Classification of Foreign Direct Investments by Theories and the Economic Growth "Case: Balkan Countries"

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Abstract: The purpose of this paper is to analyze the factors that will influence the economic growth. Factors that have impeded investment and economic development in these nations include political unrest, weak institutions, and restricted access to credit and finance. (OECD 2021). The region's current socio-economic conditions provide an impetus for Balkancountries governments to induce more foreign investment as a mechanism for fostering economic growth FDI promotes economic growth in both the host country and the country of origin. The host country benefits from FDI by financing projects planned, developing new technologies and generating new jobs. Investing companies benefit from the expansion of markets and, consequently, the growth of their shares in international markets. The world is full of development opportunities, be it for countries that have just begun to modernise to the richest countries. Overall, the region's economic growth and development still have a lot of room for improvement, even though some Balkan nations have made strides in recent years. Higher rates of economic growth and development in the Balkans may be facilitated by policies aimed at enhancing political stability, bolstering institutions, decreasing corruption, encouraging investment, and expanding access to finance.

Keywords: (FDI) Foreign Direct Investment; Economic Growth; theories; Balkans

JEL Classification: M10; M20

1. Introduction

In developing countries, foreign direct investments have played a very important role in capital formation, knowledge transfer, promotion of new technologies, capacity building, and unemployment reduction.

Numerous literatures claim that FDI promotes economic growth by facilitating access to foreign markets and by providing capital and technology (Crespo &

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Fontoura, 2016). In this sense, the developing economies of Western Balkan countries such as Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, and Serbia have a lot to benefit from foreign direct investments. The countries of the Western Balkans have paid much attention to foreign direct investments because these countries expect from them an increase in the level of employment, the transfer of new technologies, the increase of capital, the promotion of competition in their countries, making the quality of goods and services and finally economic growth.

To absorb as much FDI as these countries have; improved their legal framework, ensure economic stability, improved infrastructure, improved the climate of doing business, ensured political stability, ensured access to markets, influenced the tax policy, etc According to Uvalic (2010), these important events that the region experienced from 1991-2001 had very serious consequences in the economy of these countries, affecting many macroeconomic indicators such as inflation, unemployment, poverty, education, monetary stability, etc. Many macroeconomic objectives such as long-term sustainable development, price stability, employment, balanced regional development and a stabilized balance of payments were impossible to achieve with macroeconomic instruments. This situation caused the countries of the Western Balkans to have a very slow pace in joining the European Union.

After 2001, the countries of the Western Balkans began to implement stabilizing macroeconomic policies by undertaking reforms in many sectors of their economies. At this time, the privatization of state properties and banks began in order to improve the economic climate and countries to have more foreign trade and the absorption of foreign direct investments. Until 2008, before the global crisis, these countries performed well in economic terms, but during the economic crisis, the countries of the Western Balkans had obvious structural and economic problems (Bartlett dhe Prica, 2012). Years later, these countries turn into countries of consumption (consumption exceeds production), have an increase in the current account deficit, high unemployment, inappropriate development policies and the transition of these economies to a service economy and lose competitiveness with the global market. The opening policies after 2001 were not so successful in these countries compared to other European countries (Uvalic, 2013).

2. Literature Review

This part targets and discusses the main theoretical aspects of existing literature pertaining to FDI. Nowadays, domestic capital is not sufficient for fast economic development and competition in foreign markets. History has shown us that countries need foreign financing to ensure sustainable, long-term economic growth. Countries need Foreign Direct Investments as a means of financing the construction

of new infrastructure and the creation of jobs. On the other hand, multinational companies benefit from FDI by expanding their footprint in international markets. In this context, Foreign Direct Investment~~s~~ can be a very important alternative for ~~a~~ faster and more competitive economic growth.

The term Foreign Direct Investment (FDI) is used to describe a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy (OECD).

Lasting interest means the existence of a long-term relationship between the direct investor and the direct investment company as well as a significant degree of influence on the latter.

The terms “direct investor” and “direct investment enterprise” are defined by the IMF and the OECD as follows: A direct investor can be an individual, a legal or natural person, a public enterprise, a government, a group of individuals or legal entities and/or individuals, who own a direct investment enterprise active in a country outside the direct investor’s country of residence. A direct investment enterprise is a legal or physical entity of which a foreign investor owns 10% or more of the shares or has the voting power of a commercial company or the equivalent of a partner.

According to the same source, the importance of FDI is very crucial because:

FDI is a key-element in international economic integration because it creates stable and long-lasting links between economies.

FDI is an important channel for the transfer of technology between countries, promotes international trade through access to foreign markets, and can be an important vehicle for economic development.

According to the EU Statistics Office (EUROSTAT), FDI is the category of international investments that reflects the objective of realizing sustainable interest by an investor of one economy from an enterprise resident in another economy. A direct investment enterprise is one in which a direct investor owns 10% or more of the ordinary shares or voting rights (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise).

According to the World Bank (WB), foreign direct investment is the net inflow of investment to realize sustainable management interest (10% or more of the voting shares) from the enterprise operating in an economy other than that of the investor’s. This is the sum of equity capital, reinvestment of earnings, other long-term capital and short-term capital, as shown in the balance of payments.

Foreign direct investment (FDI) is an ownership stake in a foreign company or project made by an investor, company, or government from another country (Hayes, 2022).

Foreign investment can be defined as the transfer of movable or immovable assets in whole or in part, from the country of origin to the host country for the purpose of using it to improve the welfare of the host country, under the control of the owner (Sornarajah, 2010).

Foreign direct investment can be defined as a long-term investment made by a firm or an individual in one country, into business interests located in another country, with all risks and profit opportunities (Koluman, 2020).

If we have to give a certain definition of what FDI is, we will see that it is difficult to give an exhaustive answer. Due to the fact that foreign investors in different countries have different characteristics and operate in accordance with the legislative and regulatory framework of their countries, this causes the definition of FDI to change. FDI is much more complex in nature than portfolio investment, as it often involves the transfer of basic assets, such as technological know-how, and managerial and organizational skills. Consequently, the definition of FDI cannot practically be considered in isolation from the definition of multinational companies, which is also difficult to define. The main definitions of FDI can be found in the Balance of Payments Manual of the International Monetary Fund and the 1999 World Investment Report of the United Nations.

3. The Purpose, Objectives and Research Methodology

The purpose of the study - The purpose of this paper is to assess the relationship between foreign direct investment (FDI) and socio-economic environment variables in Balkan countries. This dissertation develops a data set and an econometric model to analyze flows, poverty, and socio-economic relations at the macro level panel data set.

Study objectives- The first objective of this study is to review, the theoretical developments of the models that explain FDI and their impact on the economy. Also, this study will review the empirical works of applied models to identify research gaps.

The second objective of this study is to present a comprehensive description of FDI for the Balkan countries.

Methodology - At the center of the theoretical treatment are the models of economic growth in the field of economic sciences. Developing countries have a more stable fluctuation of FDI, even in the theoretical treatment, very little is discussed about

small developing countries, leaving a gap regarding the importance of FDI in these places.s. In this study, we consider unbalanced panel data from 6 countries over a period of 13 years from 2008-2022. With panel data analysis, different effects on FDI across countries and over time can be investigated, allowing for heterogeneity control, (Badi & Baltagi 2008). For the realization of this paper, I will rely on theoretical approaches by coordinating two main tools for study: theoretical models of FDI in economic growth, such as: Borenstein, De Gregorio & Lee model, Mankiw model, Easterly m,odel and econometric analysis with secondary data obtained from sources such as; Worldbank, UNCTAD and EUROSTAT

3.1. Theories of Foreign Direct Investment

Capital is a vital ingredient for economic growth, but since most nations cannot meet their total capital requirements from domestic sources alone, they turn to foreign investors. Foreign direct investment (FDI) and foreign portfolio investment (FPI) are two of the most common avenues for investors to invest in an overseas economy.

FDI means investment by foreign investors directly in the productive assets of another country. FPI means investing in financial assets, such as stocks and bonds, of entities located in another country. FDI and FPI are similar in some respects but very different in others. As retail investors invest more and more overseas, they should be aware of the differences between FDI and FPI, as countries with a high level of FPI may encounter increased market volatility and economic turmoil. currency during times of uncertainty (Elvis Picardo, 2022). To better understand the difference between FDI and FPI, imagine that you are a multi-millionaire based in Italy and you are looking for your next investment opportunity. You are trying to decide between (a) the purchase of a company that produces copper wires in Albania and (b) buying a large stake in a company that manufactures copper wire. The first is an example of direct investments, while the second is an example of portfolio investments. An increase in international capital flows has resulted in faster financial globalization than trade globalization. Capital flows rinvestment, trade, or business operations. Inside of a firm, these include the flow of funds in the form of investment capital, capital spending on operations, and research and development (R&D).

Because of this importance, it has become necessary to understand the basic theories which help to explain the movement in capital flows. In this part of the paper, we will discuss the historical background and origin of FDI theories, the classification of FDI theories, and macro and microeconomic theories of FDI. The origin of FDI has not yet been identified, but it is thought to date back to the classical school, specifically mentioned in the book “Wealth of Nations” by Adam Smith and then by Ricardo. Absolute advantage (Smith, 1776) and comparative advantage (Ricardo, 1776) are two important concepts in economics and international trade. They greatly influence how and why nations and businesses devote resources to producing

particular goods and services. Absolute advantage describes a scenario in which an economic entity can produce a product at a higher quality at a faster rate for a greater profit than a competing business or location can achieve. Comparative advantage, on the other hand, takes into account the opportunity costs involved when choosing to produce multiple types of goods with limited resources (Segal, 2022).

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3.1. Nature of Theories

A theory is a statement of the relationship among factors observed in the empirical world, so a theory is a simplified representation of reality (Mittelstaedt, 1977; Zaltman & Wallendorf, 1979; Wacker, 1998). A is a principle that has been formed as an attempt to explain things that have already been substantiated by data. Sipas Edward E. Marandu &Tebo Ditshweu (2018)49 the authors agree on some features that must be fulfilled by a theory to be considered good:

1. To have explanatory power, A good theory should possess the ability to tell why and how a specific relationship leads to specific events.

2. Predictive power, A good theory should have the capability to forecast what will occur at some future time provided certain conditions are met.

3. Factual basis, A good theory should be supported by facts. General, A good theory should be broad so as to cover a wide range of relevant situations. Thus, a good theory of FDI should be sufficiently broad so as to cover a wide range of FDI situations.

4. Unifying power, A good theory should have the capability to bring together areas that have previously been viewed as unrelated.

5. Face validity, A good theory should be plausible; that is on the surface, seem to make sense.

6. Validity, A good theory must be verifiable, in the sense that it should be possible to test the relationships hypothesized by the theory.

7. Simplicity, Finally, a good theory should be simple enough that it can be understood.

Theories that explain foreign direct investments are classified into two categories, Macroeconomic FDI theories, and Microeconomic FDI theories. Macroeconomic theories of FDI emphasize country-specific factors that are more related to trade and the international economy, while microeconomic theories of FDI are specific to firms, leaning towards an industrial economy and market structures. Lipsey (2004) describes the macroeconomic view by viewing FDI as a particular form of capital flow across national borders, from countries of origin to host countries, measured in the balance of payments statistics. Macro-level determinants that affect a host country's ability to attract FDI include market size, economic growth rate, GDP, infrastructure, natural resources, institutional factors such as the country's political stability, and others.

4. Analysis and Discusions

The analysis of results and findings is an important step in any research or experimental process, as it allows researchers to draw meaningful insights from the data and make informed decisions based on the results.

***FDI Theory is based on strength of the currency* -**

Some authors have studied the relationship between currencies and foreign direct investment, as we can mention in Aliber (1970), Dinkar & Rahul (2014), Blonigen (1997), Aizenman (1992)56, Goldberg and Kolstad (1995) 57 etc. According to these authors, the countries that have the weakest currencies compared to the countries that have the strongest currencies have a higher capacity to attract FDI because the companies benefited from the differences in the rate of market capitalization. Exchange rates can affect both the total amount of foreign direct investments that occur and the distribution of these investment expenditures in a number of countries. According to Linda S. Goldberg (2006)58, when a currency depreciates, meaning that its value falls relative to the value of another currency, this exchange rate movement has two possible implications for FDI. First, it lowers that country's wages and production costs relative to those of its foreign counterparts. Second, the devaluation of the exchange rate improves the overall rate of return and this makes foreigners think about an investment project in this country. Blonigen (1997) supports the role of exchange rate movements in influencing FDI. Accordingly, his currency movements may affect the relative valuations of different assets. This theory has shortcomings because it fails to explain why FDI between two or more developed countries has equal monetary values also it does not seem to be relevant to FDI in less developed and developing countries. (Marandu & Ditshweu, 2018).

***Internalization Theory* -** Internalization occurs when a transaction is handled by the entity itself without passing it on to someone else. According to James Chen (2021), this process can be applied to three types of transactions.

1. Business (In business, internalization is a transaction conducted within a corporation rather than in the open market).

2. Investment transactions (when a brokerage firm fills a buy order for shares from its own inventory of shares instead of executing the trade using outside inventory).

3. Corporate world (when the company decides to shift assets between its own subsidiaries in different countries).

4. Internationalization theory can be used to examine foreign direct investment (FDI) both at the company and industry levels (Casson, Porter & Wadeson, 2016).

The theory is based on three major concepts. First of all, companies increase profits in an imperfect market. Secondly, "since markets in intermediate products are imperfect, "they can be neglected, and internal markets are created (Nayak & Choudhury, 2014, p. 7). Finally, this internationalization of markets generates MNCs.

Internalization theory extends the market imperfections approach as claimed in transaction cost theory by focusing on failings in intermediate-product markets rather than on final products. The internalization model identifies transaction costs as a main impulse for internationalization (Buckley & Casson 1976; Robock & Simmonds 1989).

Buckley and Casson (1976) identified different factors determining the internationalization decision, which does not depend only on market imperfections but also on organizational capabilities, particularly in terms of internal market organization and coordination.

4.1. Interpretation of Economic Growth

Long-term economic growth reveals that most Balkan countries have experienced stagnation. This means that the economic development of the Western Balkans has been disappointing.

The economic results of the last 23 years for the countries of the Western Balkans can be seen in the graph below that expresses GDP growth from 1998-2021

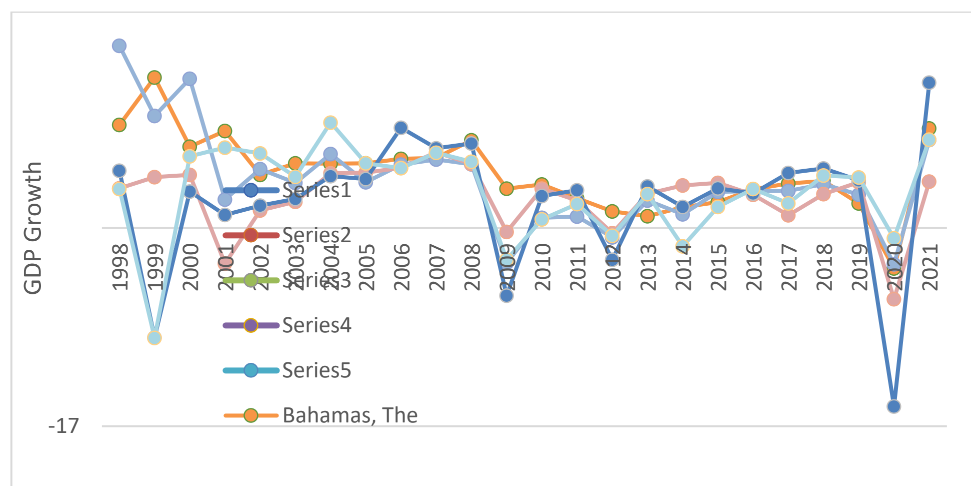

Figure1. GDP growth

Source: World Bank

As we can see from the fig. 1 After 2008, the countries were hit by the crisis thus influencing the economic growth.

Unemployment rates in these countries were higher than in other Balkan countries and among the highest in Europe. Compared to Greece and Croatia with respective unemployment rates of 7% and 8.5%, the unemployment rate in 2008 reached 13.1% in Albania and Serbia, 17.1% in Montenegro, 33.9% in North Macedonia, 23.4% in B&H and approximately 47.5% in Kosovo (world bank). This high unemployment rate has had a negative impact on poverty rates throughout the region.

Higher unemployment rates also caused high immigration flows, as WB citizens sought economic refuge in Western Europe.Currently, the unemployment rate in these countries is still high, much higher than the European average of 7% for 2021. Respectively, the unemployment rate in 2021 for Serbia was 10.1, Albania 11.7, B&H 14.9, North Macedonia 15.8, Montenegro 17 and (World Bank).

According to Saul Estrin and Milica Uvalic (2016)72 three specific characteristics should be singled out, related to privatization, deindustrialization and the sectoral distribution of FDI.

1) Privatization in most Western Balkan countries was delayed by the particularly unfavorable political circumstances in the 1990s, contributing to very limited FDI in the early years of transition.

2) Balkan countries have gone through a significant process of deindustrialization. In the beginning, the economies of the Balkans were based on industry and very little on services, but after the 2000s, the industry in these countries was destroyed and these countries turned into a service economy. Damiani (2014)72 in his paper he

claims that these countries continued the process of deindustrialization even after the 2000s. Even today these countries are less industrialized than any other region of Europe.

Table 1. Manufacturing Value Added (% of GDP)

Western Balkan countries	(% of GDP) year 2021	Western Balkan countries	(% of GDP) year 2000
Albania	6	Albania	4
Bosnia &Hercegovina	14	Bosnia &Hercegovina	9
North Macedonia	13	North Macedonia	9
Montenegro	4	Montenegro	9
Serbia	13	Serbia	27
EU	15	EU	18
Central Europe and Baltics	17	Central Europe and Baltics	18

Source: World Bank

Sectoral distribution of FDI in the Western Balkans has probably contributed to the relative decline of manufacturing.

According to Saul Estrin and Milica Uvalic (2016), until 2010, most of the countries of the Western Balkans have not attracted significant amounts of FDI in production, but have attracted more in services. However, we cannot say that the services sector is not as important as the industrial sector in economic growth. Therefore, foreign investments are also focused on this sector. But what is worrying is that these countries are turning into service countries, making foreign direct investments focus on non-tradable services, making these countries have major deficiencies in integration through business networks and global value chains into the world economy.

Table 2. Service value added (% of GDP)

Western Balkan countries	(% of GDP) year 2021	Western Balkan countries	(% of GDP) year 2000
Albania	47.7	Albania	44.3
Bosnia &Hercegovina	54.9	Bosnia &Hercegovina	54.4
North Macedonia	56.9	North Macedonia	52.8
Montenegro	59.9	Montenegro	58.2
Serbia	51.4	Serbia	40.3
EU	65	EU	62
Central Europe and Baltics	58.3	Central Europe and Baltics	55.2

Source: World Bank

According to Saul Estrin the ilica Uvalic (2016) the structure of services exported by the Western Balkans in 2012 reveals that 50-80 percents travel and transport which are sectors mainly related to tourism. Tourism is clearly important for Croatia

and Montenegro, but even in these cases being a highly season-sensitive sector it contributes to exports only during some months per year.

Foreign direct investments in production, taking into account the experience of investment companies, can generate high economic growth for the countries of the Western Balkans. Firms in production are more motivated to innovate, thus influencing the increase in productivity. Foreign Direct Investments in the Balkan countries began to appear mainly after the 90s of the last century. At the beginning of these years, the number of FDI was relatively small, but after the 2000s they began to increase significantly. This happens because the Balkans is a country that offers great opportunities for foreign investors. Recognizing the potential economic advantages of FDI, Western Balkan governments after the 2000s undertook a series of policy measures, spanning the scope of business, fiscal and legislative reforms, to establish investor rights that foster greater capital flows.

5. Conclusions

1. Privatization in most Western Balkan countries was delayed by the particularly unfavorable political circumstances in the 1990s, contributing to very limited FDI in the early years of transition

2. FDI can aid in economic growth by raising capital per worker and fostering productivity gains, but the advantages of FDI may vary depending on a number of variables, including the standard of institutions and the accessibility of skilled labor and capital.

3. Balkan countries have gone through a significant process of deindustrialization. In the beginning, the economies of the Balkans were based on industry and very little on services, but after the 2000s, the industry in these countries was destroyed and these countries turned into a service economy. Damiani (2014)72 in his paper he claims that these countries continued the process of deindustrialization even after the 2000s. Even today these countries are less industrialized than any other region of Europe

4. Theories that explain foreign direct investments are classified into two categories, Macroeconomic FDI theories, and Microeconomic FDI theories. Macroeconomic theories of FDI emphasize country-specific factors that are more related to trade and the international economy, while microeconomic theories of FDI are specific to firms, leaning towards an industrial economy and market structures. Lipsey (2004) describes the macroeconomic view by viewing FDI as a particular form of capital flow across national borders, from countries of origin to host countries, measured in the balance of payments statistics. Macro-level determinants that affect a host country's ability to attract FDI include market size, economic growth rate, GDP,

infrastructure, natural resources, institutional factors such as the country's political stability, and others.

5. So, Foreign Direct Investments in the Balkan countries began to appear mainly after the 90s of the last century. At the beginning of these years, the number of FDI was relatively small, but after the 2000s they began to increase significantly. This happens because the Balkans is a country that offers great opportunities for foreign investors. Recognizing the potential economic advantages of FDI, Western Balkan governments after the 2000s undertook a series of policy measures, spanning the scope of business, fiscal and legislative reforms, to establish investor rights that foster greater capital flows.

6. Overall, the region's economic growth and development still have a lot of room for improvement, even though some Balkan nations have made strides in recent years. Higher rates of economic growth and development in the Balkans may be facilitated by policies aimed at enhancing political stability, bolstering institutions, decreasing corruption, encouraging investment, and expanding access to financ

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