

Foreign direct investment in the function of increasing the competitiveness of Serbian agriculture

(perspectives of organic agriculture)

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Abstract— In this paper, the authors emphasize the importance of foreign direct investment in Serbian agriculture. In the contemporary world, we are witnessing a large number of significant changes of the social, economic and technological nature, as well as the new challenges facing the national economies at the macro and micro levels. In the contexts of globalization and integration into the modern economy, issues are related to competitiveness and ensuring the highest quality of national business environment. In these conditions, when almost all the raw materials are available, natural advantages have almost the only effect on competition policy. Agriculture is a broad term, which, in addition to primary agricultural production, includes manufacturing, i.e. production of finished food products.

Keywords— *foreign direct investment, agriculture, organic production, Serbia*

I. INTRODUCTION

Investment is an important segment of macroeconomic analysis as well as a stimulus for economic growth and development. Furthermore, investment is a significant factor in economic growth due to the fact that it increases the production capacities. In order to ensure the balanced growth, it is necessary to balance the savings and investment. Otherwise, the extreme increase in investment might have inflationary repercussions while an increase in savings might lead to unemployment. For transition economies, such as Serbian economy, of particular importance is to finance the economic growth by investment and not by increasing savings. Due to the fact that Serbia, as a developing country, is facing difficulties in domestic funding, it seems logical that investment is foreign while appreciating the interests of the national economy. Foreign direct investment (FDI) arrives through investment of

certain countries, companies or individuals. This paper uses the method of analysis of the investigated phenomena, temporal and spatial comparisons and synthesis of research results. The research covered the time period over the last two decades characterized by irregular economic conditions in Serbia. Therefore, the global economic crisis has further emphasized the importance of the research topic. Data sources are publications of national and international institutions, the results of previous research by domestic and foreign authors, as well as available database on agriculture.

The experience of other developing countries shows a positive relationship between foreign direct investment inflows and international competitiveness indicators. For instance, the countries of Central Europe, due to the inflow of foreign direct investment in the second half of the 1990s, achieved the largest increase in production, exports and productivity, as well as the implementation of institutional structural changes in the economy. Serbian economy is topical from the point of view of foreign investors, in particular from the aspect of the efficiency due to cheap labor in comparison with other countries across Europe. There is the obvious lack of a highly competitive, export-oriented industry in Serbia, so that the economic growth is based on the activities of trade, transport, financial services, whereas the development of the real sector of the economy is entirely absent.

II. FOREIGN DIRECT INVESTMENT

A. *The share of agriculture in the overall foreign direct investment*

Foreign direct investment (FDI) should have a significant positive impact on economic growth, exports and

competitiveness of host countries. Although agriculture is of fundamental importance to sustainable development and poverty reduction, FDI in agriculture is modest, because it is exposed to greater risks than FDI in other areas, due to the influences of weather, climate, infrastructure deficiencies, land management and human resources. National policies are crucial to attracting FDI and increasing benefits. Due to the fact that the majority of FDI in Serbia were domestic market oriented, linked to the privatization and services, their impact on share of agriculture and food industry in total FDI was limited, as shown in Fig.1.

By analyzing the data in Fig. 1, we concluded that the smallest part of foreign direct investment was directed at the agricultural sector, and we mainly addressed the primary agricultural production.

In order to enhance its international competitiveness, Serbia should attract more FDI into new projects in the field of agriculture, which are export-oriented.

TABLE I.

Year	Agriculture ^a		Food industry	
	Investment	% share	Investment	% share
2004	9,449	1.0	97,559	9.9
2005	11,578	0.7	65,132	4.0
2006	11,345	0.2	78,37	1.4
2007	20,97	0.5	133,69	3.4
2008	57,908	1.6	147,94	4.1
2009	29,288	1.6	335,97	18.6
2010	14,556	1.0	71,167	4.7
2011	13,675	0.4	85,687	2.7

^a. Source: Chamber of Commerce and Industry of Serbia

Fig. 1. Foreign direct investment in Serbia in agriculture and food industry (in USD thousands)

Reasons for a small share of agriculture in total FDI flows in Serbia are the following: low profitability of the sector, unstable economic and climatic conditions for the production, unfavorable agrarian structure, lack of quality standards and government subsidies necessary for the placement of agri-food products on foreign markets ... One way to correct the wrong strategy is to channel foreign direct investment into the right way so that it brings new jobs, provides new techniques and technologies, increases exports etc. Most of the FDI has been directed at the financial sector, trade and other business services, so that its influence on the increase in industrial and agricultural production is relatively limited, due to the fact that banks and companies (in which foreign direct investment is placed) are domestic-market-oriented and even import-oriented.¹

¹ P. Kapor, Strane direktne investicije u poljoprivredi. Ekonomika poljoprivrede, 2nd ed., 2009, pp 231–244

B. The inflow of foreign direct investment

Since 2001, when the process of transition of Serbian economy and industry towards an open market economy has begun, the inflow of foreign direct investment has also been initiated. In the pre-crisis period, foreign direct investment was at the level of \$ 1.7 billion, which is far below the most successful transition countries. Thus, foreign direct investment in Poland was 7.4 billion dollars, 5.6 billion dollars in the Czech Republic, in Hungary 3 billion dollars etc. The mentioned investment when compared to per capita has a similar position; only in relation to Poland arrears are lower.

By analyzing the data in Fig. 2, we can conclude that foreign direct investment in Serbia is the lowest compared to neighboring countries. Croatia had, in a certain time period, lower foreign direct investment in relation to Serbia, but in the last three years, Serbia had the lowest FDI inflows. It is necessary to take appropriate measures so that the FDI in Serbia reaches the level of the surrounding countries, because FDI represents a significant factor in economic development. The inflow of foreign direct investment can be shown as follows:

TABLE II.

Country	Year ^b						
	2005.	2006.	2007.	2008.	2009.	2010.	2011.
Bulgaria	3.9	5.2	3.5	2.3	2.3	2.4	2.5
Croatia	1.8	3.6	2.5	2.7	2.5	2.5	2.7
Hungary	7.5	6.1	4.8	4.8	5.9	5.4	4.8
Romania	6.5	11.4	9.8	7.2	7.3	7.0	7.2
Serbia	1.5	4.3	2.2	3.5	2.0	1.9	2.0

^b. Source: Center for Liberal-Democratic Studies, Belgrade

Fig. 2. The inflow of foreign direct investment (in billions of dollars)

A specific problem of foreign direct investment has emerged from privatization, not from greenfield investment. Practice in other countries has shown that the greenfield investment had a positive impact on economic growth, and its contribution is reflected in the increase in employment and exports growth.

III. SERBIAN AGRICULTURAL SECTOR

A. Serbian agriculture in the function of the economic development

Serbia has great potential in the sector of agricultural production due to favorable climatic conditions, good natural soil characteristics and available water resources; however, this potential has not been fully exploited. Agriculture in Serbia is not considered to belong to the usual economic sector, due to the specifics of the production and the tradition associated with it, and also because of the high expectations. In all municipal or regional strategies, agriculture has been recognized as one of the main strategic lines of development, and majority of the population, both rural and urban, perceive it as the greatest opportunity for development of Serbia. Agriculture is the

economic sector that can produce more value than it is producing now, and thus contribute to the overall economic development of the country.

Also, it might represent a short-term buffer to mitigate the consequences of the transition process. However, agriculture cannot continue with employing the number of people currently employed while still being competitive in the region towards which Serbia gravitates through integration processes. The conflict of the role of agriculture in economic development and its social component characterized the previous period.

The most important asset and resource in agricultural production is land. Serbian land resources according to the way of usage indicate that arable land accounts for as much as 83%, while countries in the region have an average of about 60% of arable land. Serbia has about 0.6 hectares (ha) of fertile arable land per capita, while the average for the EU countries is about 0.4 ha per capita. In particular, still an untapped resource in the integration process of Serbia is the available intellectual capital for the development of the agricultural sector, and it consists of:

- Educational, professional institutions - in Serbia there are 5 agricultural colleges, 3 higher schools of agriculture; 10 agricultural institutes, 15 regional chambers of commerce etc;
- Over 30, 000 agricultural engineers of different specialties;
- Research projects involving regional cooperation among the countries in the region.

Fig. 3 shows the exports and imports values as far as Serbian agriculture and food industry are concerned. Based on the data in Fig. 3, we can conclude that the agricultural sector and the food industry are extremely important for Serbia, and a surplus in foreign trade is constantly being achieved. Agricultural and food products from Serbia are mostly exported to the EU and The Central European Free Trade Agreement, CEFTA-member countries. Regardless of the limiting factors, agricultural land, according to the quality and the surface it occupies, represents one of the most important resources for the development of agricultural production.

TABLE III.

Year	Exports values ^c	Imports values	Balance
2005	943 mil.	790 mil.	153 mil.
2006	1265 mil.	905 mil.	360 mil.
2007	1686 mil.	1116 mil.	570 mil.
2008	1957 mil.	1468 mil.	489 mil.
2009	1945 mil.	1308 mil.	637 mil.
2010	2241 mil.	1036 mil.	1205 mil.
2011	2700 mil.	1400 mil.	1300 mil.

^cSource: Chamber of Commerce and Industry of Serbia

Fig. 3. Foreign exchange of agriculture and food industry of Serbia from 2005 until 2011 (in millions of USD)

Agricultural and food products trade predicts that developing countries will not be able to produce all the necessary food, but a significant part is going to be imported. The consequence will be an increase in the intensity of competition in the medium term, and pressure on prices. An increase in competition is expected because, in addition to traditional exporters from the countries members of The Organisation for Economic Co-operation and Development, OECD, the new ones will appear from the countries that are developing rapidly, as well as from the countries that are currently in the process of transition. At the same time, the efficiency of world markets will increase, which will result in a further decline in real prices of most agricultural products.

B. The problems of Serbian agriculture

Serbian agriculture is facing many problems which are primarily the result of low investment, which resulted in a relatively low competitiveness and lagging behind comparable countries. There are productions and individuals that are competitive along with their products, because the competition builds on the use of abilities, skills and creativity of individuals to adapt to new conditions. The new conditions for Serbian agriculture have already been created and reflected in the transition from a centrally planned economy in which the greatest responsibility is on the state apparatus, to market economy where the responsibility of the individual is at its core. New integration processes (accession to the World Trade Organization, WTO and The European Union, EU) will further improve macroeconomic conditions, which will be reflected in the liberalization of agriculture, and therefore require an even greater competitiveness. Increasing the competitiveness is reflected in the increase in standard of living over a longer period of time and competitiveness can be increased by the investment, both in equipment and new technologies, as well as by investment in knowledge.

A larger market and new development opportunities for the EU agriculture have been created by increasing the number of member states of the European Union in recent years. These changes, among others, caused the changes in the agricultural policy of the EU, and are reflected in the reduction of market support measures, minimizing the impact on production support and an increase in support for rural development. Serbia on its European pathway will have to adapt to a series of policies, regulations and standards set by the EU, which will significantly change the situation in our agriculture².

Despite the favorable natural conditions, Serbia, in relation to the surrounding countries, still has low productivity in the agricultural sector, which indicates the untapped potential that Serbia has in the agrarian sector. Based on the data given in Fig. 4, we can conclude that Serbia has significant comparative advantages in terms of limited agricultural resources, i.e. land, but achieves significantly lower

² M. Ševarlić, D. Tomić, "Agrarna i ruralna politika u Srbiji – kompatibilnost sa drugim zemljama," Thematic proceedings Agrarna i ruralna politika u Srbiji (1), DAES, Belgrade, 2007, pp 13–22.

productivity, which is reflected by the parameter: for how many people one farmer produces food.

TABLE IV.

Country	Number of people that one farmer feeds in 2011. ^d
Germany	156
The Czech Republic	81
France	77
Austria	56
Italy	52
Slovenia	25
Bulgaria	21
Serbia	15
Romania	10

^dSource: EUROSTAT and Statistical Office of the Republic of Serbia

Fig. 4. Foreign exchange of agriculture and food industry of Serbia from 2005 until 2011 (in millions of USD)

By using a comparative analysis, we can conclude that Germany has an average 0.19 hectares of arable land per capita, and a farmer in Germany produces food for 156 citizens; in Italy every citizen has an average 0.20 hectares of arable land, and a farmer produces food for 52 citizens. The average area of arable land in France is 0.33 hectares per capita, and one farmer produces food for 77 people.

Compared to the previously mentioned countries, Serbia has the best potential since it has nearly 0.60 hectares of arable land per capita, one farmer produces food for only 15 citizens, nevertheless Serbia is a significant exporter of food. Serbian agro-economy analysis indicates a low level of utilization of installed capacity. The exception is the tobacco industry (capacity utilization is about 80%), beer industry, oil industry (where the capacities are utilized with more than 50%). All other branches of processing industry work with smaller capacity; even in fodder industry utilization of the installed capacities is less than 20%. The insufficient capacity utilization increases production costs per unit, by which the product becomes uncompetitive in the world market.

IV. ORGANIC AGRICULTURE IN SERBIA

A. Organic production potential

The EU member states, despite significant own production still continue to show the need for imports of organic products. Serbia can take advantage of this opportunity and invest significant amounts of organic products in the international market. The encouraging fact is that the area under organic production in Serbia during 2012, increased by nearly 30% compared to 2011.

There exists the potential of domestic investors because, unlike other segments of the agricultural industry, in organic production even with the small investment, significant revenues can be expected. This is one of the greatest benefits of investing in organic production, particularly relating to fresh fruit and berries. Attracting domestic capital in the organic production sector requires a comprehensive assessment of sales opportunities. Due to the fact that the domestic market for organic products is small, connecting potential investors with the participants in the international markets should be the main goal in creating the appropriate environment for investors.

We should take into account the fact that Serbia has small farm holdings, so that the average size of a farm in Serbia is about 3.5 hectares of arable land, while the average size of agricultural holdings in the European Union, is about 17 hectares of arable land. The chance of not only Serbia, but also all developing countries which have fragmented plots, is found in the production of organic food. A unique circumstance for Serbia is the production of organic food in conditions of emerging from the crisis, because its production does not require greater financial investment, and significant financial effects will be achieved for the state and individual producers.

The competitiveness varies, especially in agriculture, so that in a given period, it can occur that Serbia is not at all export competitive in corn production and, with the same technology and yield, it may be competitive the next year, because the price on the world market has increased. Competitiveness is achieved by reducing costs of production regardless of whether the production is extensive, or the simplest and most effective, if used with the new technology and knowledge. Therefore, the best way to increase the competitiveness is by investment and investing in knowledge. However, due to the fact that investment in new technologies in our country is so modest, Serbia is not competitive in most part of the agricultural production, despite the potential that it certainly obtains.

In Serbia, agriculture is the largest individual "employer" and has the greatest potential for the growth and creation of jobs. Not only because of hundreds of hectares of the unarable land, but also because of the forthcoming increase in the prices of oil, gas, phosphate (an increase in the cost of machinery and transport, an increase in mineral fertilizer price) that will inevitably require more human labor and more labor in agriculture.³

B. Organic farming and agriculture: a chance for Serbia?

Organic farming stands out as our great chance, as it offers the opportunity for rural areas and small producers to ensure a safe product placement, as well as to sell their products even before the start of production. Our country has excellent pre-requirements for this and two-thirds of arable land is suitable for organic farming, but only 0.3 percent is used for this purpose, while, for example, Austria has 16 percent of the area under organic farming. Domestic agriculture has still to develop its potential in organic food production and the production that gives higher yields per hectare (vegetable

³ B. Vlahović, D. Tomić, M. Ševarlić, „Konkurentnost agroprivrede Srbije činilac uspeha na međunarodnom tržištu“, DAES, Belgrade, 2009, pp 61-80

crops, viticulture, fruit growing), in the production of energy from biomass (bio-charcoal for energy production and fertilizer for Terra Preta technology), through improving a link between livestock and crop production (until recently it was considered to be a polyface farming and today it is referred to as integrated farming system, that is, meat and organic fertilizer), and by developing a higher level of food processing in rural areas that, with the additional work and the use of local energy from biomass, has great potential etc.

Serbian agriculture is the sector with the highest export potential, but the current system of exports, which relies on mutual unrelated export companies with insufficient resources and even less long-term interest and willingness to provide stable foreign markets, represents an obstacle to its development.

Poverty in urban and rural areas in Serbia is different from the situation in other poor countries – there exists a surplus of food. Agriculture and village are suffocated from a lack of money that now, due to the economic recession, strikes the urban environment as well. Costs of food in Serbian towns take over 40% of average income – which places food and its production at the top priorities in terms of citizens' interests. We can conclude that Serbia, which is considered to be a country with healthy food, has a huge development potential in organic agriculture. Development of agriculture in Europe by its own example proves that farmers can deal with organic agriculture successfully. Serbia is making great efforts and is on the right way to improve the agricultural sector. Namely, the new Law on Organic Agriculture is brought and important steps are taken towards strengthening the sector. According to some estimates, Serbia has the potential of 600,000 hectares for organic production. In order to realize a full potential, it is essential that the government and farmers invest a lot of effort and use positive and negative experience of the countries with developed organic agriculture.

Organic farming is a fertile ground for achieving producers' financial gain, since it is well-known that organically grown products are 20 to 40 percent more expensive on the market than products of conventional agriculture. However, dealing with this type of production requires large startup investment.

By increasing the extent and quantity of the produced organic food, Serbia has a chance for a quick exit to the world market and exports increase. Through the production of organic food and its growing exports to the European Union market, Serbia might find the fastest way out of the crisis and reduce the foreign trade deficit. This food is now produced in Serbia on only 0.3 percent of arable land that is about 2,863 hectares. This is only the beginning of food production, which has by 30 to 50 percent higher market price. Serbia has the greatest chance in the production of fruits, vegetables and other food items. In order to reduce the foreign trade deficit, it is necessary to export high-level processing products. The areas under organic food in Serbia are constantly increasing and are even thought of in the near future as being grown on 600,000 hectares. The production of this food from the beginning of 2011 was performed within the framework of the Law on Organic Agriculture, and the adoption of a series of by-laws, that is, ordinances is also anticipated.

We would all benefit from organic farming. Our organic food can be exported to the countries of the European Union where it has already been observed that people, who regularly use organic products, are healthy. The essential aim of organic farming is to preserve the environment, along with the quality production, which is another important aspect. Successful economic development, preserved nature and healthier people – the question is only whether we will take advantage of these opportunities.⁴

Regardless of the investment opportunities that are increasingly used by foreign companies, the organic sector is still at an early stage of development. This creates great opportunities for European, especially German companies with which Serbia traditionally maintains good business relationship. Considering the demand in Europe, especially in Germany, raw materials and products from organic production have great potential. Therefore, the greatest interest might be manifested in the sector of soft fruits, certain vegetables and soy products and cereals.

C. Investment requirements of the agro-industry

Foreign investors make investment decisions based on two criteria: a rapid return on investment and high economic impact. Efficiency is a crucial factor in meeting the investment criteria. Thus, stable conditions for investment in agro-industry should meet the following requirements:

- A reliable supply of plenty of products whose quality is defined;
- Improvement of technical skills and professional skills at all levels of the value chain;
- Improving economic skills and management skills at all levels of the value chain;
- The integration of agriculture and agro-industry into the investment policy priorities;
- Full exploitation of the financial situation, enabled through the Instrument for Pre-accession Assistance (IPA), and especially of the Instrument for Pre-Accession Assistance in Rural Development (IPARD) funds;
- Familiarizing potential European investors with the agro-industry sector in Serbia facilitated through specialized information services;
- Consistently showing on a real example how joint ventures with Serbian partners are highly reliable and cost-effective.

⁴ D. Tomić, „Neka zapažanja povodom izveštaja UNDP o svetskim investicijama za 2009. godinu“, a report presentation, UNDP o svetskim investicijama za 2009.godinu, Novi Sad Fair - Master center, 2009

D. Other sources of investment

Investment in Serbia is also attractive due to low salaries and taxes. While low taxes could continue in the future, the likelihood of maintaining the current level of salaries is small. It is unacceptable that the minimum salaries in Serbia are lower than in China, while costs of living are several times higher. Production costs in Serbia will, most likely, be harmonized with those of neighboring countries.

Consequently, opportunities should be sought in specific product sectors. The sectors of wine, sugar, milk and meat are expected to remain debate topics with the European Union. However, there are no major problems when it comes to fruits and vegetables, oil seeds, grains and bulbs. In addition to fresh and processed fruits and vegetables in many forms, a huge potential for large-scale investment can be found in soy as well. There is no European or Mediterranean country which produces or processes soybeans to such a large extent.

V. MEASURES TO ATTRACT FOREIGN DIRECT INVESTMENT TO SERBIAN AGRICULTURAL SECTOR

The main task of the state and state institutions in order to improve foreign direct investment inflows is to create a favorable and stable investment climate. Then, the economy needs to be directed towards attracting new greenfield investment, which will be based on new technologies and that will be export-oriented.

The proper national policy is the key to attracting foreign direct investment and increasing benefits. Attracting foreign direct investment in the conditions of globalization, when there is a highly competitive market, requires the construction and affirmation of the benefits of a particular location, as well as work on their promotion.

Fragmentation of the majority of private agricultural holdings in Serbia, low productivity, relatively old and obsolete machinery, appear to be quite an unsuitable ground for attracting foreign direct investment. Due to the fact that world food prices are constantly rising, investment in this sector is completely justified. The Serbian market is relatively significant in the regional environment, but it is modest in global relations, limited by the purchasing power of the population. Serbia has about 4, 2 million hectares of arable land.

The main direction of the future development of agriculture and food industry in Serbia is, as follows: the optimum capacity utilization and conservation of available production capacity, an increase in the extent of agricultural production, changes in production structure in favor of intensive production for exports. All previously mentioned is in function of satisfying domestic demand and a significant increase in exports of high-quality agricultural and food products. Low level of food processing and low unit value for food prevail in exports, as well as in placement of food in the domestic market.

The key limiting factor for foreign direct investment in Serbia is still a "country risk" since foreign investors are looking for stable business climate in the long-term. Thus, the

determinant of foreign direct investment inflows depends on the political and economic risk perception of foreign investors.

A successful strategy for achieving competitiveness must include several elements and measures (management change, organizational change, reducing operating expenses, changes in economic and financial management, changes in the agricultural sector, marketing improvement, product and services innovation), which affect the elimination of the causes of the crisis.

VI. CONCLUSION

Starting from the analysis of the situation of the domestic agro-food complex and the situation on the world market, it is assumed that, in the future, agriculture will have the best chance to be the fastest to recover and to meet the demands of the world market. Competitiveness is a key factor of economic success in the domestic and international market. Increasing the competitiveness is considered to be a strategic imperative in globalization. Taking into account the importance that agriculture has in the economic system of Serbia, improving the competitiveness of Serbian agricultural sector has a significant impact on the preparation for Serbian accession to the European Union. Taking into account the available natural and human resources, the main reasons for the lack of competitiveness of Serbian agricultural sector in the global environment are inadequate economic and political measures.

National policies are crucial to attracting foreign direct investment and increasing the benefits. Most foreign direct investment has been directed at the domestic market, and it was linked to domestic production and privatization, so that its effect on agriculture was limited. In order to increase the international competitiveness and exports, Serbia has to attract new projects in the field of agriculture. Agriculture offers great opportunities for economic growth, poverty reduction and environmental improvement, and in order to accomplish this, the state has to create a favorable investment climate.

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