THE IMPORTANCE OF REVIVING FOREIGN INVESTMENTS FOR THE YUGOSLAV ECONOMY [1]

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The period during the eighties brought economic stagnation in the former Yugoslavia. By the end of the decade it became clear that change had to be undertaken. Therefore, transition and privatization began in 1988, and the country opened itself up to foreign equity investment. It was an orderly and legally sanctioned transfer of the property from «the people» - the state, or other public bodies, to private entities - persons, partnerships and corporations. The establishment of wholly foreign owned enterprises was allowed with the complete liberalization of foreign investments. However, drastic changes in the Yugoslav economy have resulted from the crisis in the last five years. The beginning of the Yugoslav crisis had coincided with the profound changes in Europe after 1989, which soon brought about internationalization of the crisis.

Before the outbreak of the civil war Yugoslavia was in many ways similar to the other countries of Eastern Europe. On the other hand, it was also very different from them which could be supported by the fact that it was the only former socialist country which allowed its citizens to leave the country without any restrictions, and it was the first among them to allow foreign investment in its industries, which was way back in 1967 (on a fixed-term basis and with obligatory repatriation of investment).

Yugoslavia had attracted substantial foreign investment by 1992, when the UN Security Council applied sanctions against it, thus suspending all foreign investments, too. Foreign investments worth about US$ 3 billion have remained in the Yugoslav economy to the present day[2]. There is considerable potential for converting these contractual investments, which Yugoslavia is obliged to return, into permanent foreign investments. The agreed period for some of these investments has

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2 Federal Republic of Yugoslavia, *The Laws on Enterprises, Foreign Investment Property*, Jugoslovenski pregled, Beograd, 1996, p.16.

already expired and they are due to be repaid. Contacts with foreign businessmen and interest in investing in Yugoslavia quickly revived after the suspension of sanctions in November 1995. In first six months of 1996, the Federal Ministry of Trade registered about 334 foreign investments in joint ventures with domestic enterprises, the formation of 142 wholly foreign owned enterprises and 20 foreign investments in existing domestic enterprises. Most of the investors are from Italy, France, Germany and Austria, and they include Yugoslav who live and work in those countries[3].

1. The foreign investment legislation in Yugoslavia

The main piece of legislation relating to foreign investment in Yugoslavia is the Foreign Investment Law published in «Sluzbeni list SRJ» (Yugoslav Register), No. 79/94 and amendments to that law passed in June 1996, «Sluzbeni list SRJ» (Yugoslav Register), No. 29/96. The Law is based on the previous ones. As a matter of fact, the former Yugoslavia enacted the legislation which permitted the investment of foreign capital in 1967. Since then, the rules have been changed several times. However, the effect of the provisions was a certain slowdown in the flow of foreign investment into the country. The basic form of foreign investment in the former Yugoslavia was a joint venture agreement. It was an agreement made between a foreign and Yugoslav partner who are investing the resources necessary for joint ventures. The foreign partner might be either a natural or legal person, and the Yugoslav partner might be a Yugoslav enterprise[4].

According to the Foreign Investment Law, foreign persons may in-vest assets in enterprises and other forms of organizations for manufacturing or supplying services for the purpose of doing business in the Federal Republic of Yugoslavia, subject to reciprocity, and found enterprises in conformity with this Law and other federal laws. Therefore, foreign investment is subject to reciprocity. In other words, if Yugoslav residents are not allowed to invest in the country of registration or domicile of a prospective foreign investor, the principle of reciprocity would prevent the latter from investing in Yugoslavia. The Federal Ministry of Trade, by whom foreign investments are approved, establishes whether the reciprocity requirement has been met.

For the purposes of the Law[5], a foreign person shall be understood to mean a foreign legal entity whose head office is abroad, a foreign natural person, a Yugoslav citizen whose residence has been abroad for longer than a year, a mixed

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[3] Ibid.

[4] Yugoslav Chamber of Economy, *Doing Business with Yugoslavia*, Belgrade, 1986, pp. 145-163.

[5] Sluzbeni list SRJ (Yugoslav Register), No. 29/96, Article 2.

enterprise in which the share of foreign capital is greater than 51 percent and a foreign person which has founded a wholly owned enterprise in the territory of the FR of Yugoslavia; in reference to, a domestic person shall be understood to mean an enterprise, an entrepreneur and a natural person whose head office or residence is in Yugoslavia.

According to the Law, Article 3, a foreign person's investment consists of foreign exchange, things, services, proprietary rights, securities and dinars which are transferable abroad under foreign exchange management regulations. A foreign person may also invest the dinars stemming from the buying up and conversion of commitments (debits) based on certain foreign credits, or conversion of external debt in accordance with the Federal law. A domestic person's investment may consist of dinars, foreign exchange, things, services, proprietary rights and securities.

The amount of a foreign investment shall be specified in the investment contract or the founding contract or decision or some other document drawn up in conformity with Federal law.

1.1. The forms of foreign investment

A foreign person may do the following, either alone or together with some other foreign or domestic person:

a) found an enterprise, and

b) invest in an enterprise.

A foreign person may found in Yugoslavia a section of its own enterprise (branch), having the status of a legal entity and operating under the Yugoslav regulations. The manner of founding and operation of a section of a foreign enterprise (branch) shall be prescribed by the Federal Government. A foreign person may buy an enterprise or a section thereof or shares of an enterprise in conformity with the law. A foreign person may found an enterprise and invest in an enterprise in the territory of Yugoslavia in the manner and under the conditions set for domestic persons wishing to found an enterprise or to invest assets in an enterprise, unless otherwise provided by the Foreign Investment Law.

However, a foreign person may not found in the territory of Yugoslavia, either alone or together with another foreign person, an enterprise in the field of production of and trade in armaments and military equipment, public information, communication system (telecommunication facilities of international and national importance, integrated services networks and satellite telecommunications), public utilities (water supply and heating) or in any area which is deemed a restricted zone under the federal law[6]. That means, that mostly state-owned public enterpris-

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[6] Ibid., Article 7.

es are engaged in these activities. But a foreign person may found an enterprise in the areas and branches referred above together with domestic persons, and invest in an enterprise there. In such a case, the foreign person concerned may not acquire a controlling interest in the enterprise. This limitation relates to foreign person's minority participation in control. Shares and share certificates without controlling rights are exempt from this limitation. Therefore, a foreign person may be given a permit (concession) to use a specified natural resource or good in general use, or to pursue an activity of public concern. The conditions for being granted a concession and the duration of the concession contract and of the permit referred to above are regulated by the law[7].

The founding of and investing in insurance organizations, banks and other financial organizations, and free zones, are carried out in conformity with other federal laws governing their foundations and legal status[8].

Investment in free zones, profit transfer and repatriation of investment are subject to no restrictions. It is also permitted to take credits abroad for business in free zones or for creating conditions to do business there, as well as to grant credits to domestic and foreign legal entities operating in the zones. There are special incentives for foreign investment in free zones, which have been established in Belgrade, Novi Sad, Šabac, Niš, Zrenjanin, Sombor, Senta, Sremska Mitrovica and Prahovo in Serbia and in Bar and Kotor in Montenegro. Investors can lease buildings or land for the construction of buildings and other facilities from free zones and operate these facilities under terms negotiated with the management of the free zone[9].

1.2. Foreign Person's Rights and their Protection

According to the Law[10], a foreign person shall have the following rights stemming from its investment:

1) to control or take part in the control of the enterprise;

2) to transfer to other foreign or domestic persons its rights and duties as laid down in the investment contract or in the founding contract or decision;

3) to share the profit accruing from its investment and to transfer and reinvest such profit without any restrictions;

4) to restitution of some of the invested things, pursuant to the investment contract or founding contract or decision;

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7 Sluzbeni list SRJ (Yugoslav Register), No. 29/96, Article 20a-z.

8 Sluzbeni list SRJ (Yugoslav Register), No. 32/93; No. 55/93; No. 44/94; No. 14/94; No. 81/94.

9 *Investing in YU Financial Services*, Jugoslovenski pregled, Beograd, 1996.

10 Sluzbeni list SRJ (Yugoslav Register), No. 79/94, Article 11.

5) to restitution of investment or of the remainder of the assets invested in the enterprise in the event of cancellation of the contract, or on the expiration of the investment contract or of the founding contract or decision, or on the dissolution of the enterprise concerned;

6) to a share of equity and to the restitution of investment or assets upon dissolution of the enterprise, if it has invested assets towards the founding of the enterprise concerned;

7) other rights as provided by the federal and republic laws.

Of course, any foreign investment shall be regulated by an investment contract or a founding contract made in writing or by a founding decision, if the enterprise is being founded by one foreign person.

2. Economic potential and development prospects

The favorable geostrategic position of the FR of Yugoslavia, its outlet to the sea, the Danube, a network of international lines of communication, a relatively well developed infrastructure, abundant skilled labor force and considerable natural resources, as well as its contemporary legislation should be sufficiently attractive to foreign business, once the sanctions of the international community are lifted.

In relation to the size and population, FR Yugoslavia is well endowed with a wide range of natural resources. Some of the more important resources include metallic ores, nonferrous metals, lignite, coal, oil, natural gas, uranium ore, and rivers suitable for water power generation. However, while Yugoslavia's raw materials and basic resources are potentially very rich, dependence on oil imports and some other raw materials has been considerable and will continue to be as the Yugoslavia's industrial capacities keep on expanding[11]. The leading sector in the Yugoslav development strategy in the period after World War II has been its industry.

Yugoslavia is very much interested in attracting foreign investments which would speed up the national economic recovery. This is corroborated by the opportunity of importing the equipment being invested or procured on the basis of foreign investment without customs and import duties. The tax legislation of the republics provides further facilities. The existing low cost of skilled labor and other resources of this country, including its geographical position, should make Yugoslavia become attractive to foreign investment again.

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[11] Yugoslav Chamber of Economy, *Doing Business with Yugoslavia*. Economic and Legal Aspect, Belgrade, 1986, p. 24.

3. The return of FR Yugoslavia to the world capital market

In the period since the sanctions were imposed and up until the beginning of the implementation of the Program of Economic Recovery of FRY, the physical volume of industrial production decreased at a monthly rate of about 4% (estimated on the basis of the 1994 Statistical Almanac of Yugoslavia). In 1994, the Yugoslav gross domestic product fell by 41% in comparison to that of 1990. In the same period the number of the employed was reduced by 14,3%. In fact, the latest data show that the downward trend in the economy of FR Yugoslavia has been stopped, which was prominent for a long time, and in 1994 and 1995 the process of stabilization commenced, with the annual GDP growth rate of over 5 per cent. In the last two years FR Yugoslavia has been the country with the highest GDP growth rate among the Central-East and South-East European countries[12]. However, the inflow of foreign capital is of exceptional importance for implementation of its stabilization program of long-term economic development.

Judging by all facts, the return of FR Yugoslavia to the world capital market and fulfillment of elementary conditions for revival of the inflow of loan capital and direct investments will proceed very slowly. This even more for the fact that for more than three years there have been no direct investments in this country and the political risk has still been high.

Bearing in mind all the things mentioned above, one of the basic strategic aims of our economic and foreign economic policies is the revival of capital inflow to the Yugoslav economy. But the problem is how to achieve this.

Although legal regulations for foreign capital investment are favorable, there are yet some problems which make it less possible. The most significant factor that make foreigners hesitate or give up the idea of investment is the lack of «investment atmosphere» due to the high risk as well as the crisis of external solvency, comparatively small market, structural disproportion's, etc. Besides, the ownership transformation is still in process. Privatization is supposed to improve efficiency in the use of the assets, enable fairness in the distribution of wealth and welfare, and serve to abolish the one-party system. The tax legislation's are also not sufficiently selective in treating foreign investments - special inducements for transfer of the contemporary technology, investment in important branches of economy and some regions, as well as the origin of the investor. The selectiveness in tax legislation is characteristic for the newly-industrialized countries in Asia (Taiwan, Philippines, Singapore, South Korea, Malaysia and even China). Their experience in cooperation with the countries of their emigration is very significant.

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12 EIU, *The Economist Intelligence Unit, Country Forecast, Economies in transition. Eastern Europe and the former Soviet Union. Regional overview*, London, 1st quarter 1995.

For example the newly-established companies in production industries in Taiwan are exempted from profit tax in the first five years of their activities. As it was published in the journal «Union Bank of Switzerland» (Spring 1993) till the end of 1992 about 80 per cent of foreign investments in China originated from «the overseas Chinese», including those from Hong Kong, Taiwan, Singapore, Macao and others from all over the world[13].

What is even more important for potential investors is an appropriate protection policy which is a significant element in creating a setting for making profits. And profit is, of course, the driving force for the investor. Therefore, capital is invested in those countries where the greatest safety for the principal and profit rates are provided. Of course, it is hard to expect that Yugoslavia will become so attractive for foreign investors, including capital owners coming from our country, until the political stability is achieved and the inflation rate is kept within reasonable limits[14]. In spite of the fact that the labor force in Yugoslavia is cheap and legal regulations are favorable, including tax relieves, it cannot be counted to a great measure to «ethno-capital» in the conditions of economic and political insecurity, particularly bearing in mind the risk we have mentioned above.

Concerning the revival of foreign capital inflow the activities taken by the government in the sphere of economic policy are very significant. By taking appropriate measures the government constantly tries to encourage direct investments. These activities are taken even under the difficult conditions and in the future they will be intensified especially in the sphere of «promotional activities» of the domestic economy which should be presented to some potential partners.

Therefore, Yugoslavia needs foreign investment in order to achieve higher employment, alleviate brain drain problems, win additional markets and acquire new technologies. Yugoslavia is also aware that it has to compete with many other capital importing countries and offer appropriate terms to foreign capital.

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[13] Miao Jian Hua, *International Migration in China: A Survey of Emigrants from Shanghai, Asian and Pacific Migration Journal*, 3 (2-3), Quezon City - Philippines, 1994, pp. 445-463.

[14] Vladimir Grecic, *Oživljavanje priliva doznaka i kapitala naših radnika i iseljenika*, in Strategija povratka Jugoslavije na svetsko tržište, Editor T. Popoviæ, IEN, Beograd, 1994, pp. 154-158; Vladimir Grecic, *The Importance of migrant Workers' and Emigrants' Remittances for the Yugoslav Economy*, International Migration, 28 (2), Geneva, 1990; Predrag Kapor, *Strana ulaganja u domaæoj privredi, in Jugoslavija u evropskim finansijama*, Editor Prof. Blagoje Babic, Beogradski eskontni centar and IMPP, Beograd, 1993.