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The Importance of Foreign Direct Investments and Their Effect on Agriculture and Food Industry in Serbia

R. J. Jovanovic

Faculty of Agriculture, Pristina – Zubin Potok, Serbia

Abstract: Inefficient capital investments as limiting factors of development induce a decrease in future social wealth and Serbian export competitiveness problems. The study suggests the fact that these problems cannot be efficiently resolved without intensifying the foreign direct investment (FDI) inflow. Foreign direct investments are of particular interest to all transition countries, including Serbia, since, as opposed to other capital inflow modalities, the investment packages of FDI include, not only capital, but also technology, managerial and organisational know-how, foreign market access and the like. Therefore, they are essential not only in terms of development requirements of agriculture and food industry, but also in terms of the growth and maintenance of competitive positions and performances.

The establishment of favourable political, macroeconomic and legal frameworks for the FDI inflow is, therefore, an essential requirement of the development of agriculture and, hence, economy as a whole in Serbia as well as of the reintegration into world economic trends. Specific focus should be placed on export-oriented FDI requiring, therefore, continuous engagement in the coordination of the foreign trade policy following a precisely defined FDI attraction strategy. The carefully designed strategy should provide an adequate attitude to foreign investors, being in line with previous experiences of transition countries, particularly in terms of positive and negative FDI effects, with special reference to Serbia's experience.

Key words: Serbia, agriculture and food industry, foreign direct investments, inflow models.

Introduction

Foreign direct investments refer to the investments coming as foreign accumulation, i.e. as investments into local enterprises in the real and financial, i.e. banking sectors. The key characteristic of the inflow of foreign investment as

foreign direct investments is the purchase of local enterprises or banks or, more rarely in Serbia, the construction of totally new production facilities in the real sector of economy. Foreign direct investments as used in the present study refer only to investments in the real sector of economy. Foreign direct investments are, therefore, defined as the investments through which an investor acquires predominant or complete control over management of affairs and business operations of an enterprise. Other foreign investments through loans, gifts, grants, and other investment forms are "portfolio investments", which should be clearly differentiated from foreign direct investments. Over the 1992-1997 sanction period, average FDI in Serbia were \$ 178 million. The investment process over the 1998-2000 period was rather hampered, the economic development being hence affected as well.

Foreign investments are vital to the economic growth of developing and transition countries such as Serbia. Previous experiences have demonstrated the importance of foreign investments in the structural production and export changes in beneficiary countries. With international capital market access made difficult, foreign investment is seen as a way to engage foreign capital.

As Serbia does not currently have sufficient access to the international capital market, it is essential to consider the forms and mechanisms of foreign investments as alternatives to foreign borrowing. The inevitable structural changes of domestic production and export necessitate primarily modern equipment and technology imports. This objective can be achieved through more aggressive stimulation of FDI inflows into local economy.

1.1 Privatization to Achieve the Economic Development of Serbia

Given the fact that the goal of the transition process is market economy, privatization may be considered as its essential component, directly or indirectly affecting the direct attainment of major market economy characteristics such as: private property, the rule of law, competitiveness, efficient tax system, developed infrastructure etc. The ultimate goal of the privatization process itself is to increase efficiency and competitiveness of both the enterprise undergoing change of ownership and economy as a whole.

The market economy orientation also implies enterprise involvement in global economic trends. Since they are constantly subject to great oscillations, due to liberalization and deregulation, rapid strategic adaptation of all participants in the market game is a necessity. Here selection for sustainability is made of the enterprises with a good export portfolio or a competitive production mix. Both economic theory and practice show that these are, in fact, enterprises capable of investing primarily in new technology, that is those having and developing their capital intensive capacity to be valorized in the global market.

With this in mind, the role of privatization in a transition economy such as ours should not be restricted only to the technical preparation of the proprietary structure, but to improvements through increases in the investment capacity of enterprises. This can be considered from the viewpoints:

1. of new investments received in order to increase export performances of enterprises, and
2. of reinvestments, having broader social importance.

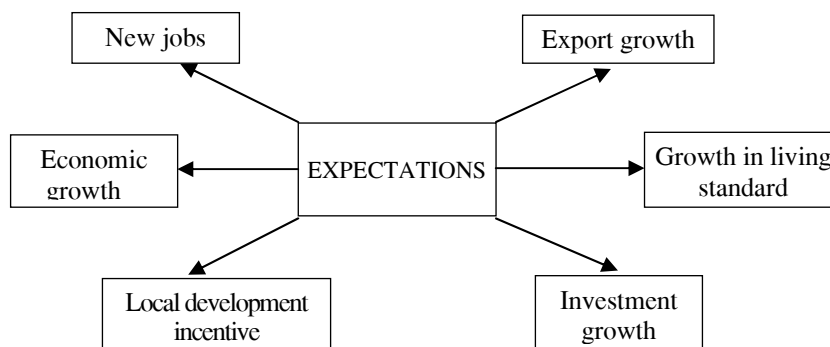
Both are dependent on the type of purchaser, that is, on their ability to conduct internal restructuring of business operations after privatization.

Privatization effects, coupled with an appropriate business environment, are essentially most dependent on the category of purchasers. These attitudes are shared by a large number of economic references. The most comprehensive analysis of privatization effects in transition countries, using the example of medium- and large-sized enterprises, was provided by Djankov and Murrell (2002). Apart from analyzing the empirical references on privatization effects, they particularly focused on the importance of specific forms of ownership, domestic and foreign competitiveness effects, consequences of some budget restrictions and of the effects of managerial capabilities on enterprise restructuring.

The analysis focused on medium- and large-sized enterprises, being actually the heart of economy and the future leading force in the process at the liberalization stage. The enterprises commonly operate within economy and society, their conduct certainly resulting from certain institutions and policies being radically modified in the 90-ies. These changes have induced the enterprises to adapt their conduct in order to survive or be successfully involved in the liberalized market environment.

The experience of the past ten years of transition has shown the superiority of economy financing through foreign capital as compared to domestic capital, since only a small number of local owners in transition economies can emerge as strategic investors in the primary activity, particularly with respect to the effect on export.

Generally, the current programme of privatization in Serbia is grounded on the investment potential of the purchaser as a strategic partner to start a chain reaction and trigger changes in an enterprise after the sale process (the sale of 70% of capital and property to one owner). Privatization-related expectations at macroeconomic level have been also high (schematic diagram 1). Some of them, however, are meant to be long-term (new jobs opened), considering the well-known fact that privatization results in the contrary – in an unemployment increase. However, theoretically, this can also be justified if privatization is seen as a pressure leverage on the economic policy to create new conditions for new jobs to be opened.



Schematic diagram 1. Expectations from the privatization process

The purchaser is directly expected to provide primarily the following: export growth, new investment growth (through direct investment or reinvestment) and local development incentives. However, these effects also necessitate monitoring of the strong interaction between two levels: the state– in charge of the development of a stimulating business environment, and the enterprise– where a new value is being created.

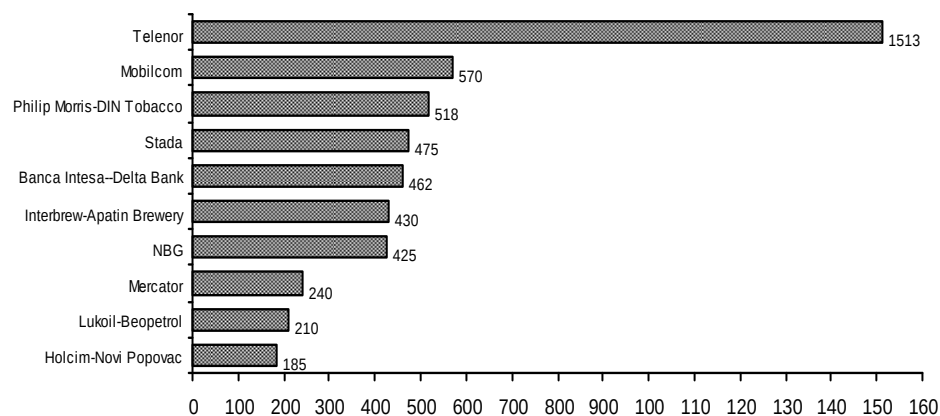
Since 2001, when a new privatization programme in Serbia was initiated, there have generally been several types of purchasers: domestic and foreign physical entities, domestic and foreign legal entities, consortia of domestic physical entities, consortia of domestic legal entities, and consortia of domestic and foreign natural and legal entities.

Table 1. Foreign purchasers in the privatization process until 2006 (in € 000)

Method	Number of enterprises	Selling price	Investments	Welfare programme
Tender	28	796,453	572,961	244,472
Auction	37	29,383	29,798	-
Capital market	56	151,308	26,840	-
Total	121	977,144	629,599	244,472

Source: Serbian Chamber of Economy, according to the Privatization Agency data

Considering the fact that tenders were invited in Serbia for the sale of large-sized and strategically important enterprises that had always been agents of the economic development and export, they were expected to be of interest mostly to foreign companies. These expectations came true, not in terms of the total number of enterprises sold to foreign purchasers, but rather in terms of their contribution to the budget inflow (about 70%) and contracted direct investments into enterprises (about 90%) of the overall amount.



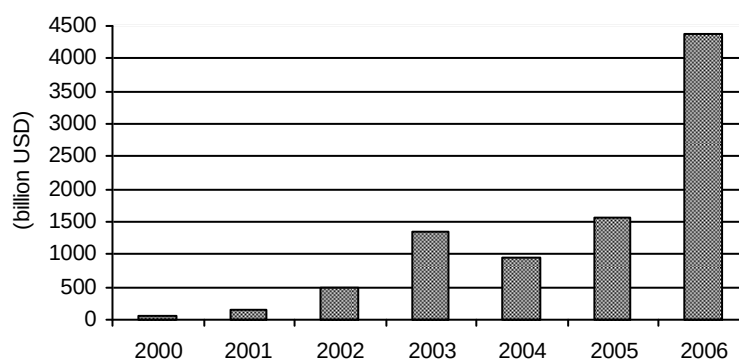
Graph 2. Major foreign investors in Serbia over 2001-2006

Graph 2 presents 10 major foreign investors in Serbia market over the 2001-2006 period (Source: Serbian Chamber of Economy, according to the SIEPE data). As seen in the graph, only three of the major investors, being Holcim, Lukoil and Philip Morris, were attracted through the real social sector privatization and Telenor, through the privatization of the public one. Other models of attracting foreign purchasers included: bank privatization, greenfield, into the service sector (Mercator, Mobilcom), whereas about EUR 1,423 million of the agricultural and food industry sectors have been privatized.

1.2 Fdi in the Republic of Serbia

The FDI inflow rate in Serbia (graph 3) during and towards the end of the nineties was recorded to be very low. Apart from the investments in 1997 (\$740 million) and 1998 (\$ 113 million), the annual FDI inflow did not exceed \$ 100 million until 2001. It was not only until 2001, 2002 and 2003 that FDI inflow started to increase – amounting to \$ 165 million, \$ 475 million and \$ 1.36 billion, respectively. The FDI inflow in 2004 decreased below \$ 1 billion and that in 2005 was recorded to be \$ 1.55 billion, the 2006 inflow reaching a record high of \$ 4.39 billion. The net FDI inflow in the first three months of 2007 was \$844.4 million (Petrovic and Jakopin, 2004).

The FDI inflow variation is not specific to Serbia. Namely, a considerable variation in FDI inflow on an annual basis is characteristic of all European transition countries, particularly so in the second half of the nineties. The institutional environment, privatization model and meeting the state debt service obligations are major factors accounting for the FDI inflow variation in the ETC. The effort to attract FDI through privatization has induced considerable annual inflow fluctuations in some ETC. Hence, different methods and the dynamics of the privatization process can account for specific differences in FDI trends.



Graph 3. FDI inward stock in the Republic of Serbia over the 2000-2006 period (net)

Source: National Bank of Serbia, Balance of Payments, Republic of Serbia (1997-2006).

Table 2. The Republic of Serbia – foreign investments in 2005 and 2006 by selected types of activities

	2005	2006
Agriculture	11,578	11,345
Processing industry	313,451	996,116
Food and beverage industry	65,132	78,370
Tobacco industry	44,175	43,717
Manufacture of textile yarns and textiles	10,347	33,052
Manufacture of wearing apparel and fur	1,072	10,177
Manufacture of chemicals and chemical products	19,215	661,062
Manufacture of plastic and rubber products	26,819	21,084
Manufacture of other mineral products	23,853	14,799
Manufacture of basic metals	19,784	23,778
Manufacture of fabricated metal products, except machinery	58,619	9,461
Manufacture of other machines and equipment	3,391	26,997
Manufacture of precision optical instruments	151	24,030
Furniture industry	19,959	4,149
Civil engineering	13,362	32,649
Wholesale and retail trade and repairing activities	356,037	466,787
Trade and repair of vehicles	54,640	24,261
Wholesale trade and intermediation	266,520	315,479
Retail trade, excepting vehicles; repairing activities	34,877	127,048
Traffic	11,663	1,581,031
Land and pipeline transport	10,083	18,513
Post and telecommunications	959	1,553,288
Financial intermediation	625,818	2,015,436
Financial intermediation	612,055	1,936,340
Insurance and superannuation funds	13,600	51,802
Real estate and renting activities	187,440	361,068
Real estate activities	14,605	90,629
Research and development	1,458	29,576
Other business activities	166,351	237,643
TOTAL NON-RESIDENT INVESTMENTS IN SERBIA	1,616,438	5,474,406
<i>Total inflow due to the withdrawal of resident investment from abroad</i>	<i>36,001</i>	<i>90,937</i>
<i>Outflow due to the withdrawal of non-resident investments in Serbia</i>	<i>-43,801</i>	<i>-1,065,924</i>
<i>Domestic investments abroad</i>	<i>-58,199</i>	<i>-112,040</i>
TOTAL	1,550,439	4,387,379

Source: "Serbia – Foreign Investments by Types of Activities in 2005 and 2006", NBS, Department of Economic Analyses and Research, March 2007

Note: Commodity and cash flows included; the table does not cover activities with FDI inflow below \$ 10 million in 2005 and 2006

The FDI inward stock for 2006 was \$ 9.8 billion. This undoubtedly indicated that Serbia lagged in FDI inflow (as far back as in 2000, the FDI inward stock in the Czech Republic, Poland and Hungary was above \$ 20 billion, hence two times the FDI inward stock in Serbia in 2006).

The regional distribution of inward FDI in Serbia (Table 3) was characterised by substantial inflow of foreign capital from neighbouring, i.e. transition countries of the South-East European region (Slovenia and Croatia being rated highest). There is similarity with other European transition countries, as far as major investors – Germany, Austria and the Netherlands are concerned; namely, these three countries, along with the USA and France, are key investors in almost all countries of the region.

Table 3. The Republic of Serbia: SDI inflow by countries (in cash – net amount – in thousand \$)

	2000-2004	2005	2006	Total
Norway	356	29	1,546,993	1,547,378
Germany	226,434	187,320	905,824	1,319,578
Greece	129,346	249,536	923,698	1,302,580
Austria	275,331	201,189	520,356	996,876
the Netherlands	703,321	92,113	-214,119	581,315
Slovenia	65,590	183,563	201,241	450,394
France	119,450	62,347	159,085	340,882
Great Britain	108,094	63,330	135,915	307,339
Hungary	22,233	24,677	244,045	290,955
Luxembourg	10,242	108,885	8,843	127,970
Croatia	51,591	40,484	25,240	117,315
Italy	41,627	18,316	52,752	112,695
Switzerland	44,994	56,990	-15,421	86,563
Bulgaria	10,172	655	54,270	65,097
Slovakia	18,365	25,447	19,325	63,137
Lithuania	32,417	6,441	10,527	49,385
The United States of America	53,603	22,257	-29,612	46,248
The Russian Federation	10,770	14,324	15,992	41,086

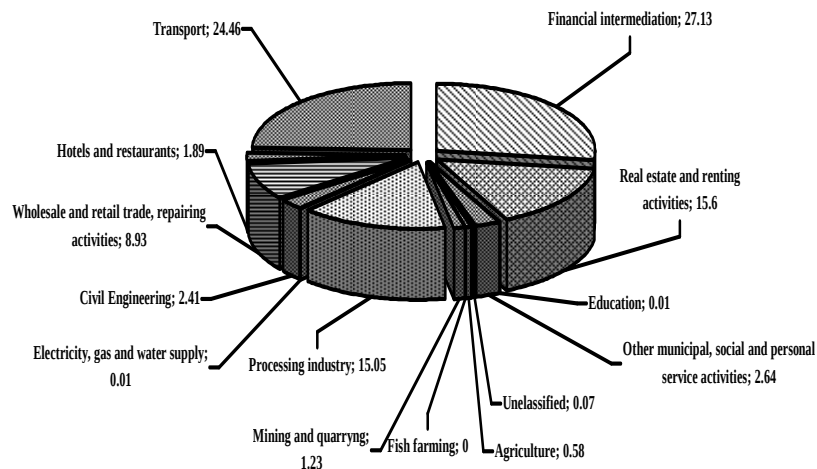
Source: National Bank of Serbia

Foreign companies that invested the greatest amount of capital through FDI in Serbia over the research period include the following: Telenor (telecommunications), Mobilcom (telecommunications), Philip Morris – DIN Tobacco Industry of Nis (cigarette production), Stada (pharmaceutical industry), Banca Intesa – Delta Bank (banking sector), Interbrew – Apatin Brewery (beer production), NBG (banking sector), Mercator, Lukoil – Beopetrol (petrol), Holcim – Novi Popovac (cement), OTP Bank (banking sector), Alpha Bank – Jugobanka (banking sector), US Steel – Sartid (steel), etc.¹

The analysis of FDI inflow in Serbia in 2006, classified by activities (table 2), suggests that the financial sector, telecommunications and processing industry were dominant ones, with the proportion of agriculture and food industry of 10-13%

¹ SIEPA (<http://www.siepa.sr.gov.yu>).

(inflow being \$ 2.01 billion, \$ 1.55 billion and \$ 0.99 billion, respectively), accounting for 83% of the total inward FDI. In 2005, apart from the inflow being considerably (3.5 times) lower, the FDI inflow structure by activities was not significantly different – the predominant sectors included also the financial sector and processing industry, which, along with trade, attracted 4/5 of the total inward FDI.

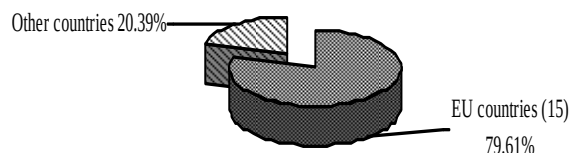


Graph 4. Foreign investments by activities over the January – September 2007 period
(Total non-resident investments in Serbia – preliminary data)

Source: NBS, Economic Analysis and Research Department, Balance of Payments Division
(commodity and cash flows included).

1.3. Fdi in Serbia from the European Union

Over the 2000-2006 period, according to FDI by country of origin, nine out of the first ten countries were from the EU. According to the data for the 2000-2007 period (preliminary data for 2007 available for the January – August period), four fifths of all foreign direct financial investments in cash planned in Serbia came from the European Union countries (a total of 79.6%), suggesting an extremely important role of European investors in the previous period (graph 5). It should be taken into account here that the data on foreign direct investments in cash were obtained by the National Bank of Serbia through commercial banks, meaning that the data on foreign investments in cash were classified by country of payment, and not by country of investment.

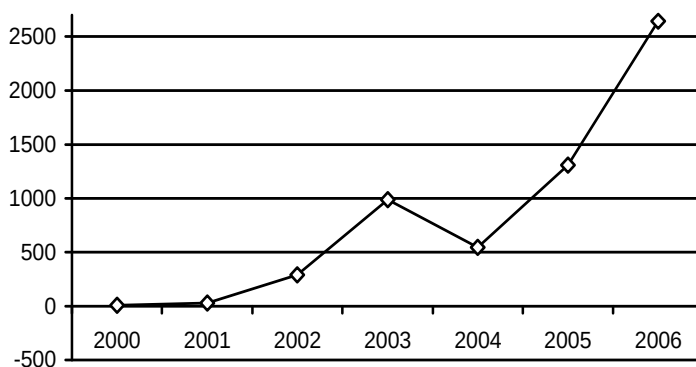


Graph 5. Serbia – foreign direct investments in cash over the 2000-2007 period (I-VIII)

Source: NBS, Economic Analysis and Research Department, Balance of Payments Division

Note: For the I-VIII 2007 period, as calculated according to preliminary estimates by the NBS; EU (12), Austria, Greece, Germany, the Netherlands, Slovenia, France, Luxembourg, Hungary, Great Britain, Italy, Bulgaria, Slovakia, Lithuania, Belgium, Cyprus.

The dynamics of FDI inflows from the EU countries did not deviate considerably from the total FDI inflow dynamics and logically so considering the high EU participation in the total inward FDI by country of origin (graph 6). The trend was a rising one, being data in itself, with the exception of 2004 (a half-billion-dollar decline).

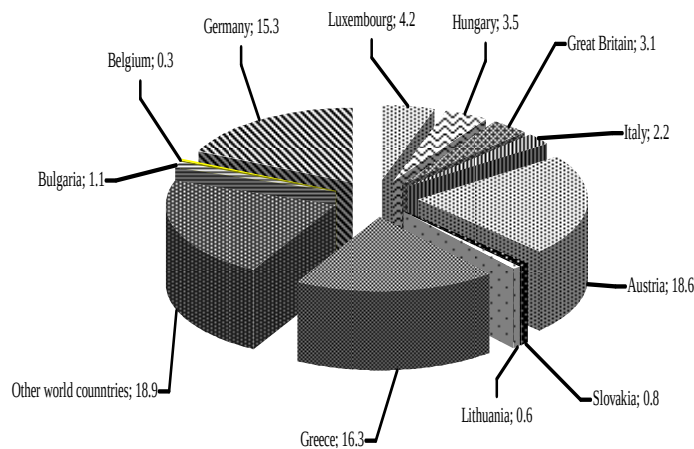


Graph 6. Serbia: Net FDI in cash from the EU (15) over the 2000-2006 period (in millions of dollars)

Source: NBS, Economic Analysis and Research Department – Balance of Payments Division.

Note: EU (15), Austria, Greece, Germany, the Netherlands, Slovenia, France, Luxembourg, Hungary, Great Britain, Italy, Bulgaria, Slovakia, Lithuania, Belgium, Cyprus.

The difference, observable when comparing the 2000 and 2006 graphs, resulted from the purchase of the Mobi63 company by the Norwegian Telenor (\$1.55 billion), considering the fact that the said acquisition originated from outside the EU.



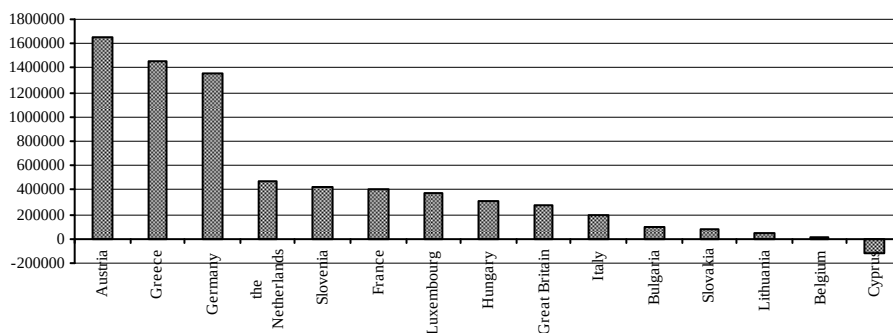
Graph 7. Participation of certain EU countries in the total FDI inflow in Serbia over the 2000-2007 period (I-VIII)

Source: National Bank of Serbia, Economic Research Department– Payment Operations Division.

Note: for the I-VIII 2007 period, calculated using preliminary NBS data.

The analysis of FDI inflows from certain EU countries to Serbia over the 2000-2007 period suggests the absolute predominance of Austria (graph 7), its share of 18.6% in the total FDI being approximate to that of all the other world countries put together (18.9%).

Greece and Germany also made a significant contribution, amounting to 16.3% and 15.3%, respectively, being followed by countries with the contribution in the total FDI inflow of above 4 %, including the Netherlands (5.4%), Slovenia (4.9%), France (4.7%) and Luxembourg (4.2%). In absolute terms (graph 8), from 2000 to the first eight months of 2007, Austria, Greece and Germany were by far more superior to other EU countries (net FDI being \$1.66 billion, \$1.45 billion and \$1.36 billion, respectively). It was only with Cyprus that outflow was higher than inflow (net FDI amounting to \$128.75 million).



Graph 8. Serbia: foreign direct investments from the EU (15) over the 2000-2007 period (I-VIII) by country, net amount, in cash (thousands of dollars)

Source: NBS, Economic Research Department – Balance of Payments Division

In the first eight months of 2007, outflow was recorded to be higher than inflow in Slovenia (net FDI -\$10.73 million), Great Britain (-\$33.93 million) and the Netherlands (- \$104.53 million). It should also be taken into account here that the data on foreign investments in cash are given by country of payment, not by country of investment.

Among the 24 major investors, 14 of them came from the EU (mostly from Slovenia: Mercator, Cimos and Droga Kolinska). If analyzed by sectors, the agriculture and food industry share (excepting oil refinery and tobacco production, etc.) was very low, due to institution-related reasons and the FDI attractiveness.²

Four cases were greenfield investments, the most desirable form of foreign capital investment (in view of all positive aspects, primarily the employment increase) and, at the same time, a FDI inflow form requiring primarily a stable investment environment, in the widest sense of the word. The experience of the transition countries that entered the EU suggests that greenfield investments are characteristic of the final stage of transition coming after the completion of the privatization process.

1.4. The Importance of Investments in Agriculture and Food Industry

Agriculture and food industry are primarily affected by farm fragmentation and unfavourable lease terms – foreign land ownership. Serbia has quality arable land and agricultural raw materials that have not been fully utilized in a modern competitive manner. The owners thereof do not generally have access to sources of financing and are insufficiently informed on both the competitiveness factors affecting traditional agricultural crops and modern market expectations.

Key fields and investment projects deserving attention from investors include the following:

- investments in high-yielding fruit and vegetable production, coupled with the establishment of new plantings, the use of modern cultivars and planting and integrated crop protection methods, and the development of greenhouse production, particularly in regions with thermal resources,
- the development of livestock production systems based on the exploitation and improvement of grassland resources in upland regions for the large-scale production of high-quality meat and the small-scale production of specific types of cheese and other milk and meat products, wool and leather products, with special reference given to environmentally friendly production systems, and, additionally, breeding high-yielding cattle,
- the construction and modernization of agricultural product storage, packaging and processing facilities – providing equipment for the high-level manufacture of food and non-food agricultural products used in large-scale production of high-quality and safe food from domestic primary agricultural products,
- the establishment and organization of a system composed of small- and large-scale producers and accompanying services (machinery rings, etc.)

² Of the EU-27 countries, Malta was the only remaining one with a negative net FDI over the January-August 2007 period, the amount being negligible, though (\$8,000). Source: NBS, Economic Analysis Department – Balance of Payments Division.

focused on highly capital-intensive activities engaged in converting the by-products of farm crop production into commercially valuable products and inflammable material, as well as on the production of crops to be used as alternative energy sources,

- the conversion and certification of areas for organic vegetable and fruit production and high-quality interconnection between the manufacturing and primary sectors, the development of high-quality virus-free planting material production,
- the interconnection, modernization and standardization of traditionally manufactured products following a niche principle, their promotion and association with investments in tourism development for mutual benefit through the creation of tourism publicity and management of tourist destinations, and the implementation of virtual export and the development of local markets, etc.

In view of the fact that the above fields further affect the regional development potential within the country, the strategic policy of Serbia is to enable the development of the stated activities through the territory-specific support to local initiatives and building of the rural development capacity of the local business environment, as well as by attracting foreign investors.³

The objectives as specified in the Agricultural Development Strategy of Serbia include the following:

1. the development of a sustainable efficient agricultural sector able to compete in the world market,
2. the improvement of quality and safety standards,
3. sustainable rural development support,
4. the improvement of the living standard of the population earning their living from agriculture and being unable to keep pace with reforms,
5. environmental conservation,
6. taking steps to facilitate the integration of Serbia's agriculture into the common agricultural policy of the EU and its accession to the WTO.

Considering the current and expected trends in primary agricultural production in Europe, the Strategy is focused on the following:

- the development of the value-added agricultural processing industry following a niche principle, to attract worldwide famous companies and new technologies able to be used in modern distribution and attract other companies – investors from international markets, and
- the establishment of mechanisms and institutions to be used in providing support in the fields of manufacture, certification, quality control and accreditation of modern market-oriented production as well as in the expanding sectors, primarily the food (ready-made meals and different mixtures) and organic food ones.

³ The above key fields and investment projects conform to the Agricultural Development Strategy of Serbia

The above stated on the FDI in agriculture and food industry of Serbia suggests that these activities should be given specific attention, due to their focus on the production and processing of products used in human nutrition.

Conclusion

The FDI inflow in Serbia has increased since 2000, the inward FDI stock in 2006 being, however, modest as compared to other European transition countries. Capital investments came to Serbia mostly from the European Union countries, the USA and the Central and Eastern European countries (mostly neighbouring ones).

Previous experiences of the European transition countries, both positive and negative, in terms of investment strategies and regimes, are of utmost importance to the Republic of Serbia. The development of a more favourable investment environment, the increase in political, economic and legal stability and the implementation of corruption reduction measures are currently essential to the intensification of foreign capital inflows, primarily those of foreign direct investments in Serbia, due to the fact that they include not only capital, but also new technologies necessitated by the modernization process taking place to enhance the manufacturing facilities and the whole of agriculture and food industry in Serbia.

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ZNAČAJ STRANIH DIREKTNIH INVESTICIJA I NJIHOV UTICAJ NA POLJOPRIVREDU I PREHRAMBENU INDUSTRIJU U SRBIJI

- originalni naučni rad -

R. J. Jovanović

Poljoprivredni fakultet, Priština – Zubin Potok

Rezime

Neefikasno ulaganje kapitala koji predstavlja ograničavajući faktor razvoja, utiče na smanjenje budućeg društvenog bogatstva, problem konkurentnosti srpskog izvoza. U ovom radu se ukazuje na činjenicu da ove probleme nije moguće efikasno rešiti bez intenziviranja priliva stranih direktnih investicija (SDI). Strane direktne investicije imaju poseban značaj za sve tranzicione zemlje pa i za Srbiju jer, za razliku od drugih modaliteta priliva kapitala, investicioni paketi koje donose SDI osim kapitala sadrže i tehnologiju, menadžerska i organizaciona znanja, pristup stranom tržištu i sl. Te su stoga neophodne ne samo sa aspekta razvojnih potreba poljoprivrede i prehrambene industrije, već i rasta i održavanja konkurentnih pozicija i performansi.

Uspostavljanje povoljnih političkih, makroekonomskih i pravnih okvira za priliv SDI predstavlja zato neophodan uslov za razvoj poljoprivrede a sa time i cele privrede Srbije i reintegraciju u svetske privredne tokove. Posebna pažnja mora biti usmerena na izvozno orjentisane SDI, pa stoga treba kontinualno raditi na koordinaciji spoljnotrgovinske politike sa precizno definisanom strategijom za privlačenje SDI. Pažljivo koncipirana strategija treba da omogući adekvatan odnos prema stranim investitorima u skladu sa dosadašnjim iskustvima zemalja u tranziciji posebno sa aspekta pozitivnih i negativnih efekata SDI, takođe, sa posebnim osvrtom na iskustvo u Srbiji.