ECONOMIC GROWTH IN THE WESTERN BALKANS PARTICULAR FOCUS ON FOREIGN DIRECT INVESTMENTS AND EUROPEAN UNION

MASTER THESIS

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ECONOMIC GROWTH IN THE WESTERN BALKANS PARTICULAR FOCUS ON FOREIGN DIRECT INVESTMENTS AND EUROPEAN UNION

ABSTRACT

Being that Foreign Direct Investments are considered as a very important tool regarding one country's economy, the purpose of this thesis is to show the impact of these investments on the Western Balkans economy, in terms of them integrating further on in the European Union. Therefore, this investment form is given a great deal of attention and special economic policies are being undertaken to bring foreign investors closer.

Usually, in the Western Balkans, in most cases, the term globalization is related to Foreign Direct Investments. These countries are aware of the changes taking place in the world economy, and for this reason, they are primarily aimed at attracting Foreign Direct Investment as the optimal path for diversifying the economy and transferring technology. The aim of this thesis is to assess the factors that impact GDP growth, assigning a special importance to FDI inflows in the region.

Considering the transitioning period of these countries as a result of having been communist countries, the investments flowing within their borders are of a great importance as well. Particular attention will be given to the FDI inflows coming from EU zone, in order to emphasize its role in the region; consequently leading to another aim of this research: the one of addressing the issue of the integration of WB countries in the common zone. This will be conducted through a comparison analysis on determining which country is closer to this big step. Under these conditions, increasing the importance of FDI in the world has pushed the governments of these countries towards their promotion.

Most certainly, FDI undoubtedly constitute one of the locomotives of economic development in the Balkan Region. Radical developments have been undertaken to transform the economic structure of our country into a FDI-oriented structure, economic liberalization, creating a more flexible climate and attracting foreign investors. This phenomenon on the other hand, leads to incentives in calling FDIs as a form of modern colonization as well. Controversially, a special attention will be addressed to the phenomenon of FDIs in terms of pointing out the disadvantages accompanied to them and challenging the concept of FDIs, which generally has been spoken out to bring development in the host countries.

Key words: Foreign direct investment, economic growth, Western Balkans, European Union.

RRITJA EKONOMIKE NË BALLKANIN PERËNDIMOR FOKUS I VEÇANTË NË INVESTIMET E HUAJA DIREKTE DHE NË BASHKIMIN EUROPIAN

ABSTRAKT

Duke qenë se Investimet e Huaja Direkte konsiderohen si një mjet shumë i rëndësishëm për ekonominë e një vendi, qëllimi i kësaj teze është të tregojë ndikimin e këtyre investimeve në ekonominë e Ballkanit Perëndimor, sa i përket integrimit të tyre në Bashkimin Evropian. Për këtë arsye, kësaj forme investimi i është dhënë një vëmendje e madhe dhe po ndërmerren politika të veçanta ekonomike për të afruar më pranë investitorët e huaj.

Zakonisht, në Ballkanin Perëndimor, në shumicën e rasteve, termi globalizim lidhet me Investimet e Huaja Direkte. Këto vende janë të vetëdijshme për ndryshimet që po ndodhin në ekonominë botërore dhe për këtë arsye ato synojnë kryesisht tërheqjen e Investimeve të Huaja Direkte si rruga optimale për diversifikimin e ekonomisë dhe transferimin e teknologjisë. Qëllimi i kësaj teze është gjetja e faktorëve që ndikojnë në rritjen e PBB-së, duke i dhënë një rëndësi të veçantë hyrjeve të IHD-ve në rajon.

Duke marrë parasysh periudhën në tranzicion të këtyre vendeve si rezultat i të qënurit ish vende komuniste, vëmendje e veçantë do t'i kushtohet hyrjeve të IHD-ve që vijnë nga BE, në mënyrë që të theksohet roli i saj në rajon, duke cuar në një cështje tjetër: atë të integrimit të këtyre shteteve në Bashkimin Europian. Kjo do të bëhet përmes një analize krahasimi për të përcaktuar se cili vend është më afër këtij hapi të madh. Në këto kushte, rritja e rëndësisë së IHD-ve në botë ka shtyrë qeverinë e këtyre vendeve drejt promovimit të tyre.

Sigurisht, IHD-të pa dyshim që përbëjnë një nga lokomotivat e zhvillimit ekonomik në rajonin e Ballkanit. Zhvillimi radikale janë ndërmarrë për të transformuar strukturën ekonomike të këtyre vendeve në shtete më të orientuara drejt IHD-ve, ku liberalizimi ekonomik ka krijuar një klime më fleksible drejt tërheqjes së investitorëve të huaj. Ky fenomen, gjithashtu çon në stimulimin e IHD-ve si një formë e kolonizimit modern. Nga ana tjetër, një vëmendje e veçantë do t'i kushtohet fenomenit të Investimeve të Huaja Direkte në drejtim të evidentimit të disavantazheve të shoqëruara me to dhe sfidimit të konceptit të investimeve të huaja direkte, të cilat në përgjithësi janë shprehur për të sjellë zhvillim në vendet pritëse.

Fjalët kyçe: Investimet e huaja direkte, rritja ekonomike, Ballkani Perëndimor, Bashkimi Evropian.

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Thank you all!

DECLARATION

I hereby declare that this Master Thesis, titled: Economic growth in the Western Balkans; Particular focus on Foreign Direct Investments and European Union is based on my original work except quotations and citations which have been duly acknowledged. I also declare that this thesis has not been previously or concurrently submitted for the award of any degree, at Epoka University, any other university or institution.

Megi Hoxha

November 27, 2018

LIST OF ABBREVIATIONS

FDI - Foreign Direct Investments

GDP - Gross Domestic Product

WB - Western Balkans

USA - United States of America

OECD - Organization for Economic Co-operation and Development

IMF - International Monetary Fund

WB - World Bank

UK - United Kingdom

ICT – Information and Communication Technology

TAIEX - Technical Assistance and Information Exchange (TAIEX)

IPA - Instrument for Pre-accession

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CHAPTER I

INTRODUCTION

Foreign Direct Investments are a relatively new phenomenon, which was first present in the 19th century in the form of lending that the British economy made to finance economic development in different countries, leading to a form of ownership over financial assets (Duce, 2003). FDI inflows began before the war where Western Europeans used a high percentage of their savings to finance foreign governments and ventures in other parts of the world. The majority of FDI of Europe (mostly of Great Britain, Germany and France) have been made during this period in the form of financing of mines, plants, public services, railways and ports, mainly in Latin America and Latin America. During this phase, in 1914, Great Britain, as the greatest power of that time, dominated the international business with about 45% of the total FDI. After the Second World War, the greatest FDIs were made of the US with such American companies as General Motors and IBM, which developed production bases everywhere in the world, especially in Europe and Latin America. Around '60s, the USA numbered 48% of the world's FDIs (Kajoshaj, 2015). In the period between the two wars in the 20th century, foreign investment had a significant decline. The Second World War marked the flourishing of the FDI phenomenon for two fundamental reasons.

First, the development of technology gave a great incentive to transport and traffic, which created the possibility of control in distance of different economic activities, creating favorable conditions for the development of FDI.

Second, after the 2nd World War, European countries and Japan needed US capital for reconstruction. In this period, the US approved a taxation system that favored overseas investment (Kurtishi, 2013).

Due to technological change, global competition and market liberalization as big encouraging tools, foreign direct investment plays a key role in the global economic integration process (Lopez, 2010). They are considered as a determining factor of economic growth, especially for developing countries, including Western Balkans countries (Demirhan & Masca, 2008).

1.1 Statement of the problem

The main purpose of this research is identifying the factors that impact GDP growth, where a particular attention will be assigned to the FDI inflows in these countries. In this context, this study also aims to conclude also the relationship there is between FDI growth and GDP growth in terms of deciding whether FDI is the one that has an impact on the economic growth of the region or the other way around. Apart from the fact that they are economically, politically and socially similar, the WB countries have different characteristics as well, which will be further highlighted and explained. This may be the reason of different results there may come up in the empirical study.

1.2 Research questions

Considering that the purpose of the study is to identify the explanatory factors of economic growth in the Western Balkans countries, the research questions will be accordingly as follows:

1. Which are the influencing factors of economic growth in the Western Balkans region?
2. What is the role of FDI inflows in the economic growth of the WB countries?
3. Is there a bidirectional causality between FDI growth and GDP growth?

1.3 Significance of the study

Being that the Western Balkans countries have all expressed their willingness to become part of the European Union, the results of this study may be helpful in this regard; if it is proved that the FDI inflows have an impact on GDP growth and it is a positive one, the countries should make the relevant changes in order to attract more FDIs. If it is the other way around, they should undertake other policies in order to have an increasing trend of their GDP growth, in order to receive more foreign investments, thus decreasing unemployment, increasing the managerial skills, getting updated with the latest technology etc.

1.4 Study area

The area of conducting the research is the Western Balkan countries, considering that is a region composed of developing economies that share similar characteristics. Through a comparison analysis, the study may conclude whether there is a relationship between the stated variables and up to which point. On the other hand, this area is of a great importance due to their willingness on becoming part of the European Union, consequently considering FDI inflows as an important tool on such event, emphasizing once again the impact that EU countries have had in this region in terms of trade and investments.

1.5 Motivation behind the study

Considering the fact that not many studies are conducted regarding the matter, the motivation behind this research relies on the fact of comprising the Western Balkans countries into a panel data empirical study and coming up with the relevant results. This research is thought to be of a great importance in terms of being an added value to the literature regarding this type of topic and also giving a general view of the FDI inflows of the countries taken under study. Referring to the fact that WB countries, apart from Croatia that is already part of the EU, have a common goal: the one of being part of the common zone, this is a very current topic, increasing the incentives of the audience to reach it out.

1.6 Structure of the research

This thesis is organized in 7 chapters, in which the first one which is already being elaborated, shows a background of the topic, followed up by the research objectives, significance of the study and the area taken under study.

The second chapter includes some general information regarding FDIs, stating some different definitions from different authors regarding the matter, followed up with types of FDIs and their respective advantages and disadvantages.

The third chapter comprises the literature regarding the topic, stating different studies conducted in different timeline and countries, whether developing or developed ones, that have concluded results that are in accordance with the economic theory or not.

Chapter 4 refers to Foreign Direct Investments in the Western Balkans countries, analyzing them in terms of the main countries that invest in them, the main industries, followed up by the reasons why other countries should invest in these economies.

In chapter 5, a special attention is given to the steps that these countries, apart from Croatia, are taking in order to be part of the European Union, the challenges they are facing and the level up to which they have managed completing the set requirements from the European Union in terms of the economic perspective.

The 6th chapter is about the data and methodology used to conduct the empirical part of the research in order to get the respective answers to the study's questions and whether they comply to the literature review or not.

The last chapter is related to the conclusions and recommendations referring the conducted research, along with some limitations faced during the study.

CHAPTER 2

GENERAL THEORETICAL APPROACH ON FOREIGN DIRECT INVESTMENTS

2.1 Definitions of Foreign Direct Investments

FDI is an issue that is increasingly affecting the global economies. This is the reason why nowadays we come across many definitions regarding FDI. According to the classical definition, "FDI is considered a company of a certain country making a physical investment by building an enterprise or any industrial firm in another country" (Rugman & Waters, 2003). Another definition of FDI comes from the IMF. "Foreign Direct Investment reflects the goal of securing a mutually beneficial economic relationship between an investor (a company) and its venture, and a foreign host country" (IMF, 2004).

But the concept underlying this thesis will be a more international one, as follows: " Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated. The concept of "sustainable interest" means the existence of a long-term relationship between the direct investor and the enterprise as well as a significant influence of the investor in the administration of the decision-making process in the enterprise (OECD, 2008).

In general, it can be said that FDI is a term used to present the purchase of physical activities outside the borders, as plants and equipment, under the control of the parent company. This may include several types such as: setting up a new branch or branch or buying assets or a foreign business. In this concept, there are not included international aid and loans granted to Western Balkan countries at different times of time by foreign governments and donors for the development of infrastructure, water supply, roads etc.

2.2 Types of FDIs

FDI is seen as a major benefit to host countries as transferring technology from investment to host countries tends to expand technological capabilities. This is because multinational enterprises tend to be in tune with the latest technology innovations (Benhabib & Spiegel, 1994). It is precisely this technological development that conveys multinational enterprises, which explains the close link between FDI and human capital accumulation (Barro, 2001). In addition to this (Borensztein, Gregorio, & Lee, 1997) argue that FDI flows are labeled as large human capital reserves and therefore they can have a permanent effect on per capita income.

In the case of stock purchase, direct investment other than investment in the portfolio includes the benefit of holding such significant shares, which give the right to control or the ability to participate in the management of a firm. An important part of FDI is that of FDI inflows and outflows.

According to (World Bank, 2018), net inflow FDI are the value of investments made by non-resident investors in the reported economy. While net outflowing FDIs are the value of investments made by economic investors reported in other countries.

Inward Direct Investments are also named direct investments in the reporting economy and include all assets and liabilities transferred among direct investment enterprises in the reported economy and their investors. It also includes the transfer of all assets and liabilities among resident and non-resident companies, if the parent enterprise is not located in the reported economy (OECD, FDI stocks, 2018).

Outward direct investments, also named as direct investment made abroad, comprise all assets and liabilities directly transferred to the economy reported in their direct investment enterprises. It also includes the shift of assets and liabilities among the domestic enterprise and its affiliates abroad if the parent company is in the reported economy (OECD, 2018).

Another investment classification is that of the partner country and the industry sector that are the two major dimensions required to give more details about FDIs. Partner country, according to standard statistics, FDI are classified by partner country, which indicates the immediate source of funds, but cannot indicate the investor's site that controls investments. To show the latter, countries can compile an additional set of domestic investment position from the invested final location. These statistics show that the site of the direct investor who ultimately controls the investments and thus carries the risk and reaps the investment rewards. The last investor is identified from proceeding to the direct investor ownership chain when the enterprise has reached the point that is not controlled by another entity (which is more than 50% of the voting power, therefore it is not owned by a unit other economic). If there is no enterprise controlling the direct investor, then the direct investor is the last investor.

The industry sector, the recommendation is to provide internal and external FDI data based on the economic activity both for the affiliate and the parent company. However, if this is not feasible, it is recommended to compile data based on branch activity for both external and internal investments.

Different FDI types and forms are categorized into 5 main types (Hecht, Moritz, Noska, & Schäffler, 2016)*:*

1. *The first type* includes FDIs that have access to specific production factors such as patents, technological knowledge, resources, or the good reputation of a company where the investment will be made. A concrete example in Albania can be the case of the Turkish company "Kurum", which deals with the production and export of Albanian steel products.

2. *The second type* takes over all the firms and FDI companies that realize even greater productivity gaining access to the cheapest production factors. Typical example in Albania is the workforce. Local governments or the country where the investment will be made encourage and simulate incentive policies in favor of exports through tax cuts or by subsidizing initial capital.

3. *The third type* of FDI has to do with firms competing internationally and making numerous investments in the countries they compete. Joint venture is the kind of business organization form that this type of FDI is best accomplished. This is because access to the products of different firms can be easily done. Such case may be that of the Albanian aluminum producer company, "PESPA ALUMIN", which carried out FDI in neighboring countries such as Italy, Bosnia and Herzegovina and Former Yugoslav Republic of Macedonia (PESPA&AL, 2018).

4. *The fourth type* relates to firms and FDI companies that aim at targeting consumers in the country where the investment will be conducted. In this type of FDI, the firm must be very elastic into adapting to the domestic goods and services. This often turns out to be impossible due to certain services or the inability to meet a certain type of demand. In the host countries it has not been possible to realize a specific trade of some goods and services from the investing country thus increasing the fourth type of FDI. In Albania, the mobile companies Telekom Albania or Vodafone Albania can be listed, which in a very short time reached quality of service in our country as well as in the company's parent company in Greece.

5. *The fifth* and final type of FDI is about the regional integration of diversified trade. This type of FDI takes on when the host country presents local advantages to foreign companies that want to invest in gaining access to the host market. But there are many legal and tax obstacles that make the company invest. In such situations, the government must take the role of the regulator and intervene.

2.3 Positive and negative impacts of FDI

Foreign Direct Investment (FDI) is one of the most important tools for the Western Balkans countries. They are still countries in transition, consequently facing a dynamic development of the economy. As already known, investments are among the items that affect the Gross Domestic Product (GDP) according to the equation: $GDP = C + I + G + NX$. Foreign Direct Investments bring a lot of improvements in a country's economy, but not only. Like everything else, everything positive is accompanied by negative features as well. In this stage, is better to observe, analyze and conclude what effects Foreign Direct Investments have more: positive or negative ones.

From the numerous studies conducted on the topic of Foreign Direct Investment (FDI) it is noticed that for foreign direct investments besides the positive side, there is the other side of the medal that represents the negative aspects. The theoretical views on this issue are different from the point of view that defends the idea that FDIs lose the identity of a country to the other extreme that FDI is necessary for the development of a genuine economy.

Mainly, FDIs find widespread use in developing countries, helping them to grow economically. FDIs enable employment growth as well as exchange of the latest and most innovative technology or experience. Foreign direct investment usually contributes to the development of the host country's investment sector.

A very important point of view of FDI is related to the causes and consequences of foreign capital in one country. The theoretical views on this issue are different from the very extremist point of view to protect nationalism. On the other hand, they are an aspect of the economy without which the latter cannot exist and should therefore be seen positively.

2.3.1 Advantages offered by FDI inflows

- *Increasing the investment levels:* Being that the local markets are not very firm and developed, this phenomenon serves as an innovative way to fill in the gap which may have been created.

- *Upgrading the used technology:* FDI inflows are usually accompanied by the latest technology which has a direct impact on the host economy.

- *Improving the competitiveness of the export entities:* Being that the production levels up and meets the needs and desires of the domestic country, exports are increased because they have more goods and services in disposal to trade.

- *Decrease of unemployment rate:* The investments made in the host country generate new jobs, contributing in the decline of unemployment rate.

- *Benefits to host country consumers:* Consumers tend to benefit from this phenomenon due to new, innovative, greater quality goods and services at relatively competitive prices, especially in the developing economies.

- *Increase in tax revenues for the government:* The generated profits by this type of activity are taxed and have a considerable contribution in the tax revenues gathered by the host country government.

- *Channel of opportunity, especially for developing countries:* According to (Lipsey, 1999), in general FDIs are the main and dynamic resource of investments in a developing country. In spite of this, FDI flows should not only be seen from the point of view of a single inflow, but of the subsequent inflows of the initial capital inflow. Specifically, in addition to the initial investment, FDIs are followed by the international capital movement, the host country, the country of origin, the mobility of managerial technological skills and so on.

- *Transformation of countries, especially post-communist ones:* FDIs play a very important role in changing the structure; meaning the progress and openness of the economy from an international point of view, and the orientation to competitive advantages as well as international co-operation. One of the advantages of FDI is that they help the economic development of the country where the investments are made.

- *Host country's productivity growth challenge:* FDIs play a decisive role in that the companies in these countries have the opportunity to explore new and foreign markets and thus generate more revenue and profits. FDIs facilitate the access to new markets and thus contribute to increased exports, thus generating more revenues from them. FDIs are a source for financing the deficit in the Balance of Payments by improving lending to host countries. FDIs play an important role in creating the right economic conditions for EU membership as well (European Commission, 2010).

2.3.2 Disadvantages offered by FDI inflows

The other side of the coin would be the disadvantages associated with FDI, which requires the governments of the host countries to determine the conditions and the size of the FDI.

- *Sectorial and geographic disparities:* Foreign-owned companies may focus on important strategic sectors and may create both sectorial and geographic disparities.

- *Decrease of domestic savings:* In the cases when FDI becomes competitive compared to the domestic investment, it has the tendency of decreasing the domestic savings, since domestic businesses are not providing income in the domestic economy.

- *Cultural, social and political risks:* Differences in cultural, social and political aspects may make the origin country's investors feel insecure, thus intimidating the foreign investments in the host country. The linguistic and cultural differences that exist between the investment country and the host country may also pose problems in FDI cases.

- *Limited level of tax revenues:* Due to liberal tax concessions, the tax revenues gathered from the foreign direct investments' activities are quite less. In order to attract more investments, governments provide tax free operations for these newly established foreign businesses, thus influencing the level of tax revenues in the country.

- *Inappropriate consumption pattern:* Considering the great level of advertising of these activities, it pushes consumers towards them even though they don't need them.

- *Extracting considerable political and economic concessions:* These firms can get political and economic concessions especially from the governments of developing economies.

- *Impact on foreign exchange reserves:* Due to the high level of outflow profit as a consequence of this type of activity, it creates an impact on the foreign exchange reserves as well.

- *High costs of communication, travel etc:* FDIs include high costs of communication, travel, etc.

- *Crowding out effect:* This phenomenon may create a crowding out effect; hosting countries government may be forced to increase their borrowing as a result of not being able to obtain enough domestic savings to afford the public expenditures.

- *Low wages:* Usually, the foreign countries invest in the host countries and provide them with very low wages, such as the case of fasonery business in Albania.

- The size of the market as well as the host country's conditions may be other important factors for FDI. In cases where the host country is not heavily tied to the most advanced neighboring countries, this poses a challenge for investors.

- It has sometimes been noted that host country governments have had problems with FDI since the host country government has less control over the functioning of companies that are wholly owned subsidiaries of a company abroad.

2.3.2.1 FDI as a form of colonization

The concept of Foreign Direct Investments has been observed differently from developing and developed countries points of view. In developing countries/emerging economies, there is a new established theory, the one of considering the phenomenon of foreign direct investments as a form of colonization (Svedberg, 2003). In this context, host countries worry about the fact that FDIs are actually disguised as some kind of modern day economic colonialism.

On the other hand, developed economies consider FDIs as a form of mutual growth and are very fond of encouraging this phenomenon and creating more connections with each other. As for the developing economies, FDIs expose host countries and leave them vulnerable to foreign companies' exploitations. In these regards, the main focus in terms of the low wages; considering that these economies are subject to high unemployment rates, these companies are willing to hire the citizens at a cheaper cost. This leads to exploitation of the labor force in the host countries.

However, the abundant land resources and their cheap price create great incentives for the foreign economies to purchase these lands, thus encouraging the modern day form of colonization. A great percentage of the natural resources no longer belongs to the host countries, emphasizing once more the impact of the foreign countries in the WB region as well.

Consequently, this leads to another concept as well: *the one of jeopardizing of national sovereignty;* considering the large impact of foreign firms in the local economy, it may have an impact in the latter, but also in the national sovereignty by being able to also cause certain influences in the political decisions of these countries.

2.4 Microeconomic effects of FDI

Specifically:

- Directly increase employment by increasing consumption and stimulating employment.
- They can maintain the level of employment, thus maintaining a stable economy, especially if investments are made in enterprises in the edge of crisis, bankruptcy, etc.
- Last but not least, the effects of foreign direct investment on productivity are quite important.

As noted in the paragraphs above, FDIs generally tend to increase productivity and lower unit costs if:

- They are export promoters and economies of scale can be created
- Available policies and conditions make it possible for the realization of economic plans.

CHAPTER 3

LITERATURE REVIEW

One of the most discussed issues around the world in terms of economic policies which governments must undertake, is to increase the welfare of their citizens. Well-being is a concept that actually goes beyond the economic dimensions, and perhaps even the ones legal, reaching to the limits of sociology and psychology (Lleshaj, 2016). However, economists when talking about the welfare of a country have in mind the economic growth of the latter. According to Mankiw (2009), this is the macroeconomic indicator that best represents the welfare level or standard of living in a country.

As for the factors that impact GDP growth, inflation has been stated to be one of them, as in a study conducted by Majumder (2016). As for their relationship, Anidiobu, Okelie and Oleka (2018) stated that there is a positive relationship, meaning that inflation positively impacts GDP growth. This was not the case of Berument, Inamlik and Olgun (Berument, Inamlik, & Olgun, 2008), in which in one of their studies they pose the argument that inflation negatively impacts GDP growth in the sense that it lowers the purchasing power of the customers.

In terms of the factors impacting GDP growth, unemployment rate was considered to be part of them as well (Andrei, Vasile, & Adrian, 2015). On the results of a study by Mosikari (2013) it was stated that unemployment rate negatively impacts GDP in the sense that high level of unemployment does not give incentives to production in the country, thus negatively impacting GDP growth.

Exports and imports also have their impact in GDP growth as stated in a research by Leo Michelis and Zestos (2004). In the same study it is concluded that exports positively impact

GDP growth, in terms of bringing more money in the domestic economy, thus contributing in the economic development of the latter. On the other hand, imports seem to negatively impact GDP, considering the citizens are purchasing goods and services from abroad because they are cheaper, thus depriving the domestic production of the said goods and services (Bakari & Mabrouki, 2016). Nevertheless, another argument is posed in terms of how imports affect GDP growth. In an empirical evidence from Kenya, considering it as a developing country, imports had a strong positive relationship with GDP growth. This was due to the fact that the nature ofthe goods that this country produced, mainly agricultural ones, was in need of other contributing factors, such as machineries, which were imported (Maina, 2016).

Regarding another factor taken into consideration, the one of trade openness, it seems that trade openness actually positively affects GDP growth (Dao, 2015). More access to international trade means more production and more circulation of goods and services, directly impacting GDP growth of especially developing countries. Grossman and Helpman (1991) advance this notion by showing that the lowering of trade barriers would generate spillovers to the local economy through contacts with foreign businessmen and markets while also raising incentives for local R&D. This statement leads to another concept: the one of FDIs.

During the last years, policymakers, mostly in the developing economies, have concluded that FDI is essential to boost the economic growth in these countries in the form of: creating employment, increasing the use of the latest global technology in the host country, thus generally contributing in the improvement of the overall conditions of these countries (Adewumi, 2009).

Some studies, such as the one of Lee, Rana, & Iwasaki (1986) argue that the economic growth of the host country is accelerated by the presence of FDI. This is due to high and steady growth economic. Apart from that, a host country usually creates a high level of capital requirements in the economy and as a result FDI needs increase, creating a favorable macroeconomic climate to attract new foreign investors. Foreign direct investment and also international trade are quite often considered as essential catalysts for economic growth in the developing economies. In these terms, developing countries are subject to FDI inflows due to low transport costs and usually to low excise duties on imports and exports, which are some important encouraging tools for foreign investors to go and invest in these countries (Javaid, 2016). On the other hand, the presence of few competitors also makes it a favorable climate for attracting many foreign investors (Hussain & Kimuli, 2012).

Foreign direct investments are seen as important vehicles in terms of the transfer of technology from developed countries to developing ones. Consequently, FDI has a role in stimulating domestic investment and facilitating the further improvements regarding human capital but also different institutions in the host countries (Makki & Somwaru, 2004).

In this context, Choe (2003) made a research on "Macroeconomic indicators for 80 countries, developing economies and developed ones with a time series data panel for the years 1995 - 2006 and examined that FDI is a factor that causes statistically significant economic growth of the host countries. The same result was also concluded from Solomon (2011) on his study regarding FDI and host country factors.

Studying the relationship between foreign direct investment and GDP growth is extremely important when analyzing developing economies, especially when considering that FDI is one of the main contributors to economic growth in these countries (Ikbal, Ahmad, Haider, & Anwar, 2013). In order to analyze the effect of Foreign Direct Investments in a certain economy, there are several factors to be taken into consideration, specifically in the cases of developing economies such as the Western Balkans countries. Apart from the local issues that may appear in a country, the latter should also worry about problems that may arise from the neighboring countries, which certainly impact the ongoing political, economic and social situation of the said country (Pradhan, 2006). FDI is widely accepted as an actor of economic growth (Hysa & Hodo, 2016). It is considerably true that FDI is one of the most effective ways by which developing economies are integrated with the rest of the world, as it provides not only capital but also technology and management know-how necessary for restructuring the firms in the host countries (Gregorio, Lee, & Borensztein, 1998).

Apart from the fact that developing countries may have access to abundant natural sources, they experience difficulties regarding physical capital, labor force and technology when compared to the developed economies (Iamsiraroj & Doucouliagos, 2015). What seems to widen the gap between developing and developed countries is the high level of corruption in developing countries, followed up by the low quality of their institutions. Another contributing factor is also the political and economic instability that exists in the developing economies. Under these conditions, "a way out" for these countries is to look for alternative methods in terms of international sources in the form of foreign direct investments (Nunnenkamp & Spatz, 2003). Developing economies aim to attract possible foreign investors by presenting new and mainly unexploited markets, access to abundant natural resources and relatively low cost labor, locational advantages, and direct and indirect incentives (Albuquerque, Loayza, & Serven, 2005).

As stated by Groizard and Busse (2006), the major increasing trend of FDI inflows across different countries in the world, is an indicator that strongly supports the phenomenon of globalization over the past two decades. Is it FDI what causes economic growth or is it the other way around? Foreign direct investments provide with tools that are essential for economic growth. These tools are: new production techniques and processes, new varieties of capital goods and even managerial skills. By providing all of the above mentioned tools, FDI acts as a promoter of economic growth in the less developed/developing countries (Samad, 2009). Rodrik (2009) on the other hand, states that a great portion of the correlation that exists between foreign direct investment and economic growth comes as a result of reverse causality, where transnational corporations locate to more productive, faster growing and profitable economies.

Regarding the relationship of FDI inflow and GDP growth, on his study on the impact of FDI in economic growth in developing countries, taking as a case study the African countries, Adewumi (2009) argues that as a continent it seems that FDI has a positive effect on economic growth, while when taking it separately by country, it showed that FDI impact negatively on the economic growth. In both cases, the results were not significant, rejecting the idea that FDI does cause economic growth. On the other hand, a study conducted by Zouheir and Sghaier (2013), a few years later for the same countries, shows that FDI has a positive impact on economic growth and that their relationship is significant, implying that FDI causes economic growth.

The case of Jordan, in terms of a developing country, indicates the opposite of what was mentioned so far. A study of Louzi and Abeer (2011) concludes that FDI does not exert an independent influence on economic growth. It is actually GDP growth the one that causes an impact on FDI inflows in Jordan. In this context, Lamine (2010) also concluded that FDI does not cause economic growth in developing countries, posing the argument that developing countries, as it could be the case of Western Balkans, being post-communist countries, foreign direct investments are a relatively new phenomenon for them, fading out the idea that FDI may actually cause economic growth.

The study of Mahmoodi (2016) investigates the causality relationship between economic growth and foreign direct investments for 8 developing countries in Europe from 1992-2013 and 8 developing countries in Asia from 1986-2013. In both cases, in long term, FDI and economic growth have bidirectional causality, implying that FDI causes economic growth and economic growth also causes FDI inflows. The same situation is repeated in the case of Asian countries in short term. As for the European countries, Mahmoodi concluded that FDI is the one that causes economic growth and not the other way around. This conclusion is also supported by a study conducted by Xu and Ndiaye (2016), who also add up the finding that FDI inflows have a positive impact on economic growth in developing countries.

FDI inflows may also cause a negative impact on economic growth. Rahman (2015) examined the effect of FDI on economic growth and concluded that FDI inflows do have a negative impact on GDP. He supported this conclusion by analyzing the relationship of FDI and inflation rate. From this analysis, Rahman pointed out that FDI impact negatively economic growth by increasing the inflation rate.

Regarding the Western Balkans case, as mentioned in an investigation conducted by Susic, Trivanovic and Susic (2017), the empirical results slightly support the idea that FDI is the one that causes GDP growth and it actually has a relatively low positive impact on the latter. In the case of Former Yugoslav Republic of Macedonia, FDI inflows cause changes in GDP growth. The type of industry and sector structure are also very influencing factors on the matter. Apart from the fact that FDI flows in Former Yugoslav Republic of Macedonia are relatively lower as compared to the neighboring countries, Krstevska and Petrovska (2012) have presented that FDI has proven to be very important indicator in terms of improving the economic performance of Former Yugoslav Republic of Macedonia. This idea is also supported by a research conducted by Jovancevic (2017), in which is stated that in Croatia, as a result of the FDI inflows, its economy has experienced a great expansion.

Different authors have examined the relationship between FDI inflows and economic growth in the Western Balkans. In the case of Albania, foreign direct investment is an important determinant in the development of the Albanian economy. Albania is still part of the transition countries and after the 1990s attracted many foreign investors. According to economic theory, there is a close link between the accumulation of human capital and foreign direct investment. This is because human capital is seen as an advantage in absorbing FDI in developing countries (Xhaferaj, 2005).

Blömstrom, Zejan and Lipsey (1996) concluded that FDI can positively influence GDP rates developing countries and argument this result as a consequence of the technology absorption factor. They also pointed out that FDI has another effect on the domestic production as well, through complementarities in the production field, affecting the total gross production of the country, not only the foreign direct investment.

Various authors have also studied FDI inflows and their relationship with employment rate. Considering FDI inflows serve as a mechanism in creating jobs (Estrin, 2017), in general, all these authors have agreed that positive impacts on GDP growth are much more evident in the case of Greenfield projects (Grahovac & Softić, 2017).

When discussing about the phenomenon of FDI, foreign investments can be considered as a "game", where the main players are the multinational firms and the government of the host country, or as a contest between governments of different countries on who is more efficient into attract FDI inflows in their countries (Faeth, 2009).

As for the importance of foreign direct investment (FDI), it lies in the ability on their ability to increase the fair competition in the host country, which results in the correction of national market inefficiencies. This positive effect on the national economies of FDI host countries motivates the host country to boost FDI's influence in competition with other host countries that view the same potential profit. Foreign Direct Investment (FDI) as one of the forms of foreign capital inflows can help finance the growing needs of developing countries' financial resources and facilitate the transfer of managerial skills from origin countries to host ones (AIDA, 2018).

CHAPTER 4

FOREIGN DIRECT INVESTMENTS IN WESTERN BALKANS

4.1 Economic Background of Albania

Albania is one of the countries that Western Balkans is composed of. It is part of the South-Eastern Europe, located in the southwest of the Balkan Peninsula. Albania is bordered by Greece, Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Italy, which often appear as the main foreign investors for this country.

After many years of dictatorial isolation from the communist regime, Albania finally started to undertake major steps regarding infrastructure development, investment promotion, all of these in the terms of integration in the European Union and NATO. At the same time, this country open up to foreign investment and free market, not only with its neighboring countries, but even further. For Albania, the beginning of the 1990s was the end of an era under the Communist regime. Because of this, Albania inherited poverty, an inefficient industrial sector that did not respect the competitive advantages and considerable problems in terms of public administration institutions.

Albania adopted a law on foreign investment in 1994 where it allowed free entry of foreign investors, free foreign exchange swaps and legal protection. A Law on Concessions was approved in 1995, which created some investment facilities in the fields of physical infrastructure, mining, tourism etc. in the form of "Build, Operate and Transfer" (BOT). Albania has signed agreements on the protection and promotion of Foreign Direct Investment (FDI) with 35 states and the agreement on double taxation prevention with 17 countries. According to the Bank of Albania, FDI has increased significantly from 1998 to 2003, mainly as a result of privatizations. However, economic progress was not supported by institutional reform. State institutions remained weak and the financial sector did not develop sufficiently. But all these shocks of the major macroeconomic variables, shaking the foundations of the market economy and those of political stability, did not sound good on the edge of foreign direct investment, although there were modest investments (Zoto, 2012). The civil war of 1997 in Albania spread its effects on the FDI are as well, resulting in a decrease of the FDI inflows in the country. Afterwards, a series of events happened that affected the increase of FDI inflows in Albania. More specifically, the successful sale of the telecommunication company AMC to COSMOTE (a Greek telecommunication company) and the one of Savings Bank of Albania to Raiffeisen Bank in Austria had a positive impact on the increase of FDI in Albania.

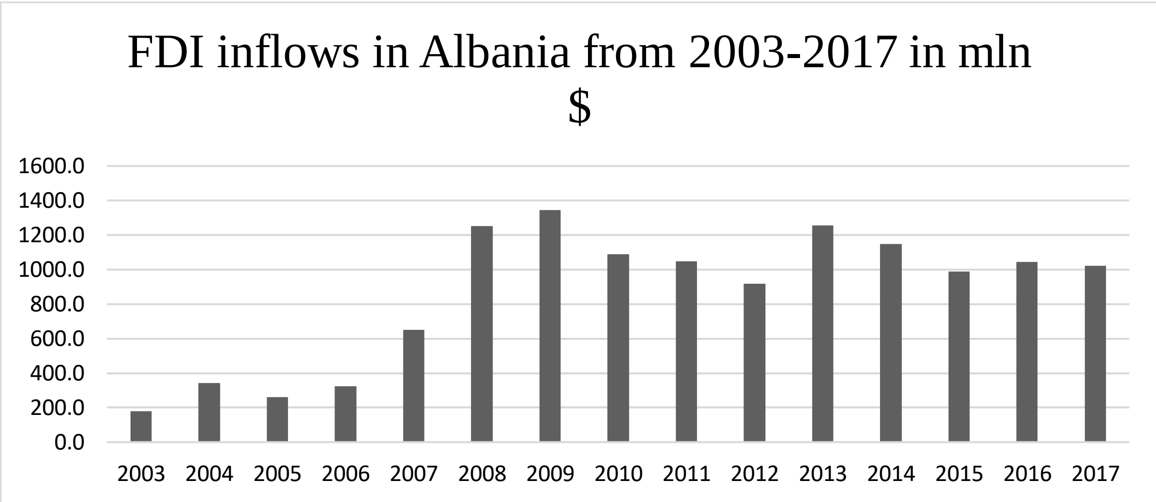

Figure 4.8 FDI inflows in Albania from 2003-2017 in million $

Source: (The Global Economy, 2018)

As it can be seen from the graph, the lowest FDI growth in Albania has been observed in 2003, while the highest one has been in 2009. The reason behind this result is the privatization process that took place in Albania during that period (Foreign Direct Investment Report, 2011);

- In 2008, the oil refining company ARMO was privatized by its sale to the consortium “The Refinery Associates of Texas, Anika Enterprises SA, Mercuria Energy Group Limited for €126 million
- In 2009, 76% of the electricity distribution operator was privatized by its sale for €102 million to CEZ of the Czech Republic

- In March 2009, the package of shares owned by the State in the AMC company; 12.6% of the capital, was sold for €48.2 million;
- In 2012, it started the privatization of AlbPetrol

4.1.1 Foreign investment stock by country of origin

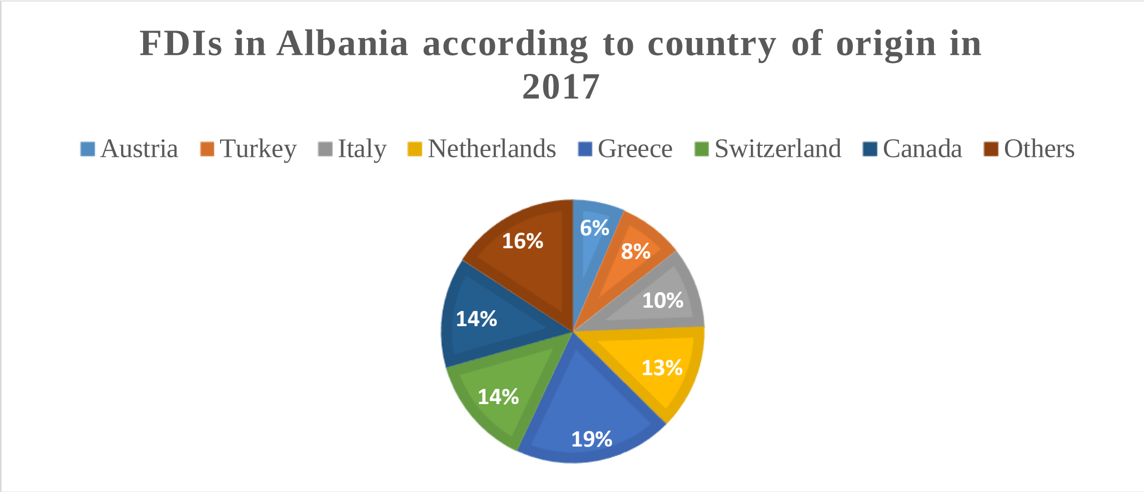

Figure 4.29 FDIs in Albania by country of origin in 2017

Source: Bank of Albania (2017)

The FDI inflow in Albania marked 983 million Euros at the end of 2016, with an increase of approximately 10.5% of the total FDI stock compared to the previous year. The largest share of FDI foreign investors in the stock of FDI, which invested in companies in Albania, is Greece at nearly 193 million Euros or 19.6% percent of the total stock. This country is followed by Canada and Switzerland which share the same percentage of 13.6%, reaching an amount of 134 million Euros. Even though it is not a neighboring country, Canada is ranked third due to Bankers Petroleum activity in Albania, while Switzerland reached that rank because of operating mostly in the energy sector. The next investing country is Netherlands with 13%, at an amount of 128 million euros and the last ones are Italy, Turkey and Austria, respectively at 10%, 8% and 6.4%. As for Italy, it occupies the greatest number of investments in Albania, being that that operate in small firms, mostly in manufacturing dhe footwear industry. Lastly, 155 million Euros is the amount that other countries, apart from these ones invest in Albania, occupying around 15.8% of total FDI stock in Albania.

4.1.2 FDI stock in Albania by economic activity

The main economic activities focusing on the FDI for 2017 are:

- Extracting industry at an approximate value of 60%
- Transport and telecommunications at 14% of total FDI stock
- Energy with about 11% of the value of FDI inflows
- Real estate, leasing, informatics, scientific research work, other professional activities with about 8% of the value of FDIs
- Other activities reaching a value of 7% of the total FDI inflows.

4.1.3 Investment opportunities in Albania

Albania is currently making steps forward towards its integration in the European Union. Apart from making progress in terms of the reforms in justice, corruption and other political and social aspects, the economic one is a very important factor as well. In this context, Albania has started paying special attention to possible foreign investors. Down below are listed some of the main industries to invest in Albania.

Table 4.1

Main investments possibilities in Albania

Industry	Reasons
Agriculture	Favorable climate Favorable water supply Not affected by the crisis of 2008 Increasing trend of exports in this industry Cheap land prices
Factories for export	Reduced transportation costs Cheaper labor force
Tourism	Considered as “Europe’s last secret” Fiscal incentives from the government (4 and 5 starts hotel are exempted from corporate tax for 10 years and the VAT is at 6%
Digital industry	Cheap labor force Technology oriented
Real Estate	Competitive land prices Value is expected to increase in the following years

Source: Conducted by own author

4.2 Economic background of FYROM

The Former Yugoslav Republic of Macedonia is one of the countries of the Western Balkans. Its neighboring countries are: Kosovo, Albania, Greece, Bulgaria and Serbia. Former Yugoslav Republic of Macedonia, as well as most of the countries of the region, was under the Communist regime. The previous economic and political condition of this country spread its effect even in the new era of democracy. In this context, taking into consideration the fact that the Republic of Former Yugoslav Republic of Macedonia is facing high rates of unemployment and consequently considerably low economic development, the role of foreign direct investments is crucial into blooming the economy of this country. A distinguishing characteristic of Former Yugoslav Republic of Macedonia is that it ranks among first in Europe in terms of the ease of doing business, and it occupies the first place in South-Eastern Europe with only 3 days to open up a new business.

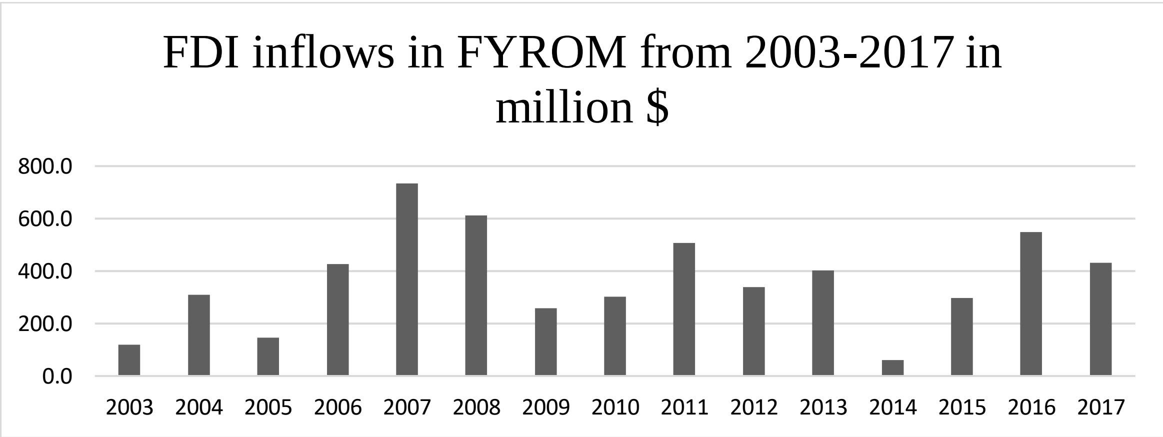

Figure 4.310 FDI inflows in FYROM from 2003-2017 in million $
Source: (The Global Economy, 2018)

Even though Former Yugoslav Republic of Macedonia shares similar characteristics with its neighboring country Albania in terms of their political and economic past, the fact is that Former Yugoslav Republic of Macedonia's FDI has had a slightly larger increase as compared to Albania. Apart from the fact that in the period 2007-2008 the country's FDI inflows have experienced their highest rates from 2002-2017, the years 2009-2010 and 2014 were the ones with the lowest change in Former Yugoslav Republic of Macedonia. This was due to corruption, administrative malfunctions and regulatory weaknesses in the country. In general, Macedonian economy has not followed up a certain trend regarding the economic growth, leading to different growth/reduction economic rates. Nevertheless, the trend seems to be increasing in the past few years, reaching a considerable level of 549.371 million $ growth in FDI in 2017 as compared to the previous year.

4.2.1 Foreign investment stock by country of origin

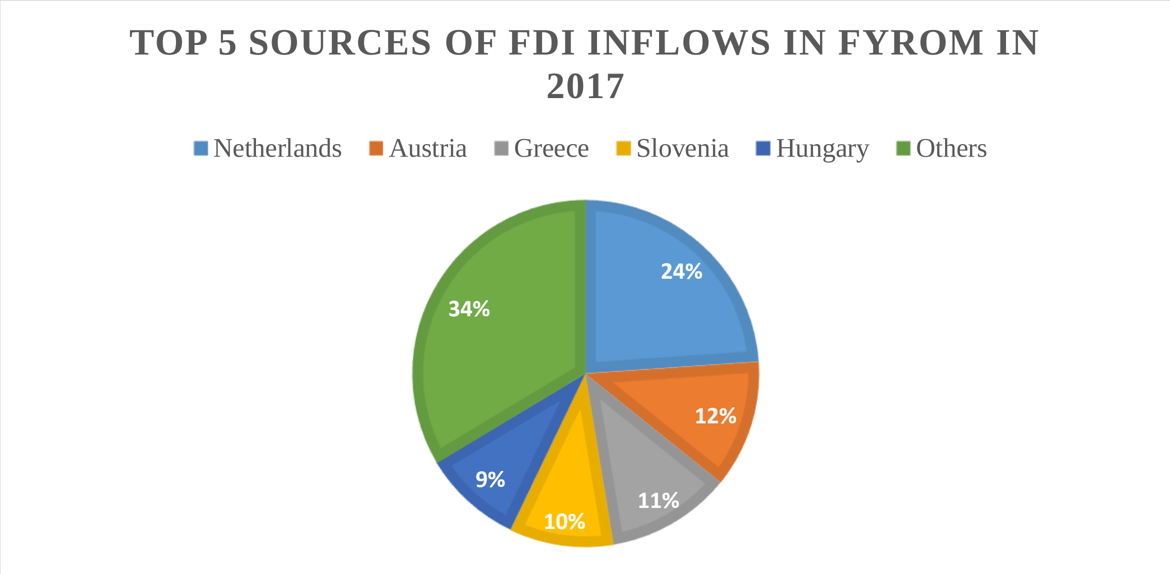

Figure 4.4 FDIs in FYROM by country of origin in 2017

Source: (Macedonia Country Commercial Guide, 2017)

The top countries investing in Macedonia are: Netherlands, occupying about 23.9% of the total FDI inflows, followed by Austria at a rate of 11.9%. The next one is Greece with 11.6% and the last two ones are Slovenia and Hungary, respectively at 9.7% and 9.3%.

Some of the main foreign investors and most significant ones are:

Table 4.2

Main foreign investors in FYROM

Country	**Company**
UK	Johnson Matthey; QBE Insurance Group Limited; Endava
Austria	Mobilkom Austria; EVN
Germany	Deutsche Telecom; Kromberg & Schubert; Dräxlmaier Group; Marquardt
France	Societe Generale
Greece	National Bank of Greece; Hellenic Bottling Company S.A; Titan Group
Netherlands	Mittal Steel; Anthura
Switzerland	Duferco
Turkey	Mensan Otomotiv
Russia	Prodis; Grishko

Source: (Agency for Foreign Investments in Macedonia, 2017)

4.2.2 FDI stock in FYROM by economic activity

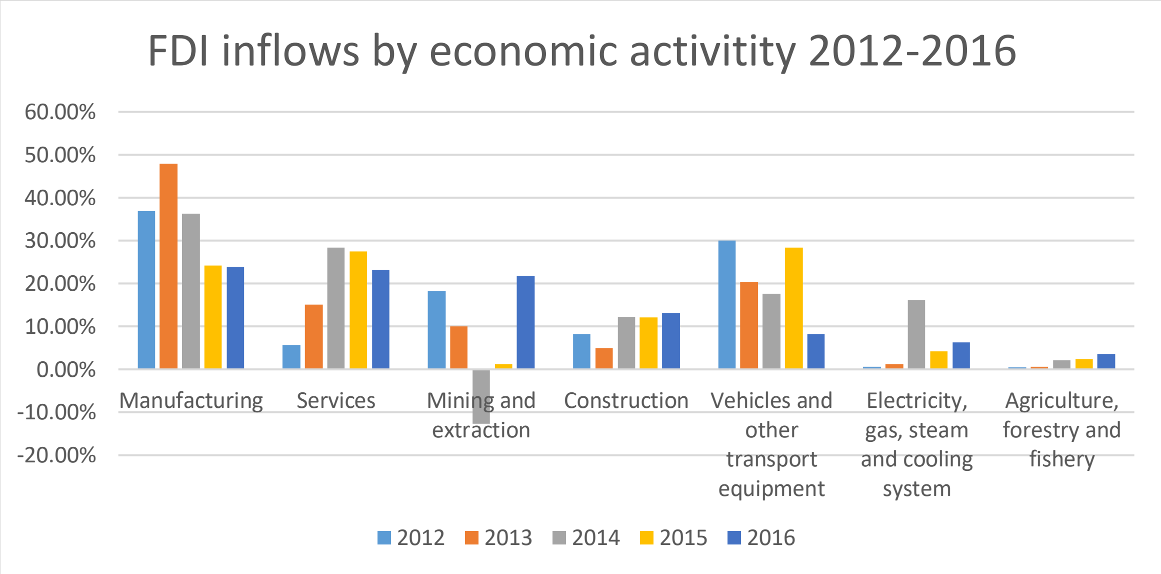

Figure 4.5 FDI inflows in FYROM by economic activity 2012-2016

Source: (Kapital Media Group, 2017)

As it can be seen from the chart, the industry where most foreign direct investments are made is the one of manufacturing, reaching its peak in 2013 at 208.77 million Euros or 36.87% of total FDIs in 2012. As for the services industry, since 2012, it has faced an increasing trend reaching its peak in 2014 at 28.31% of total FDIs. Regarding the mining and extraction, it has experienced a decreasing trend from 2012 to a negative growth in 2014, which was later upgraded in one of the highest growing rates in this country. Construction is also another industry which has faced an increasing trend in Former Yugoslav Republic of Macedonia during the last year. As for the vehicles and other transport equipment, the growth rates are relatively high when compared to the other industries, although there has been a slight decrease in 2016. Electricity, gas, steam and cooling systems along with agriculture, forestry and fishery, surprisingly enough have quite low growth rates in the last year in the Former Yugoslav Republic of Macedonia.

4.2.3 Investment opportunities in FYROM

Table 4.3

Main investment possibilities in Former Yugoslav Republic of Macedonia

Industry	Reasons
Agriculture and food processing	Favorable climate Strong reputation industry Cheap labor force

	Competitive land prices
Metallurgy	Favorable geographical structure Rich in raw materials
Textile industry	Modern technology Skilled workers
Digital industry	Best telecommunication network in the region The Law on Electronic Communication, in compliance with EU regulations
Real Estate	Competitive land prices Value is expected to increase in the following years

Source: Conducted by own author

4.2.4 Reasons to invest in FYROM

Considering the slight improvement of the economic environment along with the investments opportunities and qualified work force and also the great will of Former Yugoslav Republic of Macedonia to attract more potential investors, a considerable number of businesses have established their operations in this country. As a result of the improvement of the business environment and investment opportunities, the qualified and highly educated labor force, along with the growing interest in Former Yugoslav Republic of Macedonia's investment potential, a number of international companies have started operations in the country.

- *Trade:* about 60% of the Macedonian trade is with EU member countries
- *Transport:* the geographical position make is possible for Former Yugoslav Republic of Macedonia to serve as a transit country for the transportation of goods apart from the distribution
- *Vision for the future:* its three main foundations for the future: Europe, Energy and Economy, respectively through integration in the European Union, renewable energy production and improvement of economy through creative industries, electronics, digitalization etc, showing once more the ambitions of this country for further improvement.

4.3 Economic background of Montenegro

Montenegro is another country that form part of the Western Balkans. Its neighboring countries are: Albania, Kosovo, Croatia, Serbia and Bosnia and Herzegovina. Along with the already mentioned countries, Montenegro as well was in the communist regime, making foreign direct investments a relatively new phenomenon for this country. Nevertheless, Montenegro has managed becoming a “magnet” for foreign investors due to its business oriented system and most importantly its low corporate tax rate. Different from Albania and Former Yugoslav Republic of Macedonia, Montenegro poses monetary stability and economic freedom. Just like the other neighboring countries, a great problem in this region is the high level of corruption, the lack of justice, useless bureaucracies and organized crime. All of these factors are the ones that do have a negative impact in the trending increase of this country in terms of its FDI inflows. In 2018, Montenegro is ranked 42nd out of 190 countries regarding the ease of doing business, raising up to 9 positions as compared to the previous year (Santander, 2018).

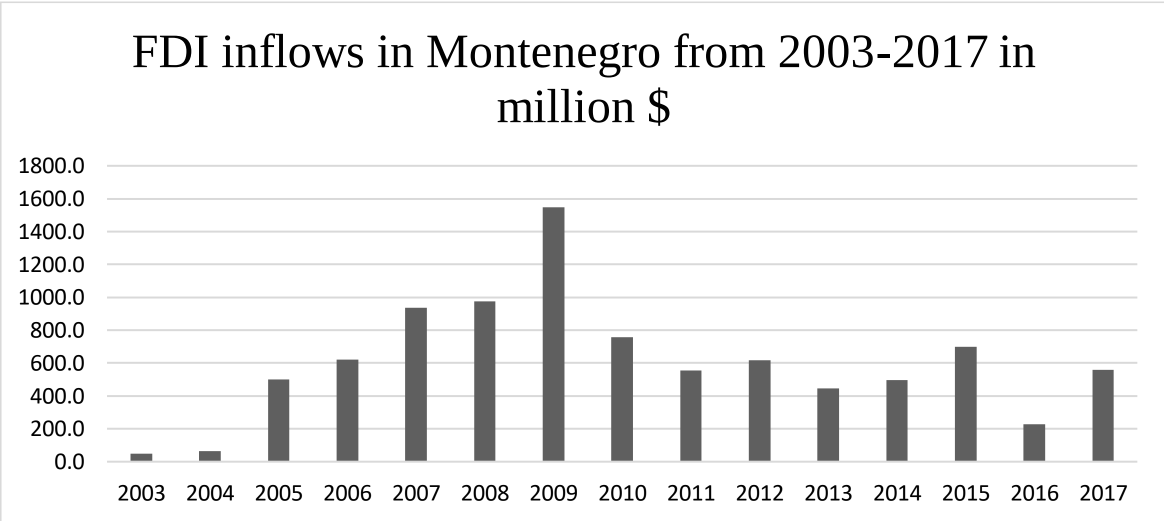

Figure 4.6 FDI inflows in Montenegro from 2003-2017 in million $

Source: (The Global Economy, 2018)

When compared to other countries of the region, Montenegro has managed to achieve a greater rate of FDI growth over the years. Its peak was experienced in 2009, right after the financial crisis of 2008. As for the last year, this country has faced a decrease in 2016 when comparing it to the previous year. Nevertheless, it is still far ahead of its neighboring states. This may have happened due to the need for improvement in the dynamics of decision making; considering the fact that many investments were not concluded because of slow administration (Government of Montenegro, 2018). However, its greatest contributor on the matter, is still tourism, which manages to have the highest share in the FDI flows in the country.

4.3.1 Foreign investment stock by country of origin

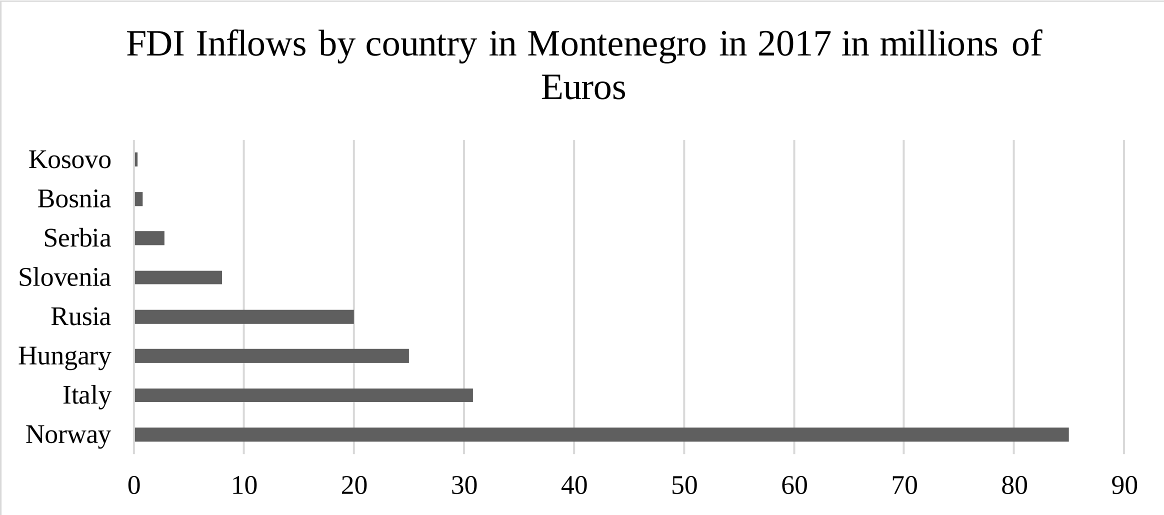

Figure 4.711 FDI inflows by country of origin in Montenegro 2017 in millions of Euros

Source: (Government of Montenegro, 2018)

What can be easily noted from the chart is the fact that Norway occupies the first place, with a high value of 85 million of Euros. A considerable amount corresponds to Italy with a value of 30.8 million of Euros, followed by Hungary at 25 million and so on. What seems to be interesting in this case is the ranking of Russia and Serbia, especially the one of Russia, considering the fact that it usually occupied the first place among the main foreign investors in Montenegro. Also there is a great difference in amount with the first ranked country (Norway); a difference of 65 million Euros. Italy invested in the banking and construction sector, while Slovenia in intercompany debts.

4.3.2 FDI stock in Montenegro by Economic activity

Table 4.4

FDI stock in Montenegro by economic activity

Country	**Industry**
Norway	Confidential information (no publicly know information)
Italy	Montenegrin domestic companies and banks
Russia	Real estate
Slovenia	Intercompany debts
Serbia	Real estate
Bosnia and Herzegovina	Real estate
Kosovo	Real estate

Source: (Central Bank of Montenegro, 2018)

4.3.3 Investment opportunities in Montenegro

1. Construction of Highway Bar-Boljare: a strategic construction for Montenegro, which will serve as a link to the border of Serbia, connecting Montenegro to the other part of South-Eastern Europe.
2. Airport of Tivat: the further development of this airport, which will ease even more the arrival of tourists near the bay of Kotor.
3. Energy sector: renewable energy by wind farms, solar energy and gas; all of these abundant sources of this country
4. Oil and Gas: Ionian-Adriatic Pipeline, giving Montenegro a chance to trade its own gas, being closer to the market, being linked to the Trans-Adriatic Pipeline.
5. Wood sector: abundant source in raw materials and export oriented
6. Mining: Even though the minerals are owned by the state, in Montenegro only two of the companies that deal with such operations, are state owned. Montenegro is rich in different minerals, contributing in the phenomenon of renewable energy as well
7. Tourism: one of the fastest growing economies with great developments in the tourism sector
8. Agriculture: apart from the appropriate climate for agriculture products, Montenegro offers the perfect conditions for the honey production, olive growing and natural herbs.

4.3.4 Reasons to invest in Montenegro

- Foreign companies that decide to invest in Montenegro share the same rights as the domestic ones, disappearing any type of discrimination among the two types
- Foreign companies also enjoy one of the most competitive tax systems, at a rate of only 9%, giving higher inventive to potential foreign investors to come and invest in Montenegro
- The labor force is qualified and employed at relatively low wages
- The national currency is the Euro, mitigating the risk of exchange risk among the countries that share the same currency
- No bureaucracies in terms of opening up a new business; the procedures are quick and very simple
- Politically stable country
- Government's privatization policy resulting in attraction of many possible investors.

- Businesses that operate in the production field can be exempted from their profit tax in the first 3 years of their operations

4.4 Economic background of Bosnia and Herzegovina

Bosnia and Herzegovina is another composing country of the Western Balkans. It shares similar characteristics with the other Western Balkans countries, in terms of political, social and economic conditions, considering the fact that this country is also another ex-communist country. However, nowadays, in terms of economic situation, it has developed relatively well, especially in the central and northern parts of its territory, which are rich in minerals and also possess good lands or forests. Mining was an important economic branch in Bosnia and Herzegovina. Based on mineral resources, it developed the black metallurgy, the color metallurgy, the chemical industry, the metallurgical processing, the electrical industry, the wood, the textile, and the food industry. After the 3-year war, Bosnia suffered a large scale of economic destruction and loss of people. Now the economy is partially activated, the refugees have returned partially, and efforts are being made to bring “peace” in the country. Agriculture is less developed. However, the north of Bosnia has reached a certain development. In this region, there are cultivated grains, industrial plants, fruits and vegetables. The presence of meadows and pastures in the mountains has influenced the development of livestock. In Bosnia and Herzegovina, about 50% of the areas have forests, and forestry is of a great economic importance (Lloyds Bank, 2018).

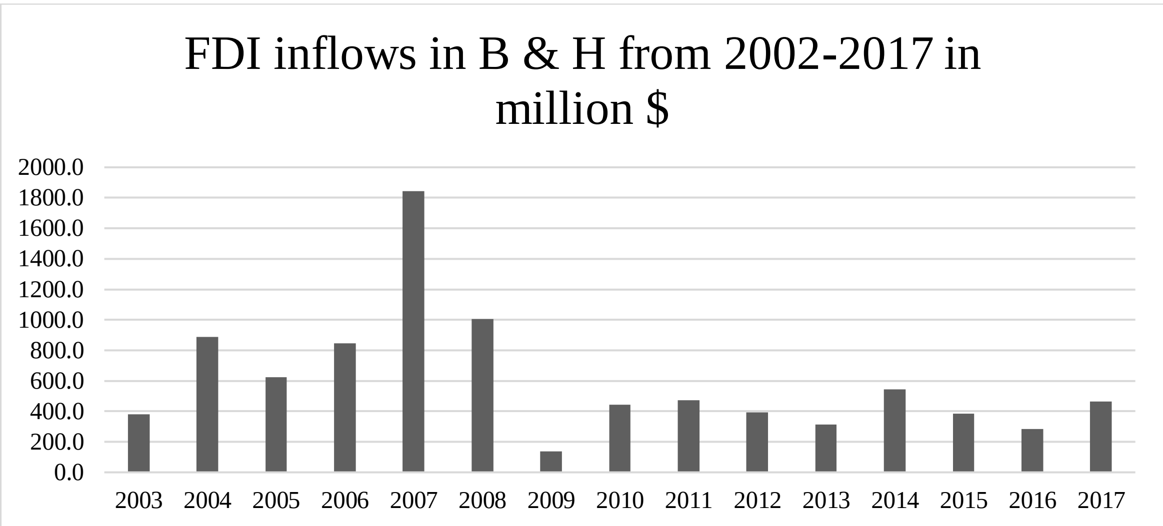

Figure 4.8 FDI inflows in Bosnia and Herzegovina from 2003-2017 in million $

Source: (The Global Economy, 2018)

Even though from 2003-2007 there may have been an increasing trend in the FDI inflow, the opposite started happening in 2008, reaching the lowest growth in FDI inflows in 2009 at a rate of 0.79%. This has come as a result of the financial crisis that took place in 2008 and continued spreading its effects further over the years.

4.4.1 Foreign investment stock by country in Bosnia and Herzegovina

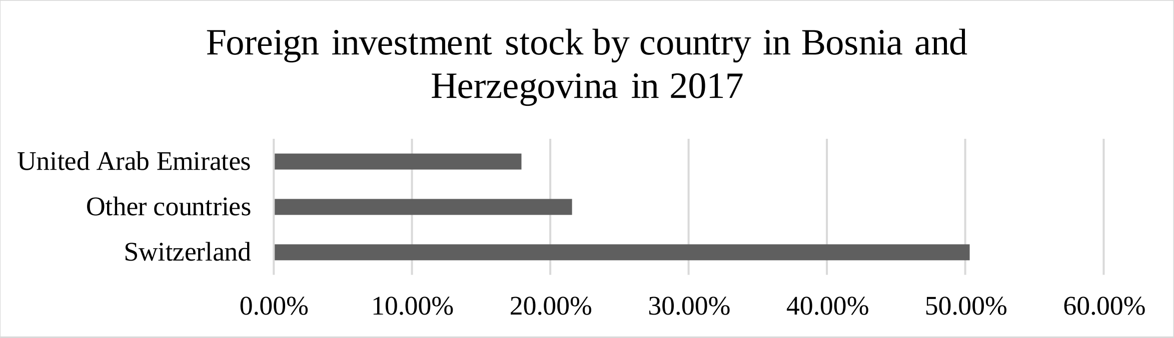

Figure 4.9 Foreign investment stock by country in Bosnia and Herzegovina in 2017
Source: (The Global Economy, 2018)

Switzerland in the one that has made more investments in Bosnia and Herzegovina for the year 2017, at a rate of 50.3%, while United Arab Emirates managed to make up 17.93% of total investments flow in 2016. The presence of Muslim people in the country is a very influencing factor on the great investments that Islamic investors conduct. The remaining part corresponds to other countries. Switzerland has overpassed countries that were usually ranked first in terms of the major countries contributing in the increase of FDI inflows in the country, such as Croatia, Serbia and Austria.

4.4.2 FDI stock in Bosnia and Herzegovina by economic activity

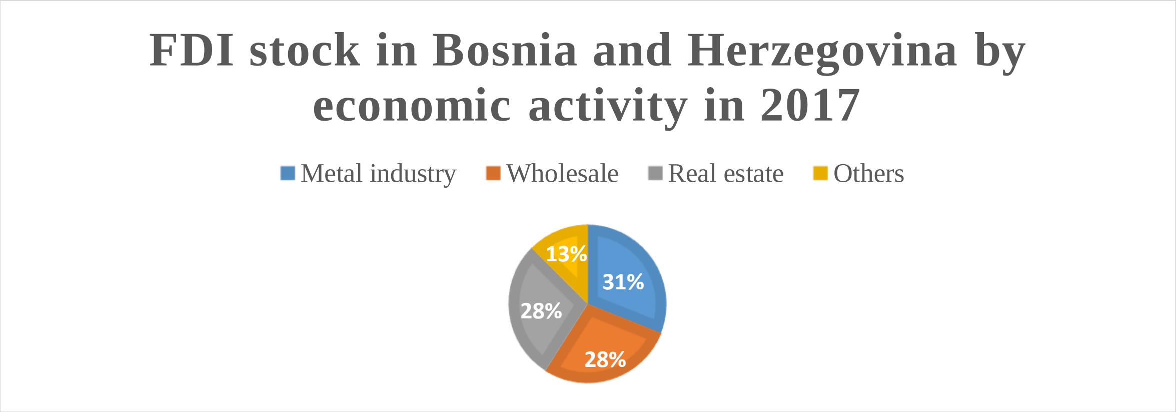

Figure 4.10 FDI stock in Bosnia and Herzegovina by economic activity in 2017
Source: (The Global Economy, 2018)

As seen from the chart, the main industry that generated most FDI inflows in the country in 2016 is the metal one at a rate of 31.04%, followed up by the wholesale industry at 27.96% of total FDI inflows. The third ranked industry is the one of real estate, which occupies 28.46% of the total FDI stock for the year 2017 and at last 12.54% of FDI inflows belong to other industries.

4.4.3 Investment opportunities in Bosnia and Herzegovina

Down below are listed some of the investments industries that possible investors need to take into consideration when thinking to invest in this country (Foreign Investment Promotion Agency of Bosnia, 2014).

- *Tourism:* the beautiful landmarks, with their unspoiled nature are the perfect attraction for tourists. Nevertheless, there is still room for improvement:
    - Need for upgrading the existing businesses in this industry
    - Need for readjusting the business model
    - Need for changing the management mindset

All of the above mentioned factors are subject to further improvement in the sector and attracting more foreign investors to make the relevant changes.

- One of the most important industries that is booming in this country in the last years is the one of *real estate;* this phenomenon has been active in the whole territory of Bosnia and Herzegovina, especially in its capital city Sarajevo. There are currently being built a lot of hotels, resorts, shopping centers etc.
    - Prices are competitive and expected to rise in the near future, giving higher incentives to possible investors to invest quickly.
    - The beautiful nature adds value to this type of investment
    - Land prices are relatively cheap
    - Electric energy price is competitive as well

- *Agriculture:* Considering the country's richness in abundant natural sources, agriculture is a great industry to invest in because of:
    - Favorable climate and microclimate conditions
    - Large resources of clean water
    - Long tradition in this industry, along with cheap labor force

    - Great education in agriculture and veterinary

- *Energy:* Regardless of being one of the most important sectors in the Bosnian economy and one with the longest tradition, there is still great potential for further investments:
    - Rich country in brown coal
    - Wind resource potential
    - Great surface of wood residues

- *Transport:* this one is considered as one of the most active industries in the country. Considering its geographical location, makes it very favorable for the country to provide great developments in this sector.

- *Construction:* a great need for repair of the existing buildings and also for further development of the cities and villages in Bosnia.

4.4.4 Reasons to invest in Bosnia and Herzegovina

- Bosnia and Herzegovina's location is very strategic in terms of establishing a new business
- If investments exceed 5 million Euros, foreign investors don't have to pay corporate tax
- Foreign investors share equal rights as all citizens of Bosnia and Herzegovina regarding property
- Abundant natural resources
- Attractive landscapes
- No employment tax for non-residents
- Educated and relatively cheap labor force
- Stable currency in terms of Euro
- Trade agreements in the region
- EU oriented, in terms of being part in the near future in the latter
- Foreign investors don't have to pay custom duties on the investments they make in the country

- Foreign investors have the right to freely invest all of their profit from investments in all types of currency
- They are freely eligible to hire foreign citizens

4.5 Economic background of Croatia

Croatia is the last Western Balkans country to be taken into consideration in this study. Croatia's economic development has been long defined by agriculture. The lack of fuel and raw materials for industry, on the one hand and the delayed industrial process, on the other hand, have defined the agrarian profile.

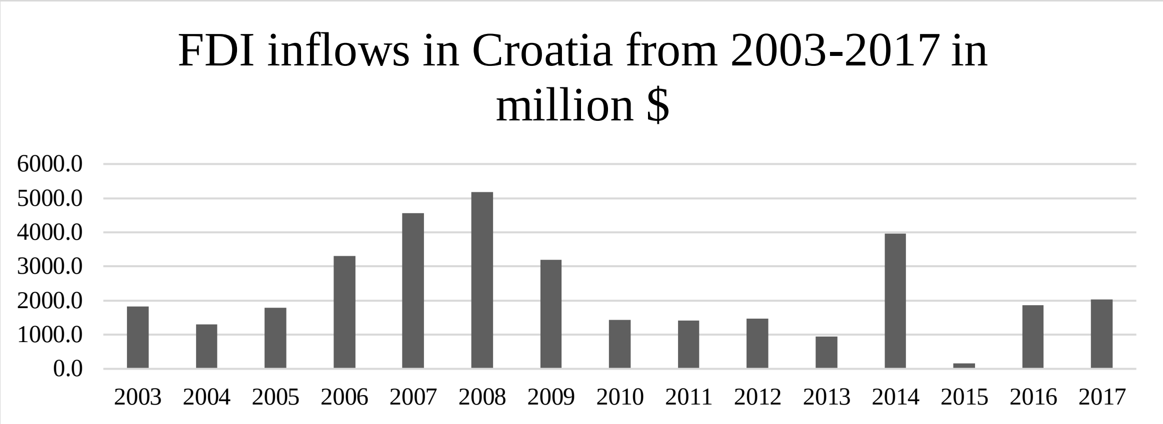

Figure 4.11 FDI inflows in Croatia from 2003-2017 in million $

Source: (The Global Economy, 2018)

When observing the FDI inflows of Croatia, there are generally some very satisfying figures, even though not in all cases. There has been an increasing trend until 2008, followed up by a decrease in the next years as a result of the financial crisis. An interesting figure is the one of 2014, where there is a considerable increase from 2013 to 2014. This was due to the integration of Croatia in the European Union, spreading its effect even in the foreign direct investments, considering the increased credibility of this country in the region and further. In 2015, seems FDI inflows did not contribute as much in the GDP of Croatia, but that immediately changed the next year where FDI inflows increased significantly.

4.5.1 Foreign investment stock by country in Croatia in 2017

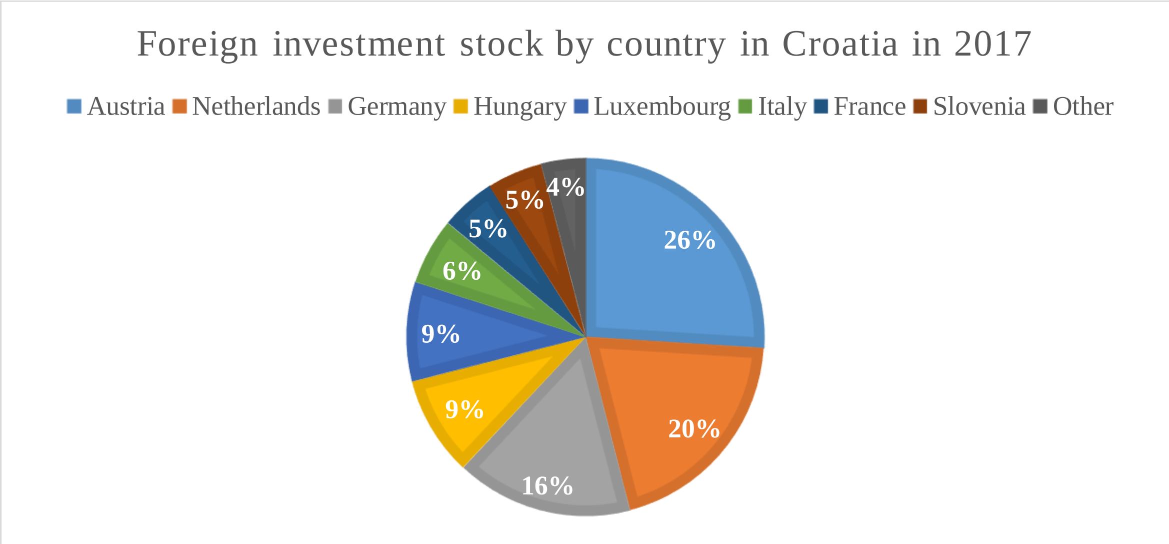

Figure 4.12 Foreign investment stock by country in Croatia in 2017

Source: (The Global Economy, 2018)

As it can be observed from the graph, the main investor in Croatia for the year 2017 is Austria, occupying 26% of the total FDI inflows in the country. Second ranked is Netherlands with 20%, followed up by Germany, Hungary and Luxembourg, respectively with 16%, 9% and 9% as well. The last ranked countries are Italy, France, Slovenia and others. Considering the low percentage of others in this section, it can be easily enforced the impact that these countries' investments have in Croatia.

4.5.2 FDI stock in Croatia by economic activity

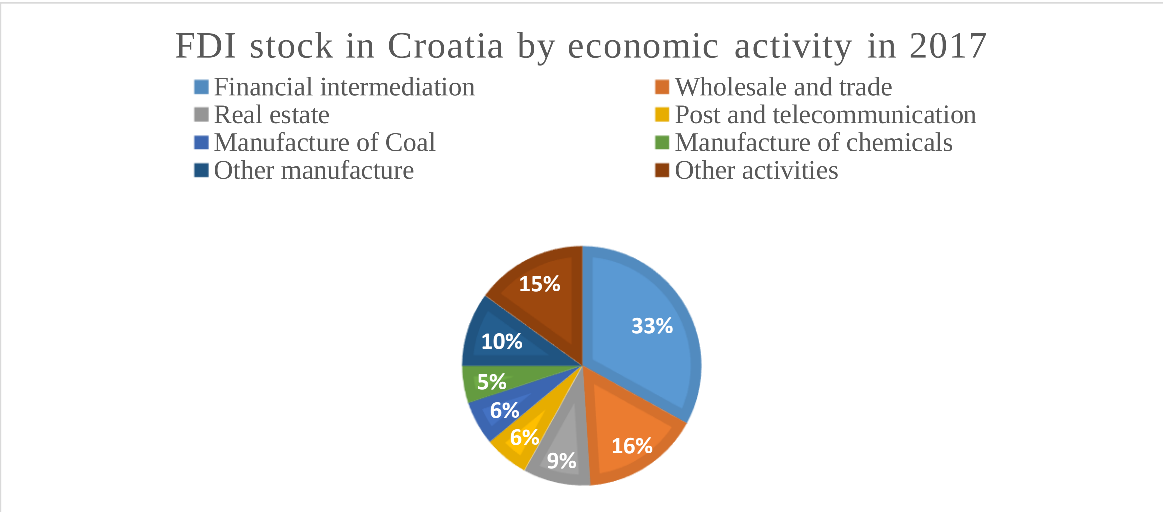

Figure 4.13 FDI stock in Croatia by economic activity in 2017

Source: (The Global Economy, 2018)

There are several industries that contribute in the FDI inflows in Croatia. For 2017, the main industry was the one of financial intermediation, followed up by wholesale and trade with 16% and other activities such as real estate with 9%, post and telecommunication with 6%, manufacture of coal and chemicals at 6% and 5% and at last other manufacture and other activities.

4.5.3 Investment opportunities in Croatia

There are several investment sectors in which potential investors can invest, such as follows (Agency for Investments and Improvements, 2018)

- *Tourism:* considering its nature, Croatia offers all types of tourism, including also the old cultural heritage

- *ICT:* ability of Croatian people to absorb new technology, also proved by the great productivity this country possesses

- *Food industry:* one of the biggest industries in Croatia, contributing considerably in the decrease of unemployment rate in this country. Some already operating international companies are: Meggle, Coca-Cola etc.

- *Pharmaceutical industry:* a long tradition of Croatia in this sector makes it even more favorable for potential investors to invest in this are; Croatia's discovery of a new antibiotic has increased her reputation all over the world as well, giving higher incentives to foreign investors.

- *Logistics:* Croatia's roads that connect it with many countries in the region, need maintenance, thus there is the need for construction companies to operate in this sector.

- *Textile:* a long Croatian tradition, with a large number of employees, resulting also in high productivity of the latters, being the highest one when compared to the EU average.

4.5.4 Reasons to invest in Croatia

- The tourism sector is already established, where tourists further than the region are approaching this country as tourists
- The labor force is educated and multilingual; 49% of the population speaks English, more than 12% of India that does (Grabovac, 2017)
- Closeness with Europe: its geographical location make is easier for trade with Europe, considering how close they are
- Doing business with a member of the European Union: greater access of Croatia in trades with the EU member countries
- Less barriers for foreign investors: foreign investors can even own 100% of the Croatian companies
- Tax incentives from the government for foreign investors (Croatian Agency for Innovations and Investments, 2018):
    - In some areas, the investors are tax exempted for the first 10 years of their operations in Croatia
    - EU member countries don't pay custom duties
    - Agreements for not paying the double taxation
    - Cash incentives for each new job created

4.6 Economic background of Serbia

Serbia is the last country to be taken into consideration in this study. Serbia is a country that lies in Central Europe or more specifically in the Western Balkans area. This country is bordered by Hungary in the north, Romania and Bulgaria in the east, Kosovo and Former Yugoslav Republic of Macedonia in the south, and with Montenegro, Croatia and Bosnia and Herzegovina in the west. Belgrade is the capital of Serbia. The economy of Serbia is based more on industry and agriculture. The most favorable years for the Serbs of the economy were in the early 1980s, while the most difficult position since 99, during the NATO bombing. As for agriculture in Serbia, it can be said that it is still a very important part of the Serbian economy. The total area of agricultural land in Serbia exceeds 6 million hectares with private ownership over 85%. Serbia produces various agricultural products, mainly cereals, fruits and vegetables that are important contributors to the economy of this country.

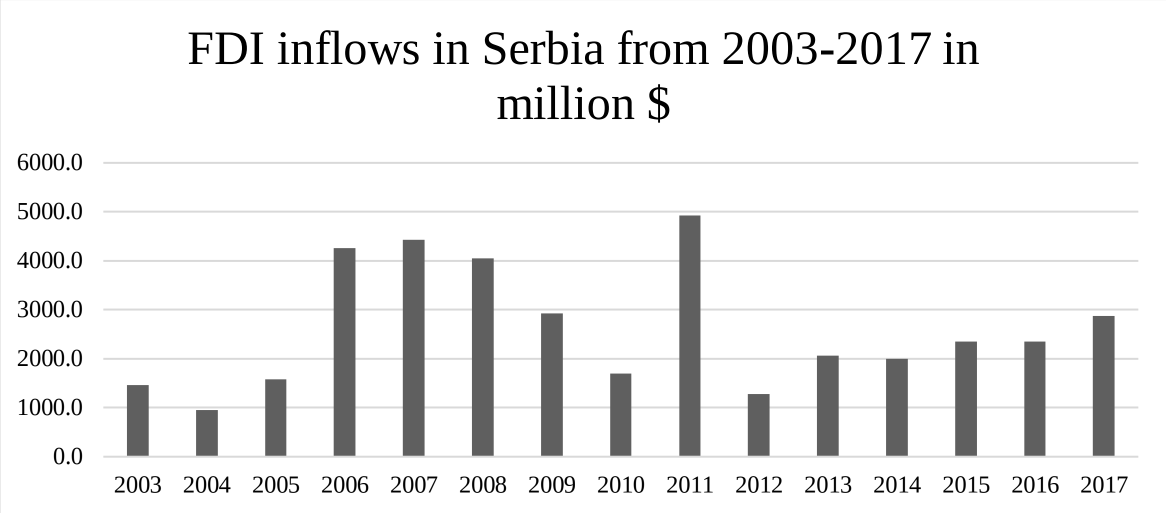

Figure 4.14 FDI inflows in Serbia from 2003-2017 in million $

Source: (The Global Economy, 2018)

By observing the graph, it can be concluded that in certain periods, such as the ones of 2006, 2007 and 2011, FDI has been a great contributor in the GDP of Serbia. The lowest value can be noticed in 2002 at a value of nearly $490.636 million, while the highest one it has been observed in 2011 at $4929.899 million. Afterwards, there has been a significant increase followed up by an increasing trend in the upcoming years.

4.6.1 Foreign investment stock by country in Serbia

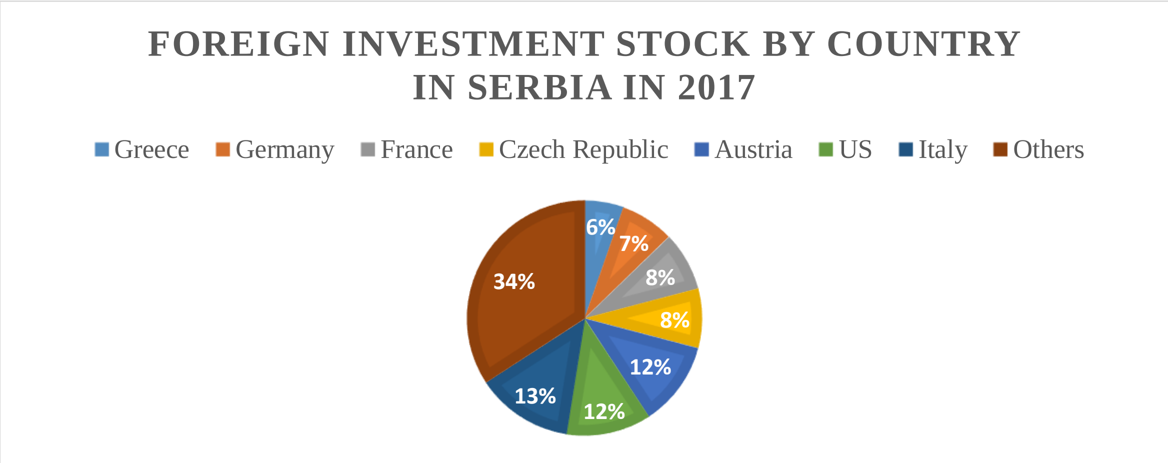

Figure 4.15 Foreign investment stock by country in Serbia in 2017

Source: (Development Agency of Serbia, 2018)

As for the main investors in Serbia, it is noted the great presence of Italy at a rate of 13.3%, followed by USA and Austria equally at 11.7% and other countries such as Czech Republic at 8.2%, France at 8.1%, Germany at 7.4%, Greece at 5.4% and others at 34.2$. What seems to be interesting is the fact that the main investors in Serbia, apart from the US, belong to the European Union, showing the impact of the union in the economic achievements of Serbia.

4.6.2 FDI stock in Serbia by economic activity

Figure 4.16 FDI stock in Serbia by economic activity in 2017

Source: (Development Agency of Serbia, 2018)

As it can be observed from the chart, the main industry, occupying 16.4% of the total investments made in Serbia for 2017, has been the one of Automotive industry, in which it can be mentioned the case of Zastava as the main producer of vehicles in Serbia, that manufactures different vehicles under the license of FIAT, RENAULT, CITROEN, MERCEDEZ-BENZ etc (Chamber of Commerce and Industry of Serbia, 2016). Afterwards, it is followed up by the agriculture sector at a value of 11.1%, a relatively high one as compared to the other sectors. Some other industries in which foreign investors tend to invest in Serbia are: Wood & Furniture, Machinery & Equipment, Electrical & Electronics, Construction, Textile & Clothing and others.

4.6.3 Investment opportunities in Serbia

- **Infrastructure and Construction**

Considering the future highway called Corridor 11, that will pass from Romania to Montenegro, this project is very important in terms of the development of infrastructure in Serbia. Apart from that, the European Union considers this project as an essential took for the development of the region as well.

Meanwhile, there are several other project to invest in such as the Belgrade bypass, the newly announced tender regarding a 25 year concession contract for the Belgrade airport "Nikola Tesla" (expert.gov, 2018).

- **Agriculture**

Agriculture accounts for 21% of the country's labor force when compared to the 2% average of the EU member countries (Development Agency of Serbia, 2018). Serbia's agricultural sector accounted for 9 percent of GDP in 2016, compared to an EU 27-average of two percent. In year 2016, some of the main exports of Serbia were coffee, cigarettes, soybeans, bananas, vegetables, and fish.

- **Medical devices**

Considering the modernization of the healthcare sector, the demand for medical devices will experience an increasing trend as well. Dentistry is also a sector which is experiencing a great development, with a rising demand for equipment, making this a great opportunity to invest in.

- **Telecommunications**

Taking into consideration the fact that Serbia has managed into creating the appropriate conditions to already render all the areas of the telecommunication sector competitive, there is an increased demand for equipment, telecom services, as there is also regarding the broadband networks.

- **Energy generation and transmission equipment**

Significant investments in the electricity sector, both by public and private sector, represent possible incentives to invest in such sector in terms of exporting this service and providing the necessary materials to make this industry develop even more.

4.6.4 Reasons to invest in Serbia

Considering that Serbia has expressed its desire to become part of the European Union, there are certain factors that contribute to such step. Some of them are its geographical strategic location, and many agreements with the EU, Turkey, Russia and many other countries that form part of the Central European Free Trade Agreement (Santander, 2018).

On the other hand, down below are listed some of the main reasons foreign investors should consider allocating their funds in this country:

- Serbia has the lowest corporate tax rate of only 10%, contributing in making this country a pro-business area
- Different agreements signed with the IMF and the European Union in which this country aspires to join in
- A young labor force, highly educated, well-trained and speaks many languages, where more specifically about half of the population speaks English
- Cheap labor force
- Agriculture oriented in terms of the natural sources

4.7 Ease of doing business

Albania:

- *Construction permits*: Albania made it easier to deal with construction permits through the re-introduction of issuing building permits and streamlining the process of receiving the final inspection and compliance certificate.

- *Electricity:* Albania made it *more* easily feasible obtaining electricity through the process of speeding up the procedures of obtaining a new connection.

Former Yugoslav Republic of Macedonia:

- *Obtaining credit:* Former Yugoslav Republic of Macedonia made progressive steps in the process of obtaining more easily credit, by creating new laws and also providing more modern features in terms of the collateral registration.

- *Protection of the minority investors:* Former Yugoslav Republic of Macedonia made some regulations in terms of protecting the minority investors by increasing the rights of the stakeholders and their role in the decisions of the respective corporates.

Montenegro:

- *Decrease of tax rates:* Montenegro decreased the tax rate on personal income and also provided a new electronic system to make it easier to pay these reduced taxes.

Croatia:

- *Protection of the minority investors:* Same as Former Yugoslav Republic of Macedonia, Croatia also paid a great attention in this regards.

Bosnia & Herzegovina:

- *Low minimum capital requirement:* Bosnia made it easier for firms to start a business through lowering the minimum capital requirement.

- *Notary system:* Bosnia managed to increase the efficiency in this regards by making it easier to open up a new business.

CHAPTER 5

WESTERN BALKANS AND THE EUROPEAN UNION INTEGRATION

Enlargement continues to be one of the key EU policies. Despite various challenges, Western Balkan countries are taking important steps in the EU integration process. From the beginning, the EU has helped reform the state and economy in the Balkans; in improving democracy and increasing efficiency in public institutions. At today's point, Western Balkan countries are trying to improve their economies and accelerate the EU accession process by taking further steps at regional level. In recent years, regional cooperation between the Balkan countries has begun to dominate economic issues, such as improving living conditions, competition and development.

For decades the Balkan countries have not been able to enter the growing economies. In fact, in 2008, the share of Western Balkan countries in world GDP declined to 0.18% from 0.38% in 1980 (International Monetary Fund, 2017). After that date, socio-economic problems in Balkan countries deepened even more so with the impact of the global economic crisis. Although today all the economies of the region are beginning to grow again, they will have to overcome the barriers in the labor market in order to maintain a real growth rate of 4% by 2023. Of particular importance here is the increase of the levels of employment of women and youth.

Among the countries taken into consideration for this study, Croatia is the only country which is already part of the European Union. The other countries have yet to fulfill some of the requirements of the EU to become actual members of this union.
"The growth the region experienced in the years after the global financial crisis is proof of the economic potential that Western Balkans possess" (Waiglein, 2018).The main purpose

is to decide on the political priorities that can put a stimulation on the investments in the private sector that will consequently contribute in boosting the regional cooperation and integration and indirectly help in the process of creating new jobs. Some of the main objectives for policy makers are undertaking the right and necessary steps for the purpose of increasing investments, export and consequently employment as well. Considering the low productivity levels in the area, it is required further improvement in terms of the business environment in order to attract foreign investors, thus promoting the economic growth.

Corruption, rule of law, and reforms continue to be the main difficulties of the Western Balkans on the road to EU integration. The countries should focus more on meeting the technical conditions of EU membership, such as reforming the justice system, transparency and the fight against corruption.

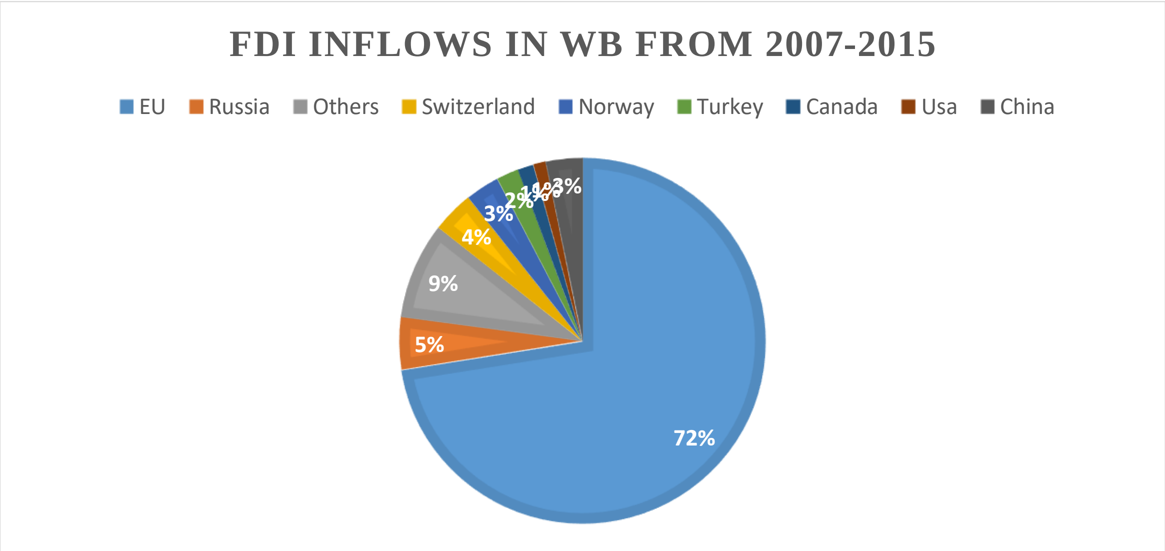

Figure 5.1 FDI inflows in WB from 2007-2015

Source: (European Union External Action, 2018)

As it can be observed from the chart, EU is the main investor in the Western Balkans, differentiating itself from the other investors at a very high percentage.

5.1 Western Balkans' path towards EU

Albania

Now that more than two decades have passed since the systemic changes that left behind the centralized economy, and especially judging by the current level of economic and social development of the country, it can be concluded without hesitation that just like in many other countries of Central and Eastern Europe, the experience of Albania with the transition has been really painful. As it is well known, immediately after the collapse of communism, the Albanian economy went into a collapsing state, in the country emerged sharp social problems, while emigration became a mass phenomenon.

Despite the important structural reforms of the first years of transition, the macroeconomic stabilization achieved after the 1997 crisis, the sustained economic growth for almost a decade and the favorable fiscal performance of recent years, the Albanian economy remained a largely based economy in the agricultural sector and services, although agriculture was and is quite fragmented, uncompetitive and only a small part of it is capable of offering market goods. Meanwhile, in recent years, due to the implications of the global economic crisis, the factors of productivity growth in the Albanian economy have shown the tendency of slowdown, which apparently *constitutes a significant conditioning in the integration process of Albania into the European Union.*

And when we talk about EU membership, in the economic viewpoint, this process is about meeting not only the political criterion (stability of institutions guaranteeing democracy, rule of law, human rights, and respect for and protection of minorities), but the ability to assume the obligations deriving from membership, including persuasion towards the goals of political, economic and monetary union, but also the fulfillment of the economic criterion - the existence of a market economy functional capacity and the ability to interact with pressures and market forces within the EU.

Albania signed The Stabilization and Association Agreement in June 2006, which was entered into force in April 2009. This agreement serves as a replacement for the Interim Agreement on Trade and Commerce, which entered into force in December 2006. From the economic point of view, Albania's status as a candidate country of the EU (2014) will encourage foreign investment and, as a result, will create job new jobs. As a candidate country, Albania will continue to benefit from EU funds under the Instrument for Pre-Accession Assistance (IPA) for the comprehensive implementation of reforms and investment strategies, and will also benefit from its participation in EU programs as well (European Union External Action, 2018).

Albania's steps towards European Union

The public debt to GDP ratio has made quite improvements, but is still subject to macroeconomic vulnerability

- This is also the case of non-performing loans, but still the banking sector is still not expanding
- Even though Albania is competitive in the energy sector, still has not made any significant steps regarding the renewable energy
- Progresses have been made regarding the property rights, which has increased the competitiveness of Albania in the construction sector
- Regarding the required policies from the EU, Albania has managed completing them at certain levels such as follows (European Commission, 2018):
- Policies undertaken to reduce the public debt as a percentage of GDP: limited performance
- Policies undertaken to reduce the number of NPL: relatively achieved implementation
- Registration of property: partial achieved implementation

Former Yugoslav Republic of Macedonia

The EU is the main trading partner of the Former Yugoslav Republic of Macedonia, forming part of 60% of the country's exports and 48% of its imports. Exports from the country are concentrated around some products where the main ones are: ferro-nickel alloys, iron and steel, and textiles. The main imports of Former Yugoslav Republic of Macedonia with the EU countries are: crude oil, electricity, flat-rolled iron and steel products, and vehicles.

Considering the fact that the Former Yugoslav Republic of Macedonia wishes to form part of the EU, there are several supports that the European Union has undertaken to help Former Yugoslav Republic of Macedonia achieve this objective:

Since 2007, the Instrument for Pre-accession (IPA) has enabled the country to focus on making changes in five key areas:

- Rural development

- Human resources
- Cross-border cooperation
- Institution building
- Regional development
- Technical Assistance and Information Exchange (TAIEX)
    - The EU also offers support through the TAIEX instrument, which helps partner countries become acquainted with, apply and enforce EU laws.
    - TAIEX funds short-term technical assistance, advice and training. TAIEX assistance is open to:
- Professional/commercial associations, workers and employers' groups
- Civil servants
- Parliaments/legislative bodies and their staff
- Judiciary and law enforcement authorities

Main challenges of Former Yugoslav Republic of Macedonia towards EU integration (European Commission, 2018)*:*

- Improvement of the domestic private sector, reducing of public debt and increasing of employment: public debt has been increasing ever since 2008, adding up the structural issues in terms of employment and also the lack of development of the private sector.

- Reducing the costs of doing business in the country; even though the business environment has made significant improvement changes

- Reducing the presence of informal sector: substantial harm is made to the public revenue, but also to employees' rights as well.

- Improving the quality of education: low skilled workers need to be leveled up, considering the large amount of the population corresponding to this group

How well has Former Yugoslav Republic of Macedonia managed completing these challenges?

- Regarding public debt: limited performance, considering it still has large public debt digits

- In terms of easing the process of doing business, it has cut the costs and the bureaucratical part of opening up a business: achieved implementation
- Increasing the transparency of the financial sector, in terms of their investments, where they are made and the impacts they have on economic growth
- Improvement of the quality of teachers and consequently the students and the future skilled workers: *fully implemented*

Montenegro

In terms of the relationship between Montenegro and EU, down below are some proof regarding the matter (European Commission, Montenegro on its European Path, 2016):

- *Trade and Investment:*
    - EU is the main investor and trading partner of Montenegro as well
    - In 2016, 32% of the foreign direct investments conducted in Montenegro were from the common zone
    - 37.5% of total exports of Montenegro were in the EU, while about 47% of imports were coming from the European Union countries
- *Funding from EU:*
    - Accordingly, EU serves also as the largest provider of financial aid in Montenegro
    - Ever since 1999, about 621 million Euros are provided in the EIB (European Investment Bank)
    - About 81 million Euros are provided in WB investment grants, leveraging investment at a value of 745 million dollars, while an investment of 16 million Euros is granted in terms of quality education and employment since 2015

Main challenges of Montenegro towards EU integration (European Commission, 2018)*:*

- Reducing the high public debt of the country through fiscal policies
- Improving the situation regarding the non-performing loans, due to their high levels currently
- Improving the country's competitiveness, thus helping reducing the external balances

- Making efforts in terms of Research & Development
- Fixing the problem of mismatching of skills and the job creation in the country

How well has Montenegro managed completing these challenges?

- Regarding the fiscal policies to reduce public debt, limited implementation has been made regarding the matter
- In terms of non-performing loans, partial achievement has been made as well
- The problem of mismatching of skills and job creation has started its steps on improvement too

Bosnia and Herzegovina

- *Agreements*
  - Bosnia became part of the Instrument for Pre-Accession (IPA) funds from 2007-2013. Bosnia and Herzegovina currently receives 822m euros of development aid by 2020 from the Instrument for Pre-Accession Assistance, a financing mechanism for EU.

- *Trade and Investment:*
  - EU is the main investor and trading partner of Bosnia and Herzegovina as it has proven to be of the whole WB countries as well
  - In 2016, 229 million Euros of the foreign direct investments conducted in Bosnia and Herzegovina were from the EU countries
  - Volume of trade between the two for the year 2017 was around 10 billion Euros
  - 72% of total exports of Bosnia and Herzegovina were in the EU, while 62% of imports were coming from the European Union countries

- *Funding from EU:*
  - Accordingly, EU serves also as the largest provider of financial aid in Bosnia and Herzegovina
  - Ever since 1999, about 2.2 billion Euros are provided in the EIB (European Investment Bank)

- About 122 million Euros are provided in WB investment grants, leveraging investment at a value of 2.8 billion dollars
- About 51 million dollars are granted to Bosnia and Herzegovina for the disaster relief after the floods that took place in 2014 (European Commission, 2018)

Main challenges of Bosnia and Herzegovina towards EU integration (European Commission, 2018)*:*

- Improvement of quality spending by focusing more on public investments and also education of the population
- Improving the quality of fiscal planning
- Positive developments in terms of labor market in terms of low pre-school participation

How well has Bosnia and Montenegro managed completing these challenges?

- Bosnia and Herzegovina has managed making improvements in terms of social spending and creating fiscal spaces for public investments in the country
- Referring to fiscal planning, it has implemented e-payment services to pay taxes
- Improvements in terms of employment services to successfully serve to job-seekers, especially women, youth and low-skilled workers
- Increase of enrollment in pre-school education has been implemented as well

Serbia

- *Agreements:*
    - Serbia became part of the Instrument for Pre-Accession (IPA) funds for 2014-2020 period (European Commission, 2018). The priority sectors for this period in terms of funding are:
        - *Democracy & governance; Rule of law; Environment action; Transport; Construction; Agriculture; Energy; Education and social policies*

- *Trade and Investment:*

- EU is the main investor and trading partner of Serbia too
- In 2016, 66% of total FDI inflows in Serbia were from the common zone countries
- Volume of trade between the two for the year 2017 was around 2.3 billion Euros
- 66% of total exports of Serbia were in the EU, while 63% of imports were coming from the European Union countries

- *Funding from EU:*
  - Accordingly, EU serves also as the largest provider of financial aid in Serbia
  - Ever since 1999, about 5 billion Euros are provided in the EIB (European Investment Bank)
  - About 117 million Euros are provided in WB investment grants, leveraging investment at a value of 2.25 billion dollars
  - Investment of 16 million Euros is granted in terms of quality education and employment since 2015 (European Commission, 2018)

Main challenges of Serbia towards EU integration (European Commission, 2018)*:*

- Strengthening of fiscal policies, considering they are weak and do not fix the increasing public debt of Serbia
- Improvement of the distribution of government expenditure; too much spending and inappropriate allocation of the public saving
- Fishing the process of on-going privatization
- Improving the informal sector and unfair competition
- Making substantial changes regarding the including of women and youth in the labor market

How well has Serbia managed completing these challenges?

- Regarding the public debt, Serbia has managed ensuring a relative reduction of the latter in 2017, which it can be concluded that it has successfully completed the challenge
- As for improvement in terms of government expenditure, focusing it more on wages and pension, it has partially managed in doing so

- Improvement of tax administration and better efficiency of inspections has been substantially performed
- Labor participation rate has been actively increasing, including women and also the youth of the country

Fulfilling the necessary reforms for the Western Balkan countries in terms of their acceptance in the EU could also affect the European Union's own empowerment and renewal.

Since the private sector base is tight, Western Balkan countries need a continuous flow of foreign capital to increase their competitive strength and to grow economically. Aware of the fact that they cannot easily overcome these difficulties, Western Balkan countries are trying to take steps at regional level, to work together, to achieve their common interests and to be closer to EU membership.

Today, the level of regional cooperation in the Western Balkans has also created a strong need for parliamentary support. Indeed, some parliamentary forums that have developed in the region not only facilitate regional communication but also contribute to common regional understanding and the European integration process.

With the support of all these institutions and activities carried out at regional level, the Western Balkan countries are trying to create a new look for themselves. These countries want the WB not to be recognized as an unstable region, but as a region that fights with corruption, which strengthens state institutions, which strives to attract foreign investment and interest in the living conditions of citizens. However, the WB countries will have to take more steps on these issues. To accelerate the EU accession process, the countries in the region concerned will have to take the most decisive steps at national and regional level in terms of rule of law, economic governance and administrative capacity building.

CHAPTER 6

EMPIRICAL STUDY

6.1 Data

For the realization of this thesis, there's certain information that needs to be gathered in order to conduct a correct study. In this context, it has been essential the use of only secondary data, mostly from online sources and library books.

The data used in this study are quantitative ones. Some other sources related to the individual analysis of each country, are taken from different national sources such as: the Central Bank of each of the countries, the IMF, the World Bank and most of the quantitative data is collected from the Global Economy website.

The main variables taken into consideration for conducting this study are:

- *GDP growth*
- *FDI inflows growth*
- *Unemployment rate*
- *Inflation rate*
- *Exports growth*
- *Imports growth*
- *Trade openness*

Considering that the main objective of this thesis is finding out the factors that impact GDP growth, data regarding these variables for each of the countries taken into consideration, are necessary. The data is taken from 2003-2017 for each of the countries under study, which are: Albania, Former Yugoslav Republic of Macedonia, Montenegro, Bosnia and Herzegovina, Croatia and Serbia. In order to make a more accurate study, more data is required, but Montenegro lacked the data of FDI inflows, limiting the study from 2003-2017. The same problem was faced also in the case of Kosovo, being that Kosovo is also part of the Western Balkans, in which the data regarding FDI inflows starts from 2008. Considering that the number of observations is already relatively low, it was thought for Kosovo to be excluded from this study.

6.2 Methodology

Taking into consideration the available data, different graphs will be conducted to show the trend of the FDI inflows in the countries taken under study. Afterwards, the regression analysis will be able to tell whether there is a relationship between the variables taken into consideration, which one impacts the other and up to which level. For this, it is needed the application of Eviews programs.

The hypotheses are as follows:

- H_0: FDI growth has no impact on GDP growth
- H1: FDI growth has positive impact on GDP growth

- H0: GDP growth has no impact on FDI growth
- H1: GDP growth has positive impact on GDP growth

- H0: Unemployment rate has no impact on GDP growth
- H1: Unemployment rate has negative impact on GDP growth

- H0: Inflation rate has no impact on GDP growth
- H1: Inflation rate has positive impact on GDP growth

- H0: Exports growth has no impact on GDP growth
- H1: Exports growth has positive impact on GDP growth

- H0: Imports growth has no impact on GDP growth
- H1: Imports growth has negative impact on GDP growth

- H0: Trade openness has no impact on GDP growth

- H1: Trade openness has positive impact on GDP growth

Considering that a comparative analysis will be made in terms of determining whether there is a relationship between GDP growth and FDI growth; a positive or negative one and up to which level, panel regression will be conducted.

6.3 Comparison analysis

In this section, the data under consideration are FDI inflows and GDP growth. These variables are gathered for a period of 15 years, starting from 2003 to 2017. The countries taken under study are: Albania, Former Yugoslav Republic of Macedonia, Montenegro, Bosnia and Herzegovina, Croatia and Serbia. The analysis planned to be conducted, will help the study on determining the relationship between the two variables, in terms of which one impacts the other and consequently up to which level. The results from this study, will be of an essential help in answering the questions of this research and making the corresponding concluding remarks.

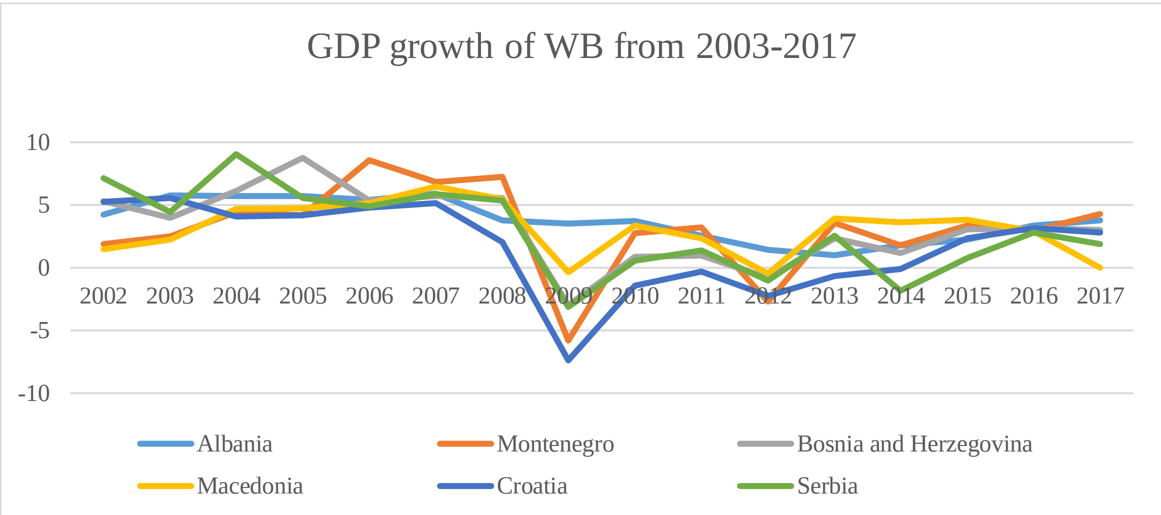

Figure 6.1 GDP growth of WB from 2003-2017

Source: (The Global Economy, 2018)

From the above graph, overall, it can be observed that the trend of GDP growth has been relatively similar for all the countries that participate in this study. During the first years of the period taken into consideration, FYROM and Montenegro seem to have the lowest GDP growth as compared to the other countries. What seems to be interesting is the fact that

Albania is the one that faced the highest GDP growth during the financial crisis of 2008-2009, while Croatia is the one with the lowest GDP growth, reaching a minimum of -7.38%.

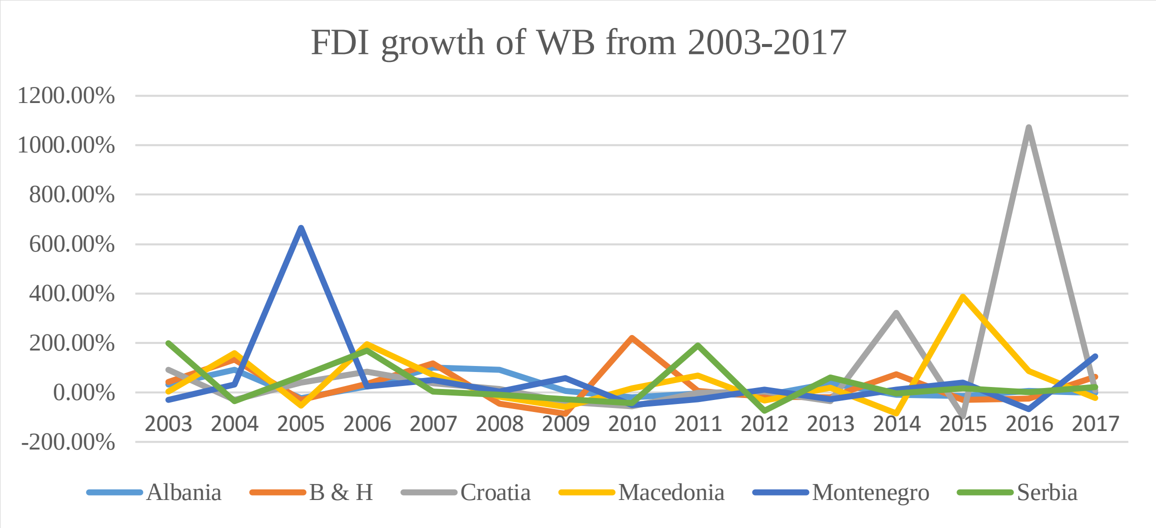

Figure 6.2 FDI growth of WB from 2003-2017

Source: (The Global Economy, 2018)

Regarding the FDI growth, it seems that the country that has experienced the highest growth in terms of FDI inflows is Croatia in 2016. Another country that seems to have high FDI growth is also Montenegro. As for the other countries, they approximately share similar percentages. The ones country with relatively lowest values are Republic of Former Yugoslav Republic of Macedonia, Albania and Bosnia and Herzegovina.

6.4 Regression analysis

In order to conduct the regression analysis on the data regarding the WB countries from 2003-2017, firstly unit root test has to be performed. Considering that the majority of the variables taken under study are growth rates, it is expected for them to be stationary in level. Nevertheless, from the conducted testing, the below stated results support our claim as follows:

Table 6.1

Unit root test for GDP growth

Panel Unit Root Summary	
Series: **GDP growth**	
Sample: 2003-2017	
Null: GDP growth contains unit roots	

	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-1.74619	**0.0404**	6	78
Im, Pesaran and Shin W-stat	-0.19523	0.4226	6	78
ADF - Fisher Chi-square	10.729	0.5523	6	78
PP - Fisher Chi-square	26.1083	**0.0104**	6	84

Source: Conducted by own author

GDP growth is considered as stationary at level due to the fact that Levin, Lin & Chu test states a probability value of 0.0404 (less than 5%) and also PP-Fisher Chi-square at a probability value of 0.0104, still at 5% significance level.

Table 6.2

Unit root test for FDI growth

Panel Unit Root Summary				
Series: **FDI growth**				
Sample: 2003-2017				
Null: FDI growth contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-2.68768	**0.0036**	6	78
Im, Pesaran and Shin W-stat	-2.1389	**0.0162**	6	78
ADF - Fisher Chi-square	35.2958	**0.0004**	6	78
PP - Fisher Chi-square	67.411	**0**	6	84

Source: Conducted by own author

By the observation of the probability values on 4 cases, it can be concluded that FDI growth is stationary at level, considering that all the corresponding values of each of the criterias are less that 5%.

Table 6.3

Unit root test for Exports growth

Panel Unit Root Summary				
Series: **Exports growth**				
Sample: 2003-2017				
Null: Exports growth contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations

Levin, Lin & Chu t*	-2.47843	**0.0066**	6	78
Im, Pesaran and Shin W-stat	-2.23579	**0.0127**	6	78
ADF - Fisher Chi-square	24.7389	**0.0161**	6	78
PP - Fisher Chi-square	49.6334	**0**	6	84

Source: Conducted by own author

Considering that all four of the conducted methods to test for unit root, all have a probability lower that 5%, it can be concluded that Exports growth are stationary at level, at 1% significance level.

Table 6.4

Unit root test for Imports growth

Panel Unit Root Summary				
Series: **Imports growth**				
Sample: 2003-2017				
Null: Imports growth contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-4.77213	**0**	6	78
Im, Pesaran and Shin W-stat	-3.50342	**0.0002**	6	78
ADF - Fisher Chi-square	34.1861	**0.0006**	6	78
PP - Fisher Chi-square	48.3037	**0**	6	84

Source: Conducted by own author

Considering the results from the above conducted table, imports growth is also stationary in level, supported by the fact that the value of probability in four of the criteria is less than 1%, meaning they are significant at 1%

Table 6.5

Unit root test for Inflation

Panel Unit Root Summary				
Series: **Inflation**				
Sample: 2003-2017				
Null: Inflation contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-2.31479	**0.0103**	6	78
Im, Pesaran and Shin W-stat	-0.98598	0.1621	6	78

ADF - Fisher Chi-square	14.5331	0.268	6	78
PP - Fisher Chi-square	23.7024	**0.0223**	6	84

Source: Conducted by own author

Inflation is also stationary in level, considering that Levin, Li & Chu support this statement with a probability value of 0.0103, at 5% significance level, and also b PP-Fisher Chi-square where its probability expresses a value of 0.0223, still less than 5%.

Table 6.6

Unit root test for Unemployment rate

Panel Unit Root Summary				
Series: **Unemployment rate**				
Sample: 2003-2017				
Null: Unemployment rate contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	2.79254	0.9974	6	78
Im, Pesaran and Shin W-stat	-0.52182	0.3009	6	78
ADF - Fisher Chi-square	19.1022	0.0861	6	78
PP - Fisher Chi-square	20.9767	0.0507	6	84

Source: Conducted by own author

Considering that all of the probability figures are higher than 5%, it can be concluded that unemployment rate is not stationary in level, but it is so in first difference, as it will be observed down below:

Table 6.7

Unit root test for Unemployment rate

Panel Unit Root Summary				
Series: **d(unemployment_rate)**				
Sample: 2003-2017				
Null: Unemployment rate contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	2.79254	0.9976	6	72
Im, Pesaran and Shin W-stat	-0.52182	**0.0018**	6	72
ADF - Fisher Chi-square	19.1022	**0.0035**	6	72
PP - Fisher Chi-square	20.9767	**0.0000**	6	78

Source: Conducted by own author

Considering that the probability figures of Im, Pesaran and Shin W-stat, ADF - Fisher Chi-square and PP - Fisher Chi-square are lower than 5%, it can be concluded that unemployment rate is stationary in first difference.

Table 6.8

Unit root test for Trade Openness

Panel Unit Root Summary				
Series: **Trade openness**				
Sample: 2003-2017				
Null: Inflation contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-2.31479	0.2724	6	78
Im, Pesaran and Shin W-stat	-0.98598	0.4189	6	78
ADF - Fisher Chi-square	14.5331	0.1911	6	78
PP - Fisher Chi-square	23.7024	0.0536	6	84

Source: Conducted by own author

Since the probability values are higher than 0.05, trade openness is not stationary in level, but is it in first difference, considering that Levin, Lin & Chu t*, Im, Pesaran and Shin W-statistics, ADF - Fisher Chi-square and PP - Fisher Chi-square probability values are within the 5% border.

Table 6.9

Unit root test for Trade Openness

Panel Unit Root Summary				
Series: **d(trade_openness)**				
Sample: 2003-2017				
Null: Inflation contains unit roots				
	Statistic	Prob.**	Cross-sections	Observations
Levin, Lin & Chu t*	-2.31479	**0.007**	6	72
Im, Pesaran and Shin W-stat	-0.98598	**0.0073**	6	72
ADF - Fisher Chi-square	14.5331	**0.0112**	6	72
PP - Fisher Chi-square	23.7024	**0.0000**	6	78

Source: Conducted by own author

Table 6.10

VAR Lag Order Selection Criteria

VAR Lag Order Selection Criteria						
Endogenous variables: GDP growth, FDI growth, Exports growth, Imports growth, Inflation, Unemployment rate, Trade openness						
Exogenous variables: C						
Sample: 2003 2017						
Included observations: 60						
Lag	LogL	LR	FPE	AIC	SC	HQ
0	214.1561	NA	1.10E-12	-7.67447	-7.41*	-7.5301
1	292.2738	133.0894	3.79E-13	-8.75088	-6.6823	-7.9554
2	359.6852	97.37204	2.10E-13	-9.43279	-5.5632	-7.9425
3	411.5469	61.46567	2.41E-13	-9.53877	-3.8649	-7.3519
4	484.4205	67.4762*	1.69E-13	-10.423	-2.9488	-7.5936
5	577.097	61.7806	**9.2e-14***	**-12.044***	-2.7581	**-8.46***
* indicates lag order selected by the criterion LR: sequential modified LR test statistic (each test at 5% level) FPE: Final prediction error AIC: Akaike information criterion SC: Schwarz information criterion HQ: Hannan-Quinn information criterion						

Source: Conducted by own author

In order to determine the period in which one factor impacts the other, it is important first identifying the appropriate lag number. This is way it is needed to conduct the Lag order Criteria Test. From this test, it can be observed that according to FPE criterion, 5 lags is the optimum lag number in the case of this study. This idea is also supported by AIC and HQ criteria as well (the * sign serves as a reference point). On the other hand, SC criterion states that 0 is the optimal number of lags, while LR suggests it is 4. Considering that are 3 criterions that support the idea of taking 5 as an optimal lag number, it is concluded that the lag number to be taken into consideration for this analysis to be 2. Consequently, the VAR analysis will be further conducted, by including 5 lags.

Table 6.11

Vector Autoregression Estimates

Vector Autoregression Estimates	

Sample (adjusted): 2009 2017							
Included observations: 54 after adjustments							
t-statistics in [ ]							
	GDP growth	D_Trade	D_Unemployment	Exports growth	FDI growth	Imports growth	Inflation
GDP growth (-1)	0.684437	-0.04611	0.033156	-0.041655	4.045518	0.09461	0.01477
	-0.49112	-0.04742	-2.63E-01	-0.05634	-1.74044	-0.07375	-0.009
	[1.39361]	[-0.8776]	[0.12609]	[-0.73939]	**[2.3243]**	[1.28281]	[1.629]
GDP growth (-2)	0.302416	0.274302	-1.18E+00	0.574091	23.199	1.647476	0.482523
	-7.34644	-0.70927	-3.93E+00	-0.84272	-26.0341	-1.10322	-0.1353
	[0.04116]	[0.3864]	[-0.29925]	[0.68124]	[0.8911]	[1.49334]	**[3.552]**
GDP growth (-3)	-6.437692	0.184546	-2.404406	-0.110165	-37.4027	0.150887	-0.5044
	-7.80755	-0.75379	-4.18016	-0.89561	-27.6682	-1.17246	-0.1443
	[-0.82455]	[0.2443]	[-0.57519]	[-0.12301]	[-1.3518]	[0.12869]	[-1.494]
GDP growth (-4)	-4.068508	0.18514	2.922539	-0.155078	-17.2856	0.389969	0.30267
	-6.68899	-0.6458	-3.58129	-0.7673	-23.7043	-1.00449	-0.1236
	[-0.60824]	[0.2868]	[0.81606]	[-0.20211]	[-0.7292]	[0.38823]	**[2.447]**
GDP growth (-5)	-4.340912	0.181633	10.70532	-0.193218	-48.5108	-0.02718	-0.2441
	-6.96726	-0.67266	-3.73027	-0.79922	-24.6904	-1.04628	-0.1288
	[-0.62304]	[0.2702]	**[2.86985]**	[-0.24176]	[-1.9647]	[-0.02598]	[1.8997]
DTrade (-1)	-0.074218	0.329385	-1.263396	0.570826	10.01264	0.880831	0.11508
	-3.946	-0.38097	-2.11269	-0.45265	-13.9837	-0.59257	-0.0729
	[-0.01881]	[0.8649]	[-0.59800]	[1.26108]	[0.7162]	[1.48645]	[1.577]
DTrade (-2)	1.325084	0.140125	2.421127	-0.156989	5.696126	0.638634	0.08446
	-2.86642	-0.27674	-1.53468	-0.32881	-10.1579	-0.43045	-0.053
	[0.46228]	[0.5064]	[1.57761]	[-0.47745]	[0.5606]	[1.48364]	[1.631]
DTrade (-3)	-2.296426	0.269575	-0.608644	0.205449	-14.2578	-0.007417	-0.0015
	-2.54567	-0.24577	-1.36295	-0.29202	-9.02129	-0.38228	-0.0470
	[-0.90209]	[1.0964]	[-0.44656]	[0.70355]	[-1.5804]	[-0.01940]	[-0.032]
DTrade (-4)	-1.866129	-0.06645	2.494366	0.186641	-13.5567	-0.19081	-0.1092
	-2.43601	-0.23519	-1.30424	-0.27944	-8.63267	-0.36582	-0.0454
	[-0.76606]	[-0.2817]	[1.91251]	[0.66792]	[-1.5704]	[-0.52160]	**[-2.424]**
DTrade (-5)	-0.313156	-0.27375	2.49853	-0.29573	-5.71201	-0.251032	-0.1087

	-2.66744	-0.25753	-1.42815	-0.30598	-9.45282	-0.40057	-0.04932
	[-0.11740]	[-1.0629]	[1.74949]	[-0.96649]	[-0.6047]	[-0.62669]	**[-2.205]**
DUnemployment (-1)	0.256868	-0.02429	-1.099802	0.036521	1.378218	0.000384	0.01049
	-0.44125	-0.0426	-0.23624	-0.05062	-1.56368	-0.06626	-0.00816
	[0.58214]	[-0.5701]	[-1.35536]	[0.72153]	[0.8813]	[0.00579]	**[2.089]**
DUnemployment (-2)	-0.006194	-0.01259	-1.075172	0.072876	0.289706	-0.030852	0.01286
	-0.56046	-0.05411	-0.30007	-0.06429	-1.98614	-0.08416	-0.01036
	[-0.01105]	[-0.2266]	[-0.58307]	[1.13354]	[0.1458]	[-0.36657]	[1.241]
DUnemployment (-3)	0.224596	-0.01377	-1.373504	0.114927	1.157483	-0.016622	0.02158
	-0.71828	-0.06935	-0.38457	-0.08239	-2.54542	-0.10786	-0.0132
	[0.31269]	[-0.2001]	[-1.57155]	[1.39484]	[0.4547]	[-0.15410]	[1.625]
DUnemployment (-4)	-2.965018	0.432927	7.131602	-1.597272	-23.4515	-2.485132	0.11959
	-11.4062	-1.10123	-6.10689	-1.30842	-40.4211	-1.71288	-0.2108
	[-0.25995]	[0.3931]	[1.16780]	[-1.22077]	[-0.5818]	[-1.45085]	[0.567]
DUnemployment (-5)	1.103692	-0.11703	-1.94285	0.081928	-0.71607	0.753419	-0.1111
	-4.395	-0.42432	-2.35309	-0.50415	-15.5749	-0.66	-0.0816
	[0.25112]	[-0.2757]	[-0.82566]	[0.16251]	[-0.0458]	[1.14154]	[-1.368]
Exports growth (-1)	1.122312	0.22956	-1.537894	0.337983	5.583737	0.831941	-0.0186
	-2.52523	-0.2438	-1.35201	-0.28967	-8.94884	-0.37921	-0.0469
	[0.44444]	[0.9415]	[-1.13749]	[1.16678]	[0.6236]	**[2.19385]**	[-0.403]
Exports growth (-2)	0.723984	-0.23868	-0.0803	-0.023997	-1.09723	-0.46539	-0.0720
	-1.57251	-0.15182	-0.84192	-0.18038	-5.57261	-0.23614	-0.0290
	[0.46040]	[-1.5721]	[-0.09538]	[-0.13304]	[-0.1969]	[-1.97080]	[-0.479]
Exports growth (-3)	-1.627065	-0.08223	0.264765	0.071631	-5.63051	0.030396	0.01105
	-1.67303	-0.16152	-0.89574	-0.19191	-5.92884	-0.25124	-0.0309
	[-0.97253]	[-0.5094]	[0.29558]	[0.37325]	[-0.9496]	[0.12098]	[0.357]
Exports growth (-4)	1.419253	0.121188	0.073541	0.072634	7.251576	0.018148	0.00971
	-1.39713	-0.13489	-0.74802	-0.16027	-4.95112	-0.20981	-0.0258
	[1.01583]	[0.8984]	[0.09831]	[0.45321]	[1.4643]	[0.08650]	[0.376]

Exports growth (-5)	0.742969	-0.08711	-0.511637	-0.070029	7.434921	-0.10662	0.08758
	-1.27905	-0.12349	-0.6848	-0.14672	-4.53267	-0.19208	-0.0235
	[0.58088]	[-0.7054]	[-0.74713]	[-0.47729]	[1.6403]	[-0.55509]	**[3.703]**
FDI growth (-1)	-0.129977	0.017361	0.039983	0.011655	-0.92339	-0.001937	-0.0013
	-0.11445	-0.01105	-0.06127	-0.01313	-0.40557	-0.01719	-0.0022
	[-1.13570]	[1.5712]	[0.65251]	[0.88779]	[-1.2767]	[-0.11270]	[-0.624]
FDI growth (-2)	0.282508	0.002147	-0.009801	-0.007648	0.4701	-0.016871	-0.0059
	-0.12478	-0.01205	-0.06681	-0.01431	-0.44219	-0.01874	-0.0023
	[2.26407]	[0.1782]	[-0.14671]	[-0.53431]	[1.0631]	[-0.90033]	[-1.569]
FDI growth (-3)	-0.10202	-0.00693	-0.230708	0.004579	-0.77831	-0.043706	-0.0109
	-0.21656	-0.02091	-0.11594	-0.02484	-0.76743	-0.03252	-0.004
	[-0.47110]	[-0.3320]	**[-2.98981]**	[0.18433]	[-1.0141]	[-1.34395]	[-1.554]
FDI growth (-4)	-0.029972	-0.02733	-0.084863	-0.008902	-0.76349	-0.027369	-0.0137
	-0.18446	-0.01781	-0.09876	-0.02116	-0.6537	-0.0277	-0.0041
	[-0.16248]	[-1.5375]	[-0.85927]	[-0.42071]	[-1.1677]	[-0.98802]	[-1.001]
FDI growth (-5)	-0.048976	-0.01767	0.028928	-0.006331	-0.42913	-0.007057	-0.0087
	-0.13371	-0.01291	-0.07159	-0.01534	-0.47384	-0.02008	-0.0024
	[-0.36628]	[-1.3638]	[0.40408]	[-0.41275]	[-0.9056]	[-0.35144]	[-1.526]
Imports growth (-1)	-1.467616	-0.41367	0.935983	-0.271028	-5.73674	-0.811406	-0.0391
	-1.70815	-0.16492	-0.91454	-0.19594	-6.0533	-0.25651	- 0.03158
	[-0.85918]	[-1.5084]	[1.02344]	[-1.38319]	[-0.9471]	[-1.16321]	[-1.235]
Imports growth (-2)	-0.081971	-0.14406	-1.532532	0.002207	1.333527	-0.641466	-0.0742
	-1.44296	-0.13931	-0.77256	-0.16552	-5.11353	-0.21669	-0.0266
	[-0.05681]	[-1.0341]	[-1.98370]	[0.01333]	[0.2607]	[-0.96029]	**[-2.781]**
Imports growth (-3)	2.257721	-0.05144	0.982573	0.164484	14.79277	0.330768	0.12953
	-2.00556	-0.19363	-1.07378	-0.23006	-7.10727	-0.30118	-0.0378
	[1.12573]	[-0.2658]	[0.91506]	[0.71496]	**[2.0813]**	[1.09825]	[0.4938]
Imports growth (-4)	-0.388796	0.204677	-1.417124	-0.103379	0.57914	-0.303919	0.05018
	-1.99543	-0.19265	-1.06836	-0.2289	-7.07136	-0.29966	-0.0368
	[-0.19484]	[1.0624]	[-1.32645]	[-0.45164]	[0.0819]	[-1.01423]	[1.360]

Imports growth (-5)	1.031486	0.074073	-1.195757	0.157111	7.496399	0.158989	0.115976
	-1.71612	-0.16568	-0.91881	-0.19686	-6.08153	-0.25771	-0.03173
	[0.60106]	[0.4470]	[-1.30142]	[0.79809]	[1.2326]	[0.61693]	[0.655]
Inflation (-1)	-0.269892	-0.78713	2.783125	-2.271841	-23.7236	-0.536498	0.17409
	-7.84899	-0.75779	-4.20235	-0.90036	-27.815	-1.17869	-0.1451
	[-0.03439]	[-1.0387]	[0.66228]	[-1.52325]	[-0.8529]	[-0.45517]	[1.196]
Inflation (-2)	-4.260239	0.867212	0.029683	2.363475	4.068129	2.505406	0.13575
	-8.78116	-0.84779	-4.70144	-1.00729	-31.1185	-1.31867	-0.1636
	[-0.48516]	[1.0229]	[0.00631]	[1.34636]	[0.1303]	[1.89995]	[0.836]
Inflation (-3)	10.43522	-0.75844	1.255418	-1.302162	41.23732	-0.950551	0.03852
	-8.12784	-0.78471	-4.35165	-0.93235	-28.8032	-1.22056	-0.1508
	[1.28389]	[-0.9664]	[0.28849]	[-1.39664]	[1.4319]	[-0.77878]	[0.257]
Inflation (-4)	0.23123	1.141104	-3.354936	1.434162	7.462081	1.398474	0.12251
	-7.83606	-0.75654	-4.19543	-0.89888	-27.7692	-1.17675	-0.1448
	[0.02951]	[1.5083]	[-0.79966]	[1.59550]	[0.2687]	[1.18842]	[0.845]
Inflation (-5)	-6.033987	-0.26002	-0.680831	-0.398659	-28.6308	-1.898537	0.17419
	-7.67845	-0.74133	-4.11105	-0.8808	-27.2107	-1.15308	-0.1419
	[-0.78583]	[-0.3508]	[-0.16561]	[-0.45261]	[-1.0521]	[-1.64650]	[1.288]
C	0.056498	-0.01943	0.092352	0.012241	0.254191	-0.043587	-0.0148
	-0.20624	-0.01991	-0.11042	-0.02366	-0.73085	-0.03097	-0.0038
	[0.27395]	[-0.9762]	[0.83638]	[0.51744]	[0.3478]	[-1.40739]	[-3.826]
R-squared	0.571145	0.887551	0.760313	0.82187	0.653632	0.899994	0.9556
Adj. R-squared	-0.26274	0.6689	0.294254	0.475505	-0.01986	0.705539	0.86926
Sum sq. resids	4.211897	0.03926	1.207355	0.055423	52.89443	0.094983	0.00144
S.E. equation	0.48373	0.046702	0.258989	0.055489	1.714229	0.072642	0.00894
F-statistic	0.68492	4.059207	1.631367	2.372847	0.97051	4.628283	11.0688
Log likelihood	-7.743765	118.4939	25.99221	109.1846	-76.0641	94.63936	207.747
Akaike AIC	1.620139	-3.05539	0.370659	-2.710542	4.150524	-2.171828	-6.3610
Schwarz SC	2.946129	-1.72934	1.696648	-1.384552	5.476514	-0.845839	-5.0351
Mean dependent	0.070517	0.006198	-0.00283	0.057156	0.366135	-0.00355	0.02079
S.D. dependent	0.430473	0.081163	0.308288	0.076619	1.697454	0.133867	0.02473
Determinant resid covariance (dof adj.)		2.69E-15					
Determinant resid covariance		1.23E-18					
Log likelihood		577.0917					
Akaike information criterion		-12.0403					

Schwarz criterion		-2.75857					
Number of coefficients		252					

Source: Conducted by own author

From the above conducted analysis, it can be observed that FDI growth has a positive impact on GDP growth after 1 period (1 year, considering the data is taken on a yearly basis). The t-statistics critical value of 2.32443 supports this statement as well, considering it is significant at 1% significance level. This result is also supported by the study conducted by (Abbes, Mostéfa, Seghir, & Zakarya, 2015) in which the casual relationship between economic growth and FDI is conducted and it has been concluded that economic growth does promote FDI growth, in terms of increasing the credibility of the host country, and providing higher incentives to investor to come and invest in these countries.

Another interesting result is the one of GDP growth positively impacting inflation after 2 periods. Same situation is also repeated after 4 periods. Besides many others, this result is also conducted by Henderson (1999), in which is stated that GDP growth, being associated with an economic boom, in terms of increasing more jobs, consequently also increasing the money supply in the market, leads to an increase of inflation rate as well.

After 5 periods, GDP growth has a positive relationship with unemployment rate. This can be explained due to the fact that technology has been developing in great scales, thus substituting the labor force with machineries. This thesis has also been explained on an article conducted by Matuzeviciute, Butkus and Karaliute (2017), in which a great importance is assigned to the fact that through innovative technology promotes economic growth, and consequently increases the unemployment rate, being that labor force is substituted by the newest technological tools.

From the results of the table, trade openness seems to negatively impact the inflation rate after 4 and 5 years. This can be explained due to the fact that trade openness creates the idea of cheaper goods and services, due to higher competition. Same idea was supported by Romer (1993) which claims that inflation is lower in open economies.

According to Philipps (1958), unemployment rate and inflation are negatively related, even though this is not the case. This is the situation in which unemployment rate positively impacts the inflation rate. This has also been the case of US, back in the ‘70s, in which the country experienced stagflation, which is an economic condition accompanied by high unemployment rate and high inflation (Knotek & Khan, 2012).

As for exports growth, they seem to positively impact imports growth. As a result of increased exports and concentration of resources on a particular industries in the WB countries in order to produce more and to export more, along with the increased welfare of the citizens and consequently their increased ability and desire to purchase a higher range of goods and services, leads to an increase in imports as well. This argument is also supported by a report of OECD (2010), in which the increased ability of the customers to purchase goods and services leads to an increase in imports growth as well.

From the results of the table, exports growth seem to have a positive relationship with inflation after 5 periods. This comes as a result of the increased money supply in the market as a consequence of the increased exports growth, leading to higher inflation rates as well, as stated in a study conducted by Gylfason (1997). This study states that there is a positive relationship between exports and inflation rate.

On the other hand, FDI growth seems to positively impact GDP growth after two periods. Some studies, such as the one of Lee, Rana, & Iwasaki (1986) argue that the economic growth of the host country is accelerated by the presence of FDIs.

Along with the idea supported by Muktadir-Al-Mukit, Shafiullah, & Ahmed (2013), in which is also stated that imports growth and inflation have a negative relationship with each other, after the second period, imports growth actually seems to have a negative impact on inflation rate. Considering that with the increase of imports money supply becomes short, due to the fact that respective citizens purchase more foreign goods, thus decreasing the money supply in the market, inflation decreases as well.

On the other hand, imports growth seems to have a positive impact on FDI growth as well after the 3rd period, as it is also explained on a research conducted by Jayakumar, Kannan and Anbalagan (2014), in which increased imports “open up” the pattern for international trade, thus increasing the acknowledgement of these countries in the presence of the investing countries, thus increasing FDI growth levels.

Table 6.12

VAR Granger Causality/Block Exogeneity Wald Tests

VAR Granger Causality/Block Exogeneity Wald Tests			
Sample: 2003 2017			
Included observations: 54			
Dependent variable: GDP growth			
Excluded	Chi-sq	df	Prob.
FDI growth	11.56799	5	**0.0412**
Exports growth	3.058086	5	0.691
d(Unemployment rate)	1.013246	5	0.9615
d(Trade openness)	1.974688	5	0.8526
Imports growth	3.112406	5	0.6827
Inflation	3.347383	5	0.6466
All	21.77426	30	0.8621
Dependent variable: FDI growth			
Excluded	Chi-sq	df	Prob.
GDP growth	10.56315	5	**0.0608**
Exports growth	6.998557	5	0.2207
d(Unemployment rate)	1.81275	5	0.8744
d(Trade openness)	7.079454	5	0.2148
Imports growth	7.763386	5	0.1698
Inflation	5.719125	5	0.3345
All	27.0979	30	0.6181
Dependent variable: Exports growth			
Excluded	Chi-sq	df	Prob.
GDP growth	1.061166	5	0.9575
FDI growth	2.368109	5	0.7962
d(Unemployment rate)	3.017456	5	0.6973
d(Trade openness)	4.196886	5	0.5214
Imports growth	4.135562	5	0.5301
Inflation	10.72691	5	**0.0571**
All	80.61378	30	0
Dependent variable: d(Unemployment rate)			
Excluded	Chi-sq	df	Prob.
GDP growth	9.872771	5	**0.0789**
FDI growth	6.537226	5	0.2574

Exports growth	2.161778	5	0.8263
d(Trade openness)	9.447416	5	**0.0925**
Imports growth	11.13009	5	**0.0489**
Inflation	2.053357	5	0.8417
All	21.80996	30	0.8609
Dependent variable: d(Trade openness)			
Excluded	Chi-sq	df	Prob.
GDP growth	1.168624	5	0.9479
FDI growth	6.665164	5	0.2468
Exports growth	4.398451	5	0.4936
d(Unemployment rate)	0.42731	5	0.9945
Imports growth	11.28585	5	**0.046**
Inflation	4.63472	5	0.4621
All	100.1232	30	0
Dependent variable: Imports growth			
Excluded	Chi-sq	df	Prob.
GDP growth	4.48733	5	0.4816
FDI growth	2.270533	5	0.8106
Exports growth	8.610919	5	0.1256
d(Unemployment rate)	2.752317	5	0.7381
d(Trade openness)	4.427429	5	0.4897
Inflation	4.787916	5	0.4423
All	36.09306	30	0.205
Dependent variable: Inflation			
Excluded	Chi-sq	df	Prob.
GDP growth	29.69775	5	**0**
FDI growth	24.48508	5	**0.0002**
Exports growth	26.21571	5	**0.0001**
d(Unemployment rate)	10.59203	5	**0.0601**
d(Trade openness)	13.17943	5	**0.0218**
Imports growth	30.55933	5	**0**
All	152.5395	30	0

Source: Conducted by own author

In this case, when testing whether FDI growth causes GDP growth, from the probability value of 0.0412 of the FDI growth, it is concluded that FDI growth is significant at 5% significance level, proving the findings from the literature in which it was posed that FDI inflows were a contributing factor in the GDP growth of a country.

The other way around does apply as well, even though at a different significance level, the one of 10%, since the probability value is 0.0608. GDP growth does cause FDI inflows in a country, as it was also stated in the research conducted from Louzi and Abeer (2011) in which is concluded that is actually GDP growth the one that causes an impact on FDI inflows, as it was in the case of Jordan, a developing economy as well.

On the other hand, as for the other influencing factors of GDP growth, there is a relationship between GDP growth and unemployment rate, while the same situation applies with inflation as well. An increase in GDP growth leads to a decrease in unemployment rate, through increasing the investments made within the countries and creating more jobs, thus decreasing the unemployment rate. On the other hand, the linkage between GDP growth and inflation is explained as a result of the previous result as well. More jobs mean more money in circulation in the economy, thus increasing the money supply and consequently inflation rate.

CONCLUSION AND RECOMMENDATIONS

Considering the fact that Western Balkans countries were all part of the communist regime, the foreign direct investments have played a crucial role in the transition process of these countries. Foreign direct investment is an important determinant in the development of the Western Balkans economy. This main objective of this thesis was to prove this statement through an empirical analysis regarding six of the composing countries of the Western Balkans. Taking into consideration the fact that Kosovo lacked data due to its late official separation from Serbia in 2008, the study has been subtracted to only six of the remaining ones, in order to conduct a more accurate study, relied on more observations throughout the years. The period taken into consideration is 2003-2017 and the composing countries of this study are: Albania, Former Yugoslav Republic of Macedonia, Montenegro, Bosnia & Herzegovina, Croatia and Serbia.

Considering that the main objective of the study was to assess the factors that influenced the GDP growth of these economies, it was concluded that FDI growth, inflation and unemployment rate are actually the ones that cause an impact on GDP growth. Within the context of focusing more in terms of the effect that FDI inflows have in these transitional countries, it was also conducted a method to determine whether there is a bi-causal relationship between GDP growth and FDI growth, it was concluded that this conclusion applies both ways: FDI growth is the one causing GDP growth, but also the other way around. This is explained due to the fact that FDI increase the economic welfare of a country, as previously stated in the literature review.

On the other hand, based on the results, GDP growth has a positive relationship with unemployment rate after 5 years. A possible explanation would be the increased technological development, thus substituting the labor force and contributing in the increase of unemployment rate since people would be getting fired at a higher level Along with the same idea proved Romer (1993), trade openness seemed to negatively impact the inflation rate after 4 and 5 years. This can be explained due to the fact that trade openness creates the idea of cheaper goods and services, due to higher competition. A logical result came up also in terms of the relationship between exports growth and inflation rate, in which higher money supply in the market as a result of increased levels of exports, leads to higher rates of inflation as well.

On the other hand, imports growth seems to have a positive impact on FDI growth as well after the 3rd period, as it is also explained on a research conducted by Jayakumar, Kannan and Anbalagan (2014), in which increased imports emphasize the pattern of international trade and also increasing the awareness regarding what the hosting countries may need and lead to new business possibilities for the investing countries.

In the emerging economies such as the one of WB region, FDIs expose host countries and leave them vulnerable to foreign companies' exploitations. In these regards, the main focus is in terms of the low wages; high level of unemployment rates leads to citizens agreeing on cheap payments. On the other hand, the abundant land resources and their cheap price create great incentives for the foreign economies to purchase these lands, thus encouraging the modern day form of colonization.

FDI inflows also had an impact on imports in the WB countries. This may happen due to the fact that the new established investments in the countries, may require for imported products in order to function correctly; raw materials may be imported from abroad, while the production process happens within the borders of the new invested country.

As for the main sectors that foreign investors mainly invest in the region, are: agriculture, construction, transport and real estate. The main countries that invest in the Western Balkans are the member countries of the European Union, which acts as the main investor in this region, but also as the main trading actor for these countries. Consequently, they have a very close relationship, which tends to be even closer due to their willingness to integrate themselves in the common zone. This leads to another important issue regarding the WB countries, as stated down below:

In most Balkan countries, especially in the Western Balkans, resources are scarce in order to fulfill all the needs of particularly poor people. As a solution to this problem, international aid and even investment is very important. In this context, international aid can be seen as very important, focusing on areas of importance for reducing poverty. Creating jobs should be a top priority to provide more income to poorer households. Moreover, increasing regional inequality should attract more attention from policy-makers.

The EU integration should not be seen as a solution to all the problems in the region. In this context, it is worth mentioning the case of Romania and Croatia, especially the one of Bulgaria, which still deals with a weak system of democratic and just institutions, high corruption, high migration and low living standards.

The economy is another crucial sector to be focused, which according to the European Union, substantial transformations need to be done. The critical economic sectors are uncompetitive, accompanied with political interference and underdeveloped private sector. Due to this situation, currently none of the WB countries has achieved the goal of becoming a functioning market economy.

Considering the relatively low living standards of the WB countries, their leaders, when conducting the respective economic policies, should be careful on not to plan them only for a short term. They should also pay attention to avoiding certain applications that only serve for providing temporary solutions to the matter. Controversially, it is better to conduct policies that bring incentives to economic development even though they target the long term growth.

Most certainly that the development in terms of road constructions, energy and technology are considered as key tools for the economic improvement of a country, especially of the ones aiming to join the European Union. Nevertheless, the existing cooperation and the one to come, continues being a key priority for Western Balkans countries in terms of their relations with the EU countries, but also with themselves in the region.

Recommendations

- The government should implement taxation facilities for the foreign investments in order to attract them more

- The government should also be more careful in implementing different policies in order to reduce imports and stimulate the exports growth

- There should be more easing investing policies in terms of less costs and less time to give incentives to the foreign investments

- There should be more focus regarding the education of the population

- Countries themselves should invest more in the newest technology in order to gain competitive advantage among the regional countries

- A special attention should be given to the stability of the exchange rate as well

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