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EFFECTS OF FDI IN THE EXPORT COMPONENT OF THE REPUBLIC OF SRPSKA

Summary: *FDIs represent the most important part of international capital flows. In the period from 2000 to date, a numerous measures and facilities, liberalized investments and transfer of capital have been made in the Republic of Srpska, with the aim to enable the greatest inflow of foreign investments. Based on the available data collected from several sources, it can be concluded that privatization was the main field through which investments in the economy of the Republic of Srpska came, which implies that there were insufficiently realized investment projects that would be of exporting nature. This paper analyzes the effect of FDI on the export of the Republic of Srpska by using free linear regression.*

Key words: *foreign direct investment (FDI), fiscal policy, free linear regression.*

JEL classification: *F21*

INTRODUCTION

Foreign direct investment can be defined in short as investment of foreign capital by investors (companies) from one country to a company in another country in order to achieve common interests. In the literature, various, more complex ways of defining foreign direct investments can be found. Thus, according to one "foreign direct investment, they represent direct investment in a foreign company in order to obtain permanent control over the production, trade and finance of the enterprises in which they invest" (Nesterović 2015, 273). From the perspective of the investors, the presence in the desired markets, favorable conditions of supply of raw materials, labor and energy, profitable placement of products and services are inevitable factors in making a decision on investing. These factors are usually provided to investors by foreign direct investment by a host country that, from the perspective of investors, is considered to be a foreign market where the investor is deploying his business functions, thereby expanding his global network. What is important to emphasize is a possible domino effect, that is, the fact that foreign direct investment can increase the entry of other multinational companies (MNCs) that are in business relations with an initial investor and which follow it in all other markets. Namely, the successful investment of one company signals to the other MNCs that there is a favorable investment climate in the host country, and the risk of investment is reduced. Foreign direct investment stimulates domestic investment if there is complementarity in the production of domestic companies and affiliates. In such an environment, foreign affiliates and domestic companies establish stable relationships, from which domestic companies create an additional motivation for realizing new projects and investing additional funds. It is worth noting that the practice of the host country shows that the affiliates of foreign companies have a greater tendency to invest than domestic ones, thus increasing investment in the host country.

When it comes to the effects of foreign direct investment inflows, one can not emphasize the component of an investment package that is in the function of providing easier access to cross-border markets and strengthening the export activity of the host country. This is due to the fact that foreign affiliates are usually more export-oriented than domestic companies and their tendency to export increases in proportion to the length of time they conduct business on a foreign destination. Namely, in a situation where a foreign investor provides inputs for his production in the local market, FDI indirectly connects local suppliers with overseas markets where the current range of offers is placed. By engaging foreign capital in capacity building for supplying the domestic market with goods that have been previously imported and thus substituting imports, conditions are created for improving the trade balance of the host country. Providing information about their parent economies, and often lobbying for the privileged position of exporters from the country of beneficiaries of investments, multinational companies facilitate the entry and penetration of domestic producers into foreign markets, which usually increases exports, which therefore reduces the deficit of foreign trade, and increases net exports.

The effect on foreign trade, in particular on exports, is for countries in transition, such as, for example, B&H, especially important given that one of the common characteristics of these countries is a high deficit of the balance of current transactions caused by the deficit of the trade balance. There are two ways to cover this deficit: foreign borrowing, which should not be rely on the already high indebtedness of countries in this region, and the inflow of foreign direct investment. Although the FDI inflows from the coverage of the deficit deficit look much more attractive to Kovačević, the FDI does not need primarily to be looked at as the source of capital for covering this deficit, but rather on the opportunities that these investments provide in stimulating exports (Kovačević 2013, 131-162). This way, on the one hand, the deficit would be reduced, and on the other hand, the foreign exchange inflow from exports would enable the financing of the imbalance of the balance of payments.

1. THE EFFECTS OF DIRECT FOREIGN INVESTMENTS ON FISCAL POLICIES

Developing countries are mainly characterized by two types of fiscal policies. In such countries, certain fiscal incentives were considered the first way to stimulate private entrepreneurship in the way that certain types of incentives are available to foreign investors, to invest their production facilities in the host country. Previous practice (Šinik and Ljubojević 2017) has shown that such fiscal policy from the corner of the host country can indeed increase the inflow of foreign capital, but that those benefits for foreign investors are limited. The second segment of fiscal policy was mobilization of natural resources for the purpose of financing public expenditures. According to Krugman, whatever the prevailing economic ideology, the economic development and social progress of a less developed country largely depends on the ability of fiscal policy to generate enough revenue to finance expansive public spending programs (Krugman and Venables 1995, 866).

Experiences show that this kind of business does not bring incomes into certain areas, primarily in the fields of health, education and other social activities. On the other hand, all developing countries face the problem of rising fiscal deficits. Public expenditures are significantly higher than public revenues as a result of development programs and unexpected negative external influences that are inevitable in the time of globalization. Public revenues largely depend on the potential of taxation, and the potential of taxation of a country in general depends on five factors:

- the level of real income per resident,
- levels of inequality in the distribution of income,
- the industrial structure of the economy and the importance of certain types of economic activity,
- social, political and institutional settings in the relative power of individual sectors,

• administrative competence and integrity of state authorities.

In order to become more interesting for foreign investors, developing countries had to reduce fiscal taxation with the aim of attracting a larger volume of foreign capital. The increased inflow of foreign investments leads to shifting the IS investment curve to the IS1 position, which means that a new equilibrium point (A1) has emerged. Such an evolution of events leads to an increase in domestic product and interest rates, as can be seen in the following picture.

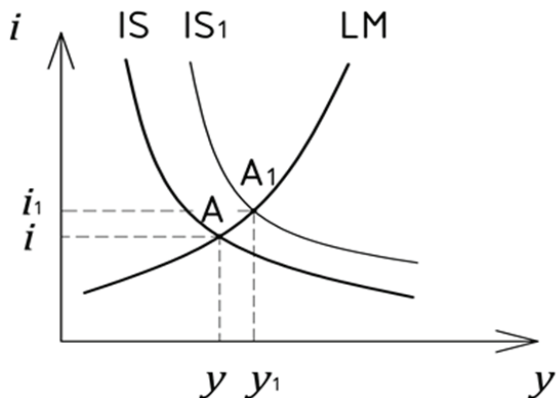

Chart 1. The impact of foreign direct investment on fiscal policy in the country that imports capital (Busse and Hefeker 2007, 397-415)

Fiscal policy management in this way can find its justification in the flow of foreign direct investment in order to improve the economy, regardless of some negative reflections.

When deciding on the best way to collect the necessary public revenue, various countries have managed in various ways and some general principles have been established from this practice. According to Nobel Prize winner Joseph Stiglitz, there are five acceptable characteristics of a good tax system:

- economic efficiency: the tax system should not interfere with the efficient allocation of resources;
- simplicity in the administrative view: the tax system should be simple and relatively inexpensive to implement;
- flexibility: the tax system should be able to respond easily to changed economic circumstances, even in some cases automatically;
- A politically responsible tax system should be formulated so that individuals can check what they pay and estimate how exactly this system supports their performance;
- equity: the tax system must treat different individuals fairly (Stiqlitz 2003, 465).

The problems of the effects of fiscal policy on economic development are reflected in the sectoral orientation of investments in stimulating the technical and technological process through fiscal easement and exemption imposed by foreign capital. The fiscal policy of the developing country should mobilize accumulation and be referred to the fiscal mechanism in the production branches of the economy. It operates through the import of capital and technology to economic development. If there is a reduction in the taxation of the countries, it becomes attractive for attracting foreign investments and attracting already existing investment capital into fixed assets and reinvesting realized profits into new investments. What is important is that tax cuts must be carried out selectively with a focus on individual industries that want to be pointed out to the forefront with foreign investors, as the tax rate must exist for the state to collect public revenues. These revenues are invested in the

infrastructure of the state, creating the suitable business environment and financing non-profitable sectors.
Every tax reform has several predetermined objectives, the most important of which is to encourage the creation of wealth. Such a vision should contribute to reducing the overall tax burden, reducing the state's share in economic activities, achieving growth in accumulation and capital. In theory, taxation by definition limits growth in three ways:
• Excessive taxation may distort the choice between taxable and non-taxable activities,
• Excessive income taxation excludes the source of current and future production and favors current consumption and excluding savings,
• Stricter taxation of income prevents the tendency to take risks and weakens international competition (Ristić and Ristić, 2016).
In creating a taxable policy, tax incentives take center stage. Namely, without fiscal charges, foreign capital would not have a significant impact on economic development. For this reason, fiscal policy and fiscal taxation must be carefully monitored in accordance with the requirements in the economy, with the strategy, priorities of the country and foreign investors with development goals. In this way, a desirable tax structure can be created and a desirable level of public revenue can be achieved.

2. THE EFFECTS OF FOREIGN DIRECT INVESTMENT ON EXPORTS

Attracting foreign direct investments is a basic requirement for increasing the production and export of host countries to a level that would allow stable economic growth in that country (Duvnjak 2018), as well as successful servicing of debts, and therefore one of the main goals of the economic policy makers is creating an investment climate that favors attracting foreign investors (Šušić and Spasojević 2016, 121). This is because the inflow of funds through direct foreign investments represents not only the inflow of capital, but also the creation of a basis for increasing trade flows, economic growth and development and creating new jobs, increasing production and ultimately increasing exports. The Republic of Srpska, or B&H as a country in transition, needs to increase the inflow of foreign direct investment, as these investments, if properly targeted, would be the driver of the country's economic growth in the upcoming period. In view of the current, still low level of domestic savings from which the development of the finances should be independently financed, as well as the shortcomings of modern technology, as well as the corresponding management knowledge, the mentioned shortcomings can be compensated by the arrival of foreign investors, which would bring new knowledge, experience and technological advances . Therefore, attracting foreign investors and adapting to their demands through an accelerated reform process is one of the key tasks facing B&H and its entities.
In theory, foreign direct investment is considered to be the best source of financing the current account deficit. The advantage of foreign direct investments in relation to, for example, portfolio investment is the fact that FDIs represent a much more stable financial flow, since investments in fixed assets are far more difficult to withdraw than investments in equity or debt securities. Here it is possible to ask the question: What is the impact of foreign direct investments on the balance of payments of a particular country? According to the UN / ECE report in the period 1990-2002. the growth of foreign direct investments significantly helped finance the growing current account deficit during the transition period in the countries of Eastern Europe, as there was no threat to future growth due to the planned outflows. The same report estimates that around 86% of the current account deficit (which has been tripled during the 1990s) of Eastern European countries in the period 1997-1999 was financed through FDI (UN/ECE 2001). For example, Hungary, the Czech Republic and Poland, as the countries with the highest inflows of FDI in those years, could, thanks to such inflows, maintain and reduce their level of external indebtedness. This, in turn, significantly improved the creditworthiness of these countries in the eyes of potential investors, which was also a

significant benefit. Namely, a better credit rating of a country brings a higher inflow of capital into country itself which should contribute to greater economic growth. Accordingly, the higher potential of economic growth attracts new capital investments, thus creating a basis for achieving long-term growth. Certainly, the mentioned effects occur with a certain time delay, but this does not diminish their significance.

The additional advantage of foreign direct investment in relation to other investments (short-term trade credits and short-term, medium-term and long-term financial loans that create liabilities based on repayment of loans) is that they do not increase the debt. What is the problem is that, regardless of the fact that they do not increase the debt, FDIs lead to capital outflows based on repatriation of profits, which with the increase in the accumulative level of foreign direct investments and changes in the financial cycle of foreign companies can drastically affect the structure of the current account.

Although the advantage of foreign direct investment in relation to loans from abroad is usually stated that FDI does not imply significant outflows in the future that could jeopardize the current balance and economic growth in these periods, it is often forgotten that FDIs also have their outflows that result from repatriation profit and situation when affiliates repay annuities based on loans from their own central offices (which is treated as a classic loan).

When the current balance is in question for the last ten years, especially in the last few years, a smaller foreign trade deficit (net exports) is notable, especially in the Republic of Srpska, which has reached its historic minimum in 2017. On the other hand, the BiH deficit has stagnated over the past few years, moving around 3.5 million Euros. This further shows that the proportionate exports to Bosnia and Herzegovina are also increasing, so that the foreign trade deficit remains one of the biggest problems of B&H economy, as shown in the following table and diagram.

Table 1. Exports of RS and B&H and FDI flows in B&H in millions of Euros in the period 2008 - 2017. (Central Bank of B&H)

Year	Export of RS	Export of B&H	FDI
2008	983	3,433	684
2009	856	2,829	180
2010	1,114	3,629	307
2011	1,310	4,206	357
2012	1,214	4,020	307
2013	1,324	4,287	208
2014	1,378	4,441	415
2015	1,286	4,597	326
2016	1,466	4,817	288
2017	1,778	5,655	398

From the previous table, it is easy to notice that in the past ten years there has been an increase in exports, both in the Republic of Srpska and in B&H. If we take 2009 as the year when the reflection of the world economic crisis peaked in our area, the increase in exports in 2017 compared to 2008 in the Republic of Srpska was around 108% (107.78%), while in B&H it was about 100% (99.89%). In the mentioned period, the flows of foreign direct investments stagnated, ranging between 180 and 415 million Euros.

The global economic crisis has had a notable influence on the inflow of foreign direct investments in the Republic of Srpska, that is, Bosnia and Herzegovina, which was felt not only in our country and in the region, but it was also a global trend. Regardless of the fact that the world economy is on its way to recovery, the level of FDI of 684 million Euros from 2008 during the last ten years has not been nearly reached, and it has generally been around half of the highest level all these years, which is best seen in the next diagram.

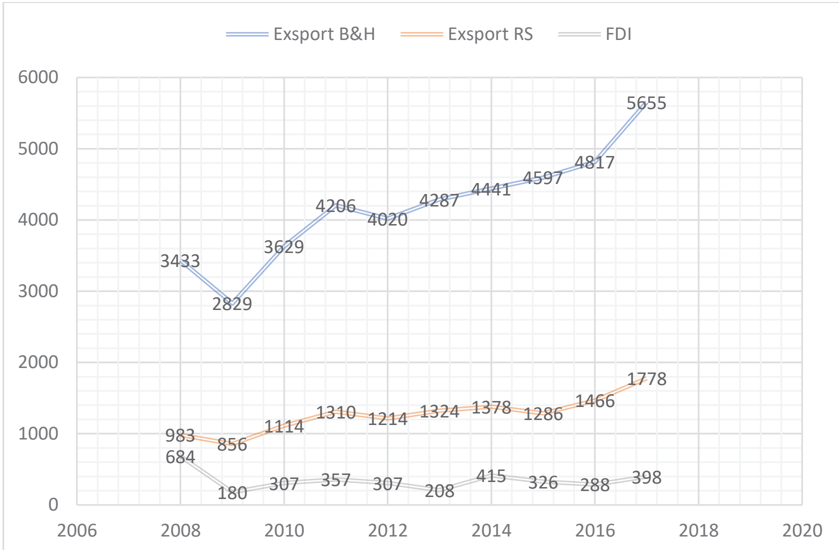

Chart 2. Export of RS and B&H and FDI flows in millions of Euros in the period 2008 -2017.
(Author based on the data of the Central bank B&H)

It is also easy to conclude from the diagram that the export of the Republic of Srpska, or Bosnia and Herzegovina, have grown in the last ten years, regardless of the stagnation of foreign investments.

From the theoretical point of view, foreign direct investment may affect the growth of the export of the host country in an indirect way, as foreign affiliates are exported. In addition, as some of the indirect ways of influencing FDI on export growth can be reported (Vukšić 2013, 353):

• The growth of the export opportunities of the domestic companies by adopting technology, new knowledge, new production processes of the company, which represents the result of greater competition in the sector where the new company has arrived or the input sector to supply the new company;

• production of a new range of products from a new company, which are cheaper and / or better inputs in the process of production of domestic companies, which affects the increase in productivity and competitiveness of domestic companies;

• lobbying a new company to better treat the export of a country where FDI inflows or providing important information, data on the country of origin of FDI

According to Bubanj, when looking at the FDI format, the most favorable effect on exports is achieved in the case of vertical investments where the foreign investor transfers some phases in the production process to another country driven by low labor costs, geographical proximity, resource wealth, etc. (Travica and Jošanov and Kajan and Vidas- Bubanja and Vuksanovicg 2007). On the other hand, horizontal FDIs that are motivated by market securing almost do not contribute to the increase in exports, as in the case of these investments, the foreign investor's goal is to expand the market for their products by selling them in the host country.

What is possible to conclude on the basis of the above is that the impulse of the increased effective aggregate demand (as a consequence of any inflow of foreign capital from a fiscal impulse) is less in the Republic of Srpska, and more in Bosnia and Herzegovina, to a large extent transfers to an increase in imports rather than an incentive to domestic production, regardless of the fact that there are positive export trends. Newly built capacities, regardless of which part of FDI was in question, additionally provide better supply of domestic markets with better quality goods. Excess goods and services are exported, thus improving the image of the host country. It is known from the theory that countries with small and insufficiently developed markets, such as the Republic of Srpska, or B&H, are usually not able to start production themselves, which are characterized by significant fixed costs, and that the effects of economies of scale are not realized, although foreign direct investments allow the host country that its economy is tested in industries with a higher level of production and high fixed costs.

For the Republic of Srpska, or B&H, it would significantly increase the influx of the so-called Greenfield investment in the real sector, with selective targeting towards branches that can contribute to increased exports. These investments provide greater opportunities for transferring foreign technology to the domestic economy, and open up ways to spill advanced technologies into other segments of the domestic economy. The professionalism of personnel managing foreign-owned companies inspires hope that this could be transferred to domestic companies in their business contacts with these companies. Apart from the increase in merchandise exports, investment in professional services related to the export of goods can also contribute to the increase in exports. Measures of economic policy should direct FDI towards sectors that can become the backbone of exports in the coming years. Also, connecting local SMEs with foreign companies can expand the network of service activities that domestic SMEs can perform for the needs of foreign partners.

3. DEPENDENCY ON EXPORT OF THE REPUBLIC OF SRPSKA FROM FOREIGN DIRECT INVESTMENTS

Foreign direct investment in the Republic of Srpska is neither adequate nor high quality sector-wide distributed. From a theoretical point of view, the Republic of Srpska could become a preferred destination for foreign direct investment, as it provides basic conditions for the profitability of an investment project. Specifically, the Republic of Srpska is characterized by macroeconomic stability in the last period, although the insufficient FDI inflow, favorable foreign investors' treatment, stimulative tax policy, positive attitude towards FDI, free access to Southeast European and EU markets, relatively cheap and well-trained workforce, natural resources etc, so it is expected to increase the FDI inflow in the future. Surely an increased FDI influx would positively affect the increase in production, and therefore the increase in exports, respectively, it would positively affect the reduction of foreign trade deficit.

In this place we will look for the dependence of the Republic of Srpska exports from foreign direct investments in the last ten years (period from 2008 to 2018) by the method of free linear regression.

Free linear regression is used to model interdependence between two variables in a way that the linear equation is adjusted to the data. In doing so, one variable is considered dependent, and the other is exploratory (independent, descriptive).

Table 2. Export of Republic of Srpska and Foreign Direct Investment (Statistical Office of the Republic of Srpska and the Ministry of Finance of the Republic of Srpska)

Year	Export of RS in milions of BAM	FDI in milions of BAM
2008	1,922	302
2009	1,673	170
2010	2,178	205
2011	2,561	373
2012	2,373	404
2013	2,588	153
2014	2,694	379
2015	2,514	153
2016	2,866	88
2017	3,476	190
2018	3,741	191

The existence of connection does not necessarily imply that one variable is the cause of the change of the other, but only that there is some kind of significant connection between them. One of the useful tools for researching connectivity is the so-called. displaying pairs of values in a two-dimensional coordinate system, or the scatter curve.
The following diagram shows the diffusion curve

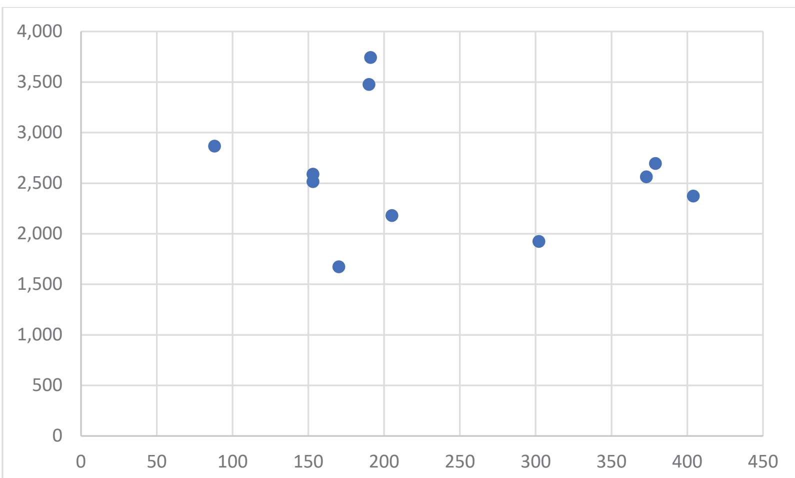

Chart 3. Scattering curve (Author)

If there is no significant connection on the graph (if the points are incorrectly distributed by the coordinate system), the linear approximation does not make sense. It is easy to see from the previous table and diagram that exports in the observed eleven years have generally grown, while foreign direct investments have mostly stagnated and there is no easily visible link between export growth and FDI size through particular years. Otherwise, the connection between the two phenomena can vary by the strength of the connection. There are several ways of determining the best parameters for the approximate direction for a set of data obtained by experimental measurement, one of which is most commonly used is the least squares method.

Table 3. Regression coefficients by the method of renting squares (Author)

FDI (x) in billions of BAM	**Export RS (y) in billions of BAM**	**xy**	**x^2**	**y^2**
0.302	1.922	0.580	0.091	3.694
0.170	1.673	0.284	0.029	2.799
0.205	2.178	0.446	0.042	4.744
0.373	2.561	0.955	0.139	6.559
0.404	2.373	0.959	0.163	5.631
0.153	2.588	0.396	0.023	6.698
0.379	2.694	1.021	0.144	7.258
0.153	2.514	0.385	0.023	6.320
0.088	2.866	0.252	0.008	8.214
0.190	3.476	0.660	0.036	12.083
0.191	3.741	0.715	0.036	13.995
$\sum x = 2.607$	$\sum y = 28.586$	$\sum xy = 6{,}654$	$\sum x^2 = 0.735$	$\sum y^2 = 77.994$

Source: Author based on data from several sources (Statistical Office of the Republic of Srpska and the Ministry of Finance of the Republic of Srpska)

The values of the arithmetic meanings $\underline{x}$ and $\underline{y}$ are:

$\bar{x} = \frac{\sum x}{n} = \frac{\sum 3.761}{11} = 0.237$

$\bar{y} = \frac{\sum y}{n} = \frac{\sum 25.586}{11} = 2.599$

If we take our example then the average annual export of the Republic of Srpska in the period 2008-2018 is 2.56 billion of BAM, while the average annual foreign direct investments amounted to 237 million of BAM.

Value of the coefficients SP_{xy}, SK_{xx}, SK_{yy}

$$SP_{xy} = \sum xy - \frac{\sum x \sum y}{n} = 6.654 - \frac{74.524}{11} = -0.121$$

$SK_{xx} = \sum x^2 - \frac{(\sum x)^2}{n} = 0.735 - \frac{(2.607)^2}{11} = 0.117$

$SK_{yy} = \sum y^2 - \frac{(\sum y)^2}{n} = 77.994 - \frac{(28.586)^2}{11} = 3.707$

Using the most commonly used method of the smallest squares

$b = \frac{SP_{xy}}{SK_{xx}} = \frac{-0.121}{0.117} = -1.035 \quad a = \underline{y} - b\underline{x} = 2.599 - (-1.035 * 0.237) = 2.84$

So it is

$y = 2.84 - 1.035x$

The coefficient of free linear correlation between the two variables in the sample, r is calculated as:

$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2} * \sqrt{n \sum y^2 - (\sum y)^2}} = \frac{SP_{xy}}{\sqrt{SK_{xx}SK_{yy}}} = \frac{-0{,}121}{\sqrt{0{,}117 * 3.707}} = -0.184$

$$r^2 = 0.034$$

Value r = - 0.184 indicates that in the sample of 11 years, there is a very weak (insignificant) negative correlation between the FDI inflows and the export of the Republic of Srpska, ie that the inflow of foreign direct investments in the last eleven years did not significantly affect the growth of exports of the Republic of Srpska.
The value of r2 is called the coefficient of determination and indicates that the impact of foreign direct investments on the annual export of the Republic of Srpska is below 3.5% (3.4%), that is statistically not significant.
It is important here to mention that foreign direct investments in the Republic of Srpska mainly relate to banking and telecommunication sector, and not to production, so that their amount has had a minor impact on the export of Republika Srpska.

The standard error of regression is the estimate of the standard deviation of the random error, s and is:

$$s = \sqrt{\frac{SK_{yy} - bSP_{xy}}{n-2}} = \sqrt{\frac{3.707 - \lfloor -1.035 * (-0.121) \rfloor}{11-2}} = 0.398$$

Such a small influence of foreign direct investments on the export of the Republic of Srpska could be changed in the near future because, according to the new Law on Foreign Investments (Official Gazette RS 21/18), foreign investors are equated with the domestic investors and have the same rights and obligations as domestic investors, and they can also establish a business entity in the Republic of Srpska under the same conditions that apply to domestic investors. Also in accordance with the above law foreign investors:
• have the right to invest and reinvest profit in any sector of economic and non-commercial activities in the Republic of Srpska, in the same form and under the same conditions prescribed by the laws of Republika Srpska and B&H for domestic investors;
• they can acquire property rights in real estate in accordance with the regulations on real rights;
• have the right to transfer incurred funds as a result of their investment in the Republic of Srpska, without limitation, in any free convertible currency
• they may, without limitation, employ workers from abroad, unless otherwise specified by special regulations governing the areas of work and employment of foreign persons.
It is hoped that the liberalization of foreign direct investment in the near future will give more serious results. As the most attractive sectors for foreign direct investments in the Republic of Srpska, at the moment are the following: agriculture and food industry, forestry and wood industry, metalworking sector, tourism, mining and construction.

CONCLUSION

Foreign direct investments represent the desire of any country, especially those that are in the transition phase, as well as Republic of Srpska, which is in deficit in terms of its own capital, knowledge, technology, export channels, etc. The positive side of FDI, which everyone wants, is to increase production, increase salaries, employment, exports, technical and managment training, tax revenues, overcoming domestic monopoly and the increase of competition. When it comes to the impact of FDI on exports of the Republic of Srpska according to the obtained results based on the coefficient of free linear correlation, the calculated value r = - 0,184 indicates that in the sample of 11 years there is a very poor negative correlation between the inflow of foreign direct investments and exports of Republic of Srpska, which means that the inflow of investments in the last 11 years did not significantly affect the growth of exports from the Republic of Srpska. The value of r2 is called the coefficient of determination and indicates that the impact of foreign direct investments on the annual export of the Republic of Srpska is less than 1% (about 0.02%), which is statistically not significant.

Generally, the good utilization of FDI in the country's economy depends on the sector where they are invested, the openness of the market and its size, the environment and some other factors that are primarily the result of economic policy. The basic motive for the arrival and operation of foreign investors in the Republic of Srpska is often not in line with the development needs of the country, and it is necessary to position the FDI with economic policies and strategies in the sense that it is necessary to undertake fundamental reforms of the business environment, which has lately been done.

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