ORIGINAL SCIENTIFIC PAPER

CONTROVERSIES OF FOREIGN DIRECT INVESTMENTS - THE CASE OF SERBIA

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ABSTRACT

Foreign direct investments (FDI) represent one of the flows of international movement of capital that can affect positively and negatively the macroeconomic factors of development of the country of origin, as well as the host country. The Republic of Serbia has been attracting significant foreign direct investments in recent years, with its promotional legislation, natural and human resources, and strategic and market position, which is also visible in the reports and evaluations of the most eminent international organizations. In this regard, the objective of this paper is, in addition to a theoretical approach to the types and carriers of FDI, the advantages and disadvantages of the impact of FDI on the economic and social development of the country receiving investments, to investigate the views of foreign investors themselves on their motives for investing in Serbia. In this respect, for the purpose of elaborating the hypothesis about the diversity of influence and investment motives of foreign investors, an empirical study was carried out on a sample of 53 FDI companies from the territory of the entire Serbia in 2022. The results showed that the primary motives for FDI in Serbia are: The possibility of exporting to other markets, political relations between the investor's country and the country receiving the investment, and subsidies and incentives for employment. The results of the research in this paper can be useful to decision-makers on the improvement of the legal and business framework for attracting direct investments to Serbia, as well as the educational, technological and innovative infrastructure in motivating FDI for investments in high technology sectors so that their impact on the macroeconomic development of the country would have a greater added value.

Keywords: *FDI inflows, legal and business framework, greenfield investments, economic growth*

JEL: F30, G11, O40, P33
DOI: 10.5937/intrev2304134B
UDC: 339.727.22(497.11)
338.24.021.8(497.11)
COBISS.SR-ID 133920521

INTRODUCTION

International capital flows represent the transfer of real and financial assets and they are very important for the functioning of the economies of both developed and underdeveloped countries. These flows are a consequence of the fact that some countries have excess assets, while others have a deficit. The largest volume of international capital is carried out between the most developed countries for the reason that less developed countries, due to insufficient competitiveness, most often appear as recipients of capital, and less often as exporters of capital, but appear as exporters of raw materials [6].

According to the UNCTAD World Investment Report for the year of 2021., FDI inflows dropped by 19% in 2020., from 4.3 billion USD in 2019. to 3.4 billion USD, as a result of the global economic crisis caused by the Covid-19 epidemic. In 2020., the total amount of FDI was 51.8 billion dollars. The COVID-19 crisis mainly affected reinvested earnings. The economic decline also affected export-oriented activities, because problems in GVCs, of which Serbian companies were an integral part, led to the interruption of manufacture. The manufacturing sector, including machinery and equipment, metallurgy, and the rubber and plastics industry, were most affected by the decline of FDI. Despite trade disruptions and GVCs, the automotive industry still saw some expansion, such as the Magna Seating plant and Cooper Tire & Rubber (USA). In the services sector, the decline of FDI also affected a wide range of activities, including construction, trade, and transport and storage. Nevertheless, Serbia remains the second largest recipient of FDI among economies in transition after the Russian Federation. The European Union is the source of 70 percent of investments in Serbia, followed by Russia, Switzerland and Hong Kong. However, inflows from various FDI source countries, including Austria, Germany and Hungary, as well as the Russian Federation and the United States of America, declined significantly in 2020. According to official sources, Serbia attracted 4.4 billion dollars in foreign direct investments in 2021., which contributed to the opening of production facilities in Zrenjanin, Indjija, Backa Topola, Belgrade, Aleksinac and Subotica, thus creating a total of 12,490 job positions. According to the Data of the National Bank of Serbia [24], the inflow of foreign direct investments reached record levels of about 8% of GDP in 2021.

LITERATURE REVIEW

UNCTAD defines foreign direct investments as investments aimed at long-term and permanent interest and control of a business entity-investor from one country in relation to another business entity from another country. FDI can appear through [30]: Establishment of completely new capacities (*Greenfield investment);* Cross-border acquisitions and mergers; Contracted joint ventures; Equity investments; Brownfield investments; and Concessions.

Since international capital flows represent the transfer of real and financial assets, these flows can be divided according to Beslac [1:168] into two types: international movement of private capital (loans, portfolio investments and FDI) and movement of public capital.

The international movement of loan capital has long been the dominant movement of loan capital. This capital moved from developed countries towards developing countries. Portfolio investments represent institutions granting loans and buying securities to a level which prevents them from making decisions and controls, on which the investments were made [21]. The motive for portfolio investments is interest, dividend or some other type of income (capital gain), but at the same time these investments also achieve diversification of the investor's risk, because investing in several types of securities reduces the risk of investment. Foreign direct investments represent such investments that provide the investor with the right of ownership, control and management of the invested capital [6]. Foreign direct investments, i.e. foreign capital, means investments from abroad, which come from private sources (institutions, companies, international organizations), but also from states and individuals [7]. It is significant for foreign direct investments that it is not necessary to achieve 100% control over the company, but to achieve such a level of ownership that allows the investor the right to manage and conduct business policy.

It is considered that the holders of FDI are multinational or transnational companies. Although some theorists distinguish between transnational and multinational companies, there is essentially no difference between them. Transnational or multinational companies are business companies that have their registered office in one country (parent company), but establish their branches (affiliations) in other countries around the world (subsidiary companies), to whom they transfer funds with the objective of returning these funds to them, which results that their financing has the same effect as lending funds. However, since the establishment of subsidiaries abroad in the form of foreign direct investment aims to achieve ownership, the ability to manage and control over the established or some other form of foreign direct investments, it cannot be said that lending is the same as investing through FDI. Foreign direct investments imply the possibility for a company in one country and its subsidiary in another country to produce the same types of products (horizontal organization) or for the products of one company to be inputs for another company abroad (vertical organization) or to manufacture several types of different products or services (conglomerates) [1]. FDI, according to the *platform* principle, refers to the fact that the company expands to a foreign country, but the production from foreign operations is exported to a third country. This is also called FDI on the export platform. This raises the question of why the same company manufactures the same type of product in two different places (two countries) [7]. This issue is often seen as one of location and internationalization. The theory of location is closely related to the theory of trade, it is based on resources, which indicates that where the best or rare and necessary resources are, that is where economic activity takes place. The location for the manufacture of certain products, in addition to others, is also determined by the factors of transportation costs (The impact of the amount of transportation costs on competitiveness and profit, is moving manufacture to closer markets).

Modern economies are based on new organizational forms, new technologies, and new ways and models of gathering information, both about consumer needs and tastes, as well as the width, depth, and types of markets. All this contributes and creates conditions for transnational companies to carry out intensive expansion of their activities, with the objective of maximizing profits. Their target are countries, i.e. underdeveloped or less developed markets that lack domestic capital, and therefore have a need for foreign direct investments with the objective of ensuring economic development, employment, new technologies and an increase in the gross national product. [29].

The international movement of capital, observed as a consequence of globalist changes, the development of financial markets, the actions of multinational companies and global organizations such as the IMF, the World Bank, the World Trade Organization, contributed to the opening of the markets of less developed and underdeveloped countries to developed markets. This further affected the increase in living standards in these countries. But globalization also has another, negative side. It was created under the influence of developed countries that want to realize their interests in all spheres of life without paying much attention to the interests of other, less developed and underdeveloped countries. Namely, developed countries are not open to all products and services from underdeveloped and less developed countries, but that is why they strive for these countries to be completely open to all their economic and other activities. In relation to these movements, FDI can have positive, but also unfavorable effects on the macroeconomic factors of development of both capital-exporting countries and capital-importing countries. There are numerous studies conducted by various authors in developing countries, as well as in developed countries related to FDI and their effects on the macroeconomic parameters of the development of those countries as investment hosts. The majority of authors see the positive effects of these investments, and in this regard the following studies are cited: Borensztein et al. [8], believe that FDI have the ability to affect the transfer of technology more than domestic investments. They included 69 developing countries in their study. Durham [11], claims that there is a direct positive impact of FDI portfolio investments on the development of the country, as a result of the research of 80 countries. Authors Güner, and Yılmaz [14], investigated the impact of FDI on development in 104 countries and concluded that they have a positive effect on capital accumulation and development in those countries. Alfaro et al. [1], on the example of 20 OECD countries and 51 country that are not members of this organization, concluded that, mostly countries that had a developed financial market also received benefits from FDI, while at the same time not realizing the automatic direct positive effects of FDI on the economic development of these countries. countries. Balasubramanyam, Salisu, and Sapsfort [2], studied aspects of the impact of FDI on the development of employment and skills of workers based on a study conducted in 46 countries. They stated that for a positive impact of FDI on the development process itself, the most important prerequisites are labor relations, respect for labor standards and training of workers. They also believe that exporting countries can have greater benefits from FDI. Bornschier, Chase-Dunn, and Rubinson [9], by conducting a study on the impact of FDI on the development of 76 less developed countries, came to the conclusion that these investments in themselves do not significantly affect the economic development of these countries, but that they positively affect it by increasing the level of the country's income. De Mello [10], based on a study of 32 OECD countries, stated the irreversibility of FDI and technological development, by emphasizing the positive impact in countries that are technological leaders, and less in those that are less technologically developed. Duttaray [12], by studying FDI flows in 66 developing countries, reached the result that in less than 50% of these countries the impact of these investments on their economic development was achieved. Basuand and Guariglia [3], in their research in 119 countries on the effects of FDI, concluded that they affect the economic development and improvement of skills and knowledge in developing countries, but also reduce the participation of the agricultural sector in the country's GDP. Basu, Chakraborty, and Reagle [4], have, by studying FDI in 23 developing countries, concluded that the positive impact of FDI on economic development occurs in the long term, and that it is not visible in current development.

The authors Bengoa, and Sanchez-Robles [11], believe that economic freedoms in a host country are an important determinant of attracting FDI, which will influence the positive flow in further economic development. Hansen, and Rand [15], believe that there is a strong connection between FDI and GDP growth in developing countries, by studying 31 country in their study. Hermes, and Lensink [16], believe, based on a study conducted in 67 less developed countries, that the prerequisite for a positive impact of FDI on development in a host country is the level of development of the financial market and institutions. Authors Hsiao, and Hsiao [17], by studying FDI in 8 countries and their contribution to development, came to the conclusion that these investments affect export and thus indirectly contribute to the economic development of the country. In a study conducted by Hyun [18], in 59 developing countries, by investigating the impact of FDI on macroeconomic indicators, he came to the conclusion that these investments have little positive effects on the current economic development in those countries. Johnson [20], in his study conducted in 90 developing and developed countries, stated that FDI flows accelerate the economic development of developing countries, which is not valid for developed countries. Li, and Liu [22], studied the impact of FDI on the development of 21 developed and 63 developing countries and came to the conclusion that the influence of endogenous factors of the connection between FDI and economic development has increased since the eighties, and also the connection of FDI with human and technological capital of those countries.

Menzinger [23], believes that FDI affect economic development, but they do not affect FDI flows, based on a study he conducted on this topic in 8 EU countries. Papanek [25], conducted two studies on the effects of FDI on the economic development of FDI recipient countries, the first on a sample of 34 countries and the second on a sample of 51 country in a ten-year interval. He came to the conclusion that: savings and FDI flows make up one third of the economic development of these countries, and that foreign aid has a greater impact on economic development than other incomes. He also concluded that there is no mandatory connection between FDI and foreign aid and an implied correlation with per capita income and the size of the country itself. Zhang, and Ram [30], based on their research on FDI in 85 countries, came to the results that confirm the positive relationship between these investments and the economic development of those countries.

RESEARCH RESULTS AND DISCUSSION

***Motives of the inflow of foreign direct investments*.** The development of the economy of each country depends on many factors. FDI, although they are not one of the most important factors in the development of every country, occupy a significant place. Countries that do not have enough of their own capital for investments and thereby ensure higher rates of economic development, as an imperative, attract FDI [26]. FDI have many forms and all these forms do not affect the economic development of the country receiving the capital in the same way, nor do they have the same effect on the country providing the capital. Therefore, FDI cannot be viewed only through the economic effects achieved by the recipient country or the capital donor country, but the role of FDI should be observed through the prism of various other effects such as employment, technology transfer, increase in the living standard of the population, increase in income per capita, infrastructure improvement, social effects. FDI have a complex effect on numerous factors of the overall economic life of the host countries as well as on the overall economic life of the countries providing the capital, but at the same time on the domicile, regional and global markets.

In principle, the inflow of FDI depends on the business environment, that is, the investment conditions of the host country as a potential capital investment destination. The basic business environment (investment conditions) of a country or destination for FDI inflow is characterized by the openness of the country or destination, on the one hand, and the risk assessment of a particular investor. In order for an investor to invest in another country or destination, he analyzes and evaluates the economic and political risks. Namely, every investor wants to know in advance predictable and low-risk conditions, which means that he wants stable macroeconomic conditions characterized by stable economic growth, stable and predictable exchange rate, low or predictable inflation rate, stable market, etc. Since foreign investors almost as a rule come from developed countries, where macroeconomic and microeconomic conditions are stable, they want to know in advance the rules of conduct from which there will be no significant deviations. This primarily refers to the rule of law and clear and unambiguous procedures that will not change from case to case. In the event that there is no rule of law and procedures are often changed, potential investors risk higher costs, which then reduces their planned profit, that is, there is uncertainty about realizing the planned profit. For investors, it is important that the political relations between the country from which the investor comes and the country to which the investor comes are at a high positive level, because political relations are the basis of all other relations.

The location of the investment destination still plays a very important role (but not the decisive one), its proximity to developed markets, lower transport and other dependent costs. The low cost of labor is also an important factor for making investment decisions because it reduces the price of products and thus they become more competitive in terms of price. Training and productivity of workers, labor standards, labor laws and labor relations are also very important. Quality infrastructure and the possibility of using different forms of energy, the development of telecommunications and the availability of modern communication networks, also influence the positive decision of a potential investor, as well as the promotion of FDI [19]. In addition to these elements, the following factors are important for foreign direct investments:

1. Low prices of energy and raw materials also contribute to the reduction of business operations' costs, and thus to the increase of profits.
2. Completion of the production process.
3. Market expansion. A number of investors who come to Serbia are motivated by exports to the Russian Federation, with which Serbia has an Agreement on Free Trade without customs and other obstacles.
4. Free zones, because using them reduces customs and tax burdens.
5. Securing political influence: This motive is most present when states appear as investors, but political influence can also be achieved through private investors.

If there are more factors in the capital receiving country that positively influence investors from other countries - capital providers, consequently the inflow of FDI will be greater [27]. The authors of this paper believe that a special motive for accepting foreign direct investments is to eliminate the possibility of the introduction of sanctions by the country providing the capital, as this would endanger their own company.

Serbia was chosen for the assessment of foreign investors' investment motives and the contribution of FDI to the development of the host country due to its realized investments, as well as the legal and business framework for these investments, which were evaluated by the World Bank with top marks: (T.1).

Table 1. *Comparison of the index of protection of foreign investors in Serbia, 2022.*

	Serbia	Eastern Europe & Central Asia	United States	Germany
Index of Transaction Transparency	6.0	7.5	7.0	5.0
Index of Manager's Responsibility	6.0	5.0	9.0	5.0
Index of Shareholders' Power	5.0	6.8	9.0	5.0

Source: [31]

In the overview of the flow of FDI to Serbia, it is important to point out that the intensification of the inflow of FDI in the Republic of Serbia occurred after 2000. through the process of privatization. Then the most productive companies were privatized, such as cement factories, breweries, sugar factories, the dairy industry, telecommunications and the like. According to available data, in the period from 2001. to 2011., the inflow of foreign direct investments in Serbia amounted to 15,100 million. euros [19]. In this period, the largest inflow of FDI was in 2006., since in that year Mobtel was sold to the Norwegian Telenor for 1.6 billion euros. After that, in 2007., 2008., 2009. and 2010., there was a decline in FDI due to the decrease in the dynamics of privatization (because until 2006. the main source of FDI was the privatization process), but also due to the effects of the global economic crisis [13]. It is necessary to say that in this period not only Serbia was interested in attracting FDI, but all the countries of the Western Balkan region, which in the meantime has been transformed into a market with dynamic growth [29].

Table 2. *Overview of FDI in Serbia in the period 2010.-2021. and basic macroeconomic indicators*

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
FDI[1] in mil €	1,278	3,544	1.008	1.547	1,500	2.114	2.126	2,548	3,464	3,915	3,038	3,866
Real growth of GDP[2]	0.7	2.0	-0.7	2.9	-06	1.8	3,3	2.1	4.5	4.3	-0.9	7.5
Foreign exchange reserves in mil. €[2]	10,000	12,058	10,915	11.189	9,907	10,375	10.205	9,962	11.262	13,378	13,492	16,499
Unemployment[2] per survey	20.9	24.9	25.9	24.0	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.0
Public debt[2] in % of GDP	39.5	42.8	52.9	56.0	66.2	70.0	67.7	57.8	53.6	51.9	57.0	56.5
Foreign debt in mil €[3]	24,123	25,645	25,644	25,679	26,234	25,260	25,526	26,662	28,254	30,787	36,488	36,986
GDP in mil. €[2]	31,548	35,432	33,679	36,427	35,467	35,740	36,779	39,235	42,892	46.005	46,815	53,329

Source: [24]

The above data show that 2011. was a record year for the inflow of foreign direct investments. In 2012., there was a decline of FDI, but growth started already in 2013. The biggest contribution to the inflow of FDI in 2013. was the sale of the trade chain: Delta Maxi to the Belgian company: Delhaize for about 900 million euros. In 2019., FDI amounted to 3,915 million EUR, and in 2021., FDI increased compared to 2020. and amounted to 99% compared to 2019., and 27% more compared to 2020. The pandemic years 2020. and 2021. did not significantly affect the inflow of foreign direct investments, so that in 2020. they amounted to 77% compared to the pre-pandemic year. In order to determine the impact of FDI on the Serbian economy, it is necessary to analyze GDP growth, the unemployment rate, the rate of economic growth [5] as well as the amount of public debt.

The previous table shows that in the case of Serbia there is no complete correlation between the inflow of FDI and basic macroeconomic indicators, which means that FDI legitimately do not affect GDP growth, unemployment reduction, public debt or foreign exchange reserves.

SAMPLING

For the purposes of this paper, in addition to the theoretical, an empirical research was conducted on the views of companies - direct foreign investors, on the topic of the level of significance of motives for FDI in Serbia. Respondents, representatives of FDI companies, were offered a set of motives that they had to rank and highlight the priority motives according to them. 53 companies from all over the country participated in the research in 2022. The survey used a questionnaire and online and telephone communication with respondents. (Out of 157 questionnaires sent to FDI companies, 33,75% expressed interest in this research).

Table 3. *Motives for investing in the Republic of Serbia*

Basic motives for investing in Serbia						
Existence of professional staff	Placement of products and services on the domestic market	The possibility of exporting to other markets	Stable legislation	Political relations of the country from which the investors come and the host country	Monetary incentives per employee	Stable tax policy
8%	6%	25%	11%	21%	18%	11%

Source: Authors

According to the results of the survey of the views of representatives of the FDI companies that participated in it, the most important motive for investing in the Republic of Serbia was the possibility of exporting to other markets, i.e., to those countries with which Serbia has concluded Agreements on Free Trade (Russian Federation, EU, EAU, EFTA, CEFTA, UK, Turkey). In second place are the political relations of the countries from which the investors come and the host countries. This motive is objectively significant if it is taken into account that due to the conflict between Russia and Ukraine, various types of sanctions have been imposed on Russia, and numerous foreign investors have withdrawn from the Russian market. In third place are monetary incentives per employee. Although the survey showed that this motive is in the third place according to the way the respondents ranked the motive (first they put this motive in the first or second place, and then move it to the third place or even lower), which is why the authors of the paper got the impression that this motive is more significant than the final grade given by the respondents. Perhaps the most important motive of FDI. If it is taken into account that Serbia encourages foreign investors by providing them with grants of several tens of thousands of euros for each new job position, then this motive really has a great advantage over other motives. In addition, the importance of this motive is also evident from the fact that a number of companies leave Serbia after engaging all means of incentives. So far, the following companies have done this: Bertex Textile, Geox, Shinwon, Simit Saraj, Home Plus, Spilit, Servfood, Hendi, Leonardo, Gold exchange.

Most often, departing companies leave employees without a resolved employment relationship, with debts to employees and to the state. An interesting result of the research is that it shows that the market of the host country is not particularly important to foreign investors, nor is the existence of professional staff, because it is common for them to carry out training and further training, taking into account the technology they bring.

CONCLUSION

Research of the motives of foreign direct investments and the effects on investors and the recipient country are different. The paper deals with the advantages and disadvantages as well as the motives of FDI in Serbia. It can be concluded that the positive effects of foreign direct investments on the importing country are reflected in:

- import of additional accumulation into the host country, they do not require the return of the investment amount nor is interest paid, as is the case with loan capital. At the same time, they contribute to economic development, which is reflected in the growth of the gross domestic product, and have a positive effect on the reduction and stabilization of inflationary trends, then improve the balance of payments. These investments, since they employ a large percentage of the domestic workforce, affect the reduction of the unemployment rate, i.e. increase the employment rate, and thus by paying taxes and contributions on the salaries of employees, they increase public revenues, while at the same time increase consumption and the standard of living of the population. Regardless of whether it is investing in less developed, undeveloped or developed countries, FDI bring new technologies that are very important for the host country. The market (goods and services) is increasing, both in terms of quality and volume, which in the extreme can (but not necessarily) lead to lower prices, but certainly increase export (a large number of foreign investors invest in other destinations not only for the purpose of expanding the market in those destinations, but also for the purpose of exports) which positively affects the trade and balance of payments of the country.

It can be concluded that the negative effects of FDI on the host country are reflected in:

- Possibilities of irresponsible use of domicile resources (natural resources and labor force) under the exclusive interests of investors, the use of qualified labor force which is paid several times less than the same or similar personnel in the country from which the investors are coming,
- Frequent non-compliance with labor standards, workers' protection and industrial relations, which along with the insufficient interest of the established instruments of the social and economic entities of the host country in these matters leads to a kind of exploitation. Regarding the transfer of skills and knowledge, the educational system of the host country invests the most in the training and education of workers, and through additional training necessary for the investor, less often the investor himself. Since the most common foreign investments are in production with low or medium-developed technologies, the need for higher knowledge and skills is less frequent, so the transfer of technology itself is not carried out to the extent that FDI assume.
- When investing in the high-tech sector, the IT industry, telecommunications and energy, the highest quality personnel of domestic companies are taken over, which is otherwise in deficit (in the IT industry there is a permanent shortage of 38,000 experts per year), which weakens their competitive abilities. Foreign direct investors in the form of multinational companies or states, exert a very large influence on such consumption model (consumer society) that does not correspond to the population of the capital importing country. Also, foreign investors in the initial years of business operations, wanting to take over local markets, use dumping prices and thus destroy domestic competition, form monopoly or oligopoly markets from which only foreign investors benefit. A possible negative effect on the capital importing country is the violation of the sovereignty (political and economic) of the host country through these investments.

Looking at the data presented, the Republic of Serbia attracted 29,948 billion euros of foreign direct investments in the period from 2010. to 2021., and in the same period the foreign debt increased from 24 billion euros to 36 billion euros, which indicates that foreign direct investments did not contribute to the reduction of indebtedness. In the same period, GDP increased from 31 billion euros to 53 billion euros, which can be interpreted as a positive impact of attracted FDI in the country.

When it comes to motives for investing in the Republic of Serbia, research has shown that the most dominant motive for investing is the possibility of exporting to other markets. This motive is a consequence of the fact that Serbia has concluded Free Trade Agreements with Russia, Turkey, the EU, the EAU, the UK, the countries of the CEFTA Agreement and the countries of the EFTA Agreement. Another motive is the high-quality political relations between the country from which the investor of this motive comes and Serbia. The consistency of this motive is best seen from the example of Russia, from which many foreign investors left after its conflict with Ukraine. The third motive, which in the case of Serbia is probably the most significant, is the monetary incentives that Serbia grants to foreign investors for every newly created job position. If you look at the unemployment rate in 2010., which was 20.9%, and in 2021., it was 11%, it can also be linked to the positive impact of FDI inflow. However, this motive also has its negative aspects, because foreign investors, after spending the monetary incentives, can go to another destination without any consequences, which ten foreign investors have already done in Serbia.

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Article history:
Received 29 November 2022
Accepted 3 Octobar 2023