THE DYNAMIC OF THE FOREIGN DIRECT INVESTMENT LEVEL IN WESTERN BALKAN COUNTRIES AND ITS IMPACT ON ECONOMIC GROWTH

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Abstract

Foreign Direct Investment (FDI) significantly impacts host economies' economic growth and development and international economic integration through globalization. This study investigates the dynamic of Foreign Direct Investment (FDI) in the last ten years in WB countries and the impact of this indicator on economic growth. This study will use secondary data obtained from World Bank indicators and, through descriptive analyses, will analyze the dynamic of FDI in the countries under study. This study concludes that FDI positively impacts the economic growth of a country, and this indicator has had a positive trend over the last years in Western Balkan countries.

Keywords: *FDI, WB countries, economic growth, globalization.*

JEL classification: *E010, F630, O110.*

Introduction

The notion that foreign direct investment is essential for the group of WB countries is frequently addressed in international and domestic literature in the countries under consideration. Kathuria et al. (2008) argues that since these countries have large current account deficits, the most apparent reason for their low investment rates appears to be low domestic (private) savings. As a result, the need to attract foreign investors is evident because, without investment, there will be no growth or catching up. The other reason is that foreign investors are expected to increase the average productivity of the economic activity in which they invest, which could lead to new investment opportunities. Thus, even with the same level of current account deficits, the authors argue that countries with a higher share of FDI would have higher investment rates, improving the speed of catching up.

The anticipated positive outcomes may not be realized despite political advocacy for investment promotion. According to the OECD (2010), all SEE countries have institutionalized their desire to attract more foreign investment by establishing investment promotion agencies. The preliminary results of the available data are encouraging. Southeast European countries relied more heavily on foreign direct investment as a source of financing than other transition countries. According to available data, only Albania had roughly the same share of inward FDI

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in GDP as the European Union average between 2000 and 2008. All the other countries could attract more FDI than their economies could support.

Foreign direct investment has much potential for the Western Balkan countries of Albania, Bosnia, and Herzegovina (BiH), Montenegro, North Macedonia (NM), Kosovo, and Serbia. International flows catalyze macroeconomic and microeconomic growth: FDI generates capital inflows and allows host economies to expand their economic opportunities by opening their markets to higher volumes of international trade; it also stimulates domestic business competition, resulting in more job opportunities and growth in GDP per capita; and FDI precipitates technological shifts, necessitating employee training and transferable skills, ultimately contributing to the advancement of the economy.

Foreign Direct Investments, especially in the Western Balkans region, help these economies improve social welfare, reduce unemployment and promote economic growth in each sector. In Western Balkan countries, unemployment rates are currently higher than in other Balkan countries and among the highest in Europe. The level of unemployment in Albania and Serbia in 2020 was around 12.8%, 15% in Montenegro, 17% in NM, and 18% in BiH. The highest value is registered in Kosovo, approximately 25%. Higher unemployment rates have also resulted in increased outflows of WB citizens seeking economic refuge in Western Europe, exacerbating the region's demographic problem and depleting the workforce required to boost the WB6 economies.

Increased FDI allows the economies to catch up with the better-performing ones, allowing them to recapture and exceed their post-socialist economic peaks. Current GDP per capita growth rates differ by region: Albania, Bosnia and Herzegovina, and Montenegro have declined since 2018, while Serbia and Kosovo have reached a plateau. When viewed in a comparative context, these statistics are less encouraging: even during periods of economic growth, current GDP per capita rates in several WB countries are lower than a decade ago. To illustrate, over the last 12 years, Albania's annual percentage growth rate in GDP per capita has fallen to roughly one-third of the country's 2008 growth rate of 8.3%. While the country's economy grew from 1.2% in 2013 to 4.3% in 2018, its current 2.7 percentile growth rate is less than a third of the 8.3% growth rate in 2008 and approximately 37% lower than the 4.2% growth rate achieved by Albania in 2010 despite the 2008 economic crisis.

The current socioeconomic conditions in the region provide the impetus for WB governments to encourage more significant foreign investment to foster economic development. Despite common incentives to attract more inward FDI, the WB6 governments differ in their ability to do so effectively. Individual country factors such as policy reforms to encourage FDI, economic growth potential, and institutional measures to ensure accountability and investor rights drive this variation.

It is widely acknowledged that FDI significantly impacts host economies' economic growth and development, as well as international economic integration and globalization. This integration entails the transformation of most modern technologies, the development of managerial and organizational skills, and the application of modern marketing techniques. Foreign direct investment is increasing due to increased productivity and efficiency in economic growth in both developing and developed countries. To that end, many countries have devised and continue to promote FDI policies and to continue to increase the flow of FDI into their respective countries.

Numerous factors can influence a business's potential and risks, and actions in individual locations can influence them. These factors can be included in three broad groups: domestic policy framework concerning FDI, business facilitation, and economic motive. On the other hand, the economic determinants of FDI can be divided into three categories that reflect the primary motivation of foreign firms to invest in host countries: market research, resource research, and efficiency research.

Conversely, globalization manifests itself in various economic, political, social, military, cultural, religious, and environmental aspects. All of these factors have a distinct and unavoidable impact on the economies of the host countries. However, the economic dimension of globalization has a profound impact on a country's level of economic development.

The third wave of globalization has emerged in the last decade, with a robust economic connection primarily from FDI flows. According to the OECD[56], globalization includes multidimensional economic integration, in which economic conditions and especially national resources become more fluid at the inter-border level while national economies become increasingly interdependent. Foreign direct investment appeals to all developed, developing, or transitioning countries. As a result, these countries compete for FDI, mainly if located in the same geopolitical region as the countries under consideration in this study. According to several studies, FDI generates economic growth in the host country[57]. Many studies show this and other direct and indirect effects (spillovers).

As a result, FDI improves a country's domestic competitiveness by influencing productivity growth, lower prices, and increasing resource efficiency. Furthermore, because FDI flows do not create debt, they are a preferred method of financing external current account deficits, particularly in developing countries where deficits can be significant and sustained (Ribakova et al. 2005). If we concentrate on the countries in the region that have experienced a period of transition, followed by numerous crises and armed conflicts, and then more destruction of resources and capital, FDI is regarded as a critical component that will contribute to economic growth and development by assisting in the long-term structural changes.

Various studies ((Ribakova et al., 2005; Estrin and Uvalic (2014); Topxhiu and Radiniqi (2018)) show that the level of FDI flow has decreased these last ten years in the Western Balkan region. Estrin and Uvalic (2014) consider the so-called "Balkan effect," which states that the region's unfortunate recent political history, which includes conflicts, fragmentation, and low growth, has had an independent effect on their prospects for FDI receipt. Whereas Wang et al. (2020) estimate that the FDI scale has shrunk in recent years compared to developing economies, developed economies have experienced violent fluctuations in FDI flow.

The level of FDI in WB countries after the financial crisis

The countries of the Western Balkans region, which have the status of candidate countries, will have more significant economic growth this year than expected, according to the report of the European Commission (2022). Like in the EU countries and these region states, growth took off in the three quarters of this year and helped economic recovery. In countries like Albania and Montenegro, the highly successful tourist season contributed the most to the economic growth above the previous forecasts. In the case of Albania, mainly the arrival of a large number of tourists from neighboring countries, but also public investments, has influenced. In countries like Serbia and North Macedonia, the main driver of economic growth is increased household spending and demand. In the case of Serbia, significant public investments in infrastructure projects have also contributed significantly to economic growth.

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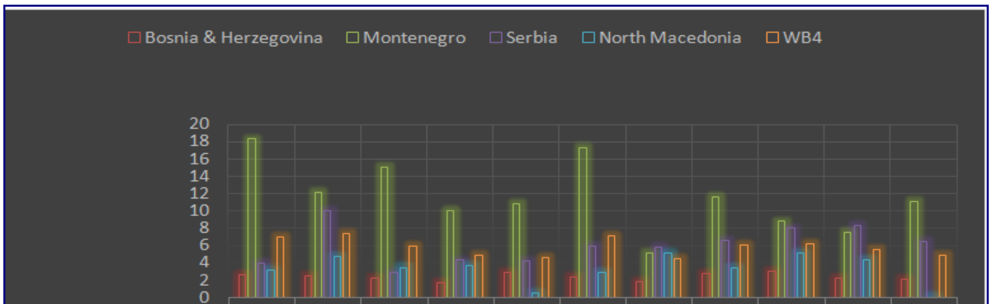

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Bosnia & Herzegovina	2,6	2,5	2,3	1,7	2,9	2,4	1,9	2,8	3	2,2	2,1
Montenegro	18,3	12,2	15,1	10	10,8	17,3	5,2	11,6	8,8	7,5	11,1
Serbia	4	10	2,9	4,3	4,2	5,9	5,8	6,6	8	8,3	6,5
North Macedonia	3,2	4,8	3,5	3,7	0,5	2,9	5,1	3,4	5,1	4,4	0,1

Graph 1. The level of FDI in Western Balkan countries

Source: World Bank Indicators, 2020

Despite the tremendous economic growth, the region's countries continue to suffer from a high level of unemployment, which is well above the average of the European Union. While the average in the EU is 7 percent, the WB countries have an unemployment level above 10 percent, despite the easing of unemployment expected by the end of this year.

While the FDI inflows dropped by 13% to USD 1.3 trillion globally, the Western Balkans, designated as Southeast Europe in the report and categorized as part of a broader region of transition economies, recorded a 33% growth, amounting to EUR 7.4 billion. According to the report, North Macedonia recorded the most significant growth in FDI in the Western Balkans, which stood at 260%. The value of FDI in this country grew from USD 205 million in 2017 to USD 737 million in 2018. *Serbia was the second* largest FDI recipient among transition economies as the FDI inflows grew by 44% to USD 4.1 billion, driven by a surge in new equity capital. Montenegro was the only country to record a decline in FDI by 12% to USD 490 million, whereas Bosnia and Herzegovina recorded a growth of 4%, amounting to USD 468 million in 2019. FDI in Albania increased by 13% to USD 1.3 billion in 2018. Despite this, it is more important to mention that a large amount of foreign direct investment went directly to the non-tradable sectors of these countries. So, foreign direct investment inflows did not contribute to the export capacity and thus did not help solve the countries' external imbalances in the long term. However, Western Balkan countries must undergo structural reforms to provide economic stability and attract foreign direct investment to support the export sectors.

Foreign Direct Investment (FDI) contributions to the Western Balkans (WB) economies have been relatively significant in recent years, especially in the manufacturing industry sector, creating thousands of new jobs and supporting economic growth, innovation, and technological progress. In 2018, the countries with the most significant foreign investors were Montenegro, with 8.8 percent, Albania, and Serbia, with eight percent[58]. Foreign investments in the region come mainly from EU Member States (Austria, Germany, Greece, Italy, the Netherlands, and Slovenia), the United Kingdom, the United States, and the Russian Federation.

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[58]https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Western_Balkans-EU_-_international_trade_in_goods_statistics&oldid=479958#The_Western_Balkans_trade_with_the_EU_and_other_main_partners, 2019.

Conclusions

The primary role of FDI, especially in developing countries, is to influence the economic growth of these countries, as well as to reduce the unemployment rate and increase the income per capita. The current socioeconomic conditions in the region provide the impetus for WB governments to encourage increased FDI as a tool for fostering economic development. Despite common incentives to attract more inward FDI, the WB6 governments differ in their ability to do so effectively. Individual country factors such as policy reforms to encourage FDI, economic growth potential, and institutional measures to ensure accountability and investor rights drive this variation. While the FDI inflows dropped globally, the Western Balkans, designated as Southeast Europe in the report of the European Commission, recorded a 33% growth, with North Macedonia recording the most significant growth in FDI in the Western Balkans. In conclusion, it is crucial to mention that a large amount of foreign direct investment went directly to the non-tradable sectors of these countries. So, foreign direct investment inflows did not contribute to the export capacity and thus did not help solve the countries' external imbalances in the long term. Thus, Western Balkan countries must undergo structural reforms to provide economic stability and attract foreign direct investment to support the export sectors.

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