree of economic development significantly depends on the levels of FDI and that the increase of direct investment shows a positive correlation with the regional development which is the subject of this paper.

Furthermore, FDI represents a reduction in regional disparities because it directly contributes to the regional development and a reduction in the unemployment rate.

Finally, the Polish model in terms of a reduction in regional inequality and an increase in economic wellbeing may be partially applied to the Republic of Serbia while implementing the Regional Development Strategy.

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Wpływ bezpośrednich inwestycji zagranicznych na rozwój ekonomiczny Serbii i Polski

Streszczenie

Inwestycje są kluczowe dla rozwoju gospodarczego. We współczesnym środowisku intensywnych powiązań finansowych z ekspansją firm ponadnarodowych, znaczna część inwestycji jest dokonywana przez firmy zagraniczne. Czynnikami korzystnymi dla bezpośrednich inwestycji zagranicznych (ang. FDI) są zasoby naturalne, położenie geograficzne, specyfika siły roboczej, poziom technologii oraz inne warunki w danym kraju. Intensywny proces globalizacji w ostatnich dekadach przyczynił się do łatwiejszego przesuwania kapitału poprzez usuwanie ograniczeń. Głównym celem tej pracy jest zbadanie charakteru FDI w Serbii i Polsce oraz ich roli we wzroście gospodarczym a także ich wpływu na lokalne gospodarki. Praca ta przedstawia analizę porównawczą pomiędzy Serbią a Polską w zakresie wpływu FDI na rozwój gospodarczy obu krajów.

Słowa kluczowe: wzrost gospodarczy, FDI, rozwój, kapitał

Impact of FDI on the Economic Development of Serbia and Poland

Abstract

Investments are crucial for economic growth. In the contemporary environment of intensive international financial connections and with the expansion of transnational companies a substantial part of investments are made by foreign companies. Beneficial factors for foreign direct investments are natural resources, geographical position, specifics of the labour force, the technology level and other specifics for certain country conditions. The intensive globalisation process in recent decades contributed to an easier movement of capital by cutting restrictions. The main purpose of this paper is to investigate the nature of FDIs in Serbia and Poland and their role in economic growth, as well as the effects they create in local economies. This paper will show a comparative analysis between Serbia and Poland regarding the impact of FDIs on the economic development of both countries.

Key words: economic growth, FDI, development, capital

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