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Does the Economy Size Affect FDI?- Evidence from Western Balkan Countries (2005-2014)

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I. Introduction

Foreign direct investments are considered as important indicators for developing developed places and not enough economically developed. Foreign Direct Investment (FDI) is an important source of development financing, particularly for developed and less developed economies as it contributes to productivity gains by bringing in new investment, better technology, management expertise and export markets (Sahoo, P. 2012). The importance of FDI has been noticed since 1980 when borrow-giving of loans from comercial banks for places in development increase, therefore as a response of created situation for loan borrowing, a lot of places changed the access through foreign direct investments and created a favorable enviroment for investments attraction, through taking such acting as: lowering taxes and other facilities in supporting business making (Aitken & Harrison, 1999).Through the last two decades, economies in transition have finished big reforms with the purpose of creating an economy of open trade. They have faced three essential stages: a) stabilization and structural alteration programs; b) reform of the legal and regulatory framework; and c) industrial competitiveness and regional cooperation policies to reap economies of scale in production and to increase firm-level capability building (UNCTAD, 2013).

The impact of FDI in host places is multiplied as in technologic development as well as in knowledge advance, through importing new technology as well as people with education and different experiences. FDI is an important tool that facilitates transferring technology from developed places for places not so developed (Islami, Xh. et al, 2016). Therefore, in capitalist economy the FDI role is very important for local economic growth and for increasing general productivity for places not enough developed.

In Western Balkan through ten years' period has been changed in frequency of investments through having a decrease after global economy crises of the year 2008, when the power of investments of developed places has been weaken a lot and the risk of their investment in that period of time is increase as a result of economic and financial non-stability in places of Western Balkan. After FDI stagnation as a percentage of GDP from 2002 till in 2005 year, FDI fluxes are increased steeply whereas the global and financial crisis hit the main interested places in 2007 year (UNCTAD, 2013). The objective of FDI in emerging developing countries is to tap the domestic market, and thus market size desides market seeking FDI. The size of the market or per capita income are indicators of the sophistication and breath of the domestic market. Market size is an important factor determining FDI as it provides potential for local sales, greater profitability of local sales to export sales and relatively diverse resources, which make local sourcing more feasible (Wang, Z. Q., & Swain, N. J. 1995).

In this study economy size is evaluated with GDP at market price. Why is this indicator taken to evaluate the economy size? One of the main indicators for economy size of a place is GDP that contains consume, investment governmental costs and netoexport ($GDP=C+I+G+Exn$), so it is considered as the main variable about economy of a place. So, with this study we want to measure that if the economy size influences which in the concrete case is evaluated with GDP at market price in attracting FDI inflows. This study gives a review of long- term relationship in between economy size of Western Balkan and attracting foreign direct investment in this region. And helps top redetermine main factors that can be seen as important indicator to attract foreign direct investments.

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a) Study objectives

Through referring the writings in the abstract and in introduction, it can be understood that the aim of this study is to:

- Express empirically the impact of economy size of places of Western Balkan in attracting FDI inflow for 2005 to 2014 period.
- To show the long-term relationship in between economy size of places with FDI inflows (for ten years' period).
- To show politic factors for attracting of foreign direct investments.

II. Literature Review

With foreign direct investment have dealt a lot of authors that studied and analyzed their relationship with legal, politic, geographic factors in order to clearlify their role in developing host place as well as identifying different factors to attract foreign direct investment. The literature suggests that FDI improves raises national welfare by raising the volume and efficiency of investment through a rise in competitiveness, technological diffusion, accelerated spillover effects and the accumulation of human capital (Adolfo Maza, et al. 2013; Keller & Yeaple, 2009; Blomtsrom & Kokko, 2003).Therefore, a lot of places create policies that favorize attracting foreign direct investments. Whereas, a lot of authors made research with the purpose to identify correctly the factors which make the host place convenient to be invested from foreign investitors.

Before starting literature review should give a definition for FDI, with the purpose that the readers to understand clearly their concept. "Foreign direct investment (FDI) refers to long term participation by country A into country B. It usually involves participation in management, joint-venture, transfer of technology and expertise" (Agrawal, G., & Khan, M. A. 2011). According to Choe, J. I. (2003) in order for FDI to have a positive impact on economic growth, the country must have achieved a level of development that enables it to take advantage of the benefits of high productivity. For FDI attraction in South-East European countries talks even the rapport (UNCTAD 2013) which claims that South-East European countries are following a two-pronged strategy: First, they have been upgrading their institutions and investment policies to bring them in line with EU standards. Investment policy is one of the most advanced dimensions of policy reform in South-East Europe. All countries have created a liberal regime to attract FDI, providing equal treatment of foreign and domestic investors (national treatment), guarantees against expropriation and the free transfer of funds. Second, South-East European countries have joined regional agreements such as CEFTA, which opened to most of these countries in 2006 (with the exception of Croatia, which had joined in 2003). This agreement, which contains an important investment chapter, represents a significant accomplishment along the path to EU accession and an important stepping stone to sustainable long-term growth. Indeed, South-East European countries and the EU both consider CEFTA an important mechanism of preparation for prospective EU membership. EU-supported regional integration has proved to be a particularly efficient instrument for advancing policy reform in all areas, including investment through, for example, the Stabilization and Association Agreement (SAA)[1]. Even for economy and trade size influence in attracting FDI inflow have been dealt by a lot of authors. Kurecic, P. et al (2015) analyzed the impact of economy size and European integration in pulling foreign direct investment for 1994-2013 period. Results showed that neither in EU and in non-Eu places, the size of the place does not have impact in pulling foreign direct investments. Also, (Wei, S. J, 2000; Asiedu, E., 2002) finds that there is no significant impact of growth or market size on FDI inflows and that market size and growth impact differ under different conditions, in these studies the total real GDP introduces trade size. Whereas opposite results are expressed by (Mughal, M. M., & Akram, M. 2011) according to whom the trade size for places in development is an important factor that effects FDI inflows. Trade size, real GDP is found to have a significant positive impact on FDI inflows and from (Wang, Z. Q., & Swain, N. J. 1995; Ang, J. B. 2008; Ramirez, M. D. 2006). It is worth mentioning that from a policy point of view important factors for attracting FDI inflows are: financial development, human capital, good infrastructure, economic stability and liberalized markets (Ang, J. B. 2008; Bengoa, M., & Sanchez-Robles, B. 2003).

a) Study hypothesis

Hypothesis zero (H_0): Economy size of Western Balkans does not impact in attracting FDI inflows.

III. Methodological Approach

The aim of this study is to analyze empirical relationship in between economy size of Western Balkan places and FDI inflow. The relationship is analyzed with correlation method the main purpose of correlation is to evaluate the relationship in between variables. Our model for economy size impact of Western Balkan in pulling FDI inflow, is analyzed through two variables: Growth bruto product (GDP) at market prices current in dollar US[2] and FDI net inflows (BoP, current US$)[3]. The

[1] Kosova has signed an agreement with UE for SAA, which will be in power in 2016 that releases product circulation in between Kosovo and EU places.

[2] GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. Data are in current U.S. dollars. Dollar figures for GDP are converted from

technique used to measure econometric is Pearson Correlation which is realized with statistical program SPSSv. 21.0.

Data - All data are gathered from World Bank. The data taken from World Bank data base because it presents a plausible resource and majority of the analysis of this nature are based in this data base, which allows taking the data precisely through downloading data in Excel. The analyzed data are in frequency of one year to ten years (2005-2014).

Table 1. is a guide to read correlation coefficient "r" in between variables.

Table 1 : Describing Matrix correlation

Value of r	Condition	Strength of relationship
1.00	r is one	It is a perfect relationship between the two variable
0.50	r is greater than 0.00 but less than 1.00	It is a positive relationship between the two Variables
0.00	r is zero	There is no relationship between the two variables
-0.50	r is between 0.00 and -1.00	It is a negative relationship between two variables.
-1.00	r is negative one	It is a perfect negative relationship between the two variables.

Source: Amit Saini et al (2015)

IV. Economy Size and fdi Inflow in Western Balkan Places for 2005-2014

In general, Western Balkan places have had a rapid GDP growth at market price, till in economy crisis of 2008 year (see table 2). Continuous growth from 2004 year till in 2007 year, whereas from 2008 year and after can be seen a drastic decrease of GDP at market price. This decrease from analyzed places with low consequences was Kosovo, because Kosovo is not depended from exported products and as a result it has not had lost of selling or reduction of export that can influence in GDP rate at market price. In table 2, it is introduced the going of Foreign direct investment, net inflows (% of GDP) for the period which is the object of this study.

Table 2 : GDP at market prices (current US$) period (2005-2014)

Year / Economy	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	%	%	%	%	%	%	%	%	%	%
Kosovo	2.7	9.1	18.5	17.7	-0.6	3.1	14.8	-2.9	8.8	4.4
Albania	11.5	10.2	19.0	20.4	-6.5	-1.0	8.1	-4.4	3.7	3.4
Montenegro	8.9	19.4	36.1	23.2	-8.4	-0.1	9.6	-9.9	9.2	2.8
Macedonia, FYR	10.1	9.6	21.5	18.9	-5.1	0.1	11.6	-7.1	10.5	5.2
Croatia	9.2	11.1	19.1	17.3	-11.0	-4.8	4.3	-9.3	2.3	-1.1
Bosnia and Herzegovina	8.8	15.1	23.0	21.2	-7.7	-2.4	8.7	-7.7	5.5	2.5
Serbia	5.6	16.6	31.6	22.3	-13.5	-7.4	17.8	-12.3	11.7	-3.6

Source: Authors, data are taken from world bank

domestic currencies using single year official exchange rates. http://data.worldbank.org/indicator/NY.GDP.MKTP.CD

[3] Foreign direct investment refers to direct investment equity flows in the reporting economy. It is the sum of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Ownership of 10 percent or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship. Data are in current U.S. dollars. http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

Whereas regarding Foreign direct investments crises of 2008 year does not have a huge impact meaning it had an average around the same investments as before 2008 even after this year and till 2014 year, so it can be seen around one same amplitude of FDI for Western Balkan places. (see table 3).

Table 3 : Foreign direct investment, net inflows (% of GDP) period (2005-2014)

Year / Economy	2005 %	2006 %	2007 %	2008 %	2009 %	2010 %	2011 %	2012 %	2013 %	2014 %
Kosovo	3.6	9.1	12.5	9.4	7.2	8.3	8.2	4.5	4.9	2.7
Albania	3.2	3.6	6.1	9.6	11.2	9.1	8.1	7.5	9.8	8.7
Montenegro	n/a	n/a	25.6	21.6	37.4	18.3	12.3	15.1	10.0	10.8
Macedonia, FYR	2.3	6.2	8.8	6.2	2.8	3.2	4.8	3.5	3.7	0.5
Croatia	4.0	6.5	7.6	7.4	5.1	2.4	2.3	2.6	1.6	6.9
Bosnia and Herzegovina	5.7	6.7	11.9	5.4	0.8	2.6	2.6	2.3	1.9	2.7
Serbia	7.8	16.2	11.0	8.2	6.9	4.3	10.6	3.1	4.5	4.6

Source: Authors, data are taken from world bank

Whereas in table 4, it is presented the average value for each state of Western Balkan for GDP value of growth rate even for variable share of FDI in GDP, in the way that these value are entered in statistical program SPSS and with the help of correlation analysis are reached the results of the study (see table 5).

GDP at growth rate is counted from the authors as the data in world bank are in real value and not in growth norm. The data of table 4, in the first row "Average GDP Growth rate" is counted as average of horizontal sum for each row taken from table2. Whereas in the second part "Average share of FDI in GDP" is counted as an average of horizontal sum of each row taken from table 3.

Table 4 : The average share of FDI in GDP and the average GDP growth rate in Western Balkan places

Economy	Average GDP Growth rate	Average share of FDI in GDP
Kosovo	7.6%	7%
Albania	6.4%	7.7%
Montenegro	9.1%	16.8%
Macedonia, FYR	7.5%	4.2%
Croatia	3.7%	4.6%
Bosnia and Herzegovina	6.7%	4.3%
Serbia	6.9%	7.7%

Source: Authors, data are taken from World Bank

V. Empirical Founding and Testing Hypothesis

In all surveys found in academic literature for the impact of economy size, GDP at market price has positive or negative impact in attracting FDI inflows. From our analysis for the impact of economy size of Western Balkans in attracting FDI inflows results as in the proceeding. Independent variable GDP growth rate enter in regression analysis through explaining 29.4% of the dependent variable of variance FDI inflows (Adjusted R^2 = 29.4). Even though the scale of mistake in regression model is high even without statistical importance, we do not continue with presentation of regression model because the data are not important in the concrete case. In our case for testing Hypothesis zero is more convenient correlation analysis. In table 5, is presented the relationship in between variables of the study through Correlation Matrix.

Global Journal of Management and Business Research (B) Volume XVI Issue IV Version I Year 2016

Table 5 : Correlation Matrix

Parameters	Correlations	FDI inflow	GDP growth rate
FDI inflow	Pearson Correlation	1	.642
	Sig. (2-tailed)		.120
GDP growth rate	Pearson Correlation	.642	1
	Sig. (2-tailed)	.120	

Source: Authors, data are taken from world bank, for GDP at market price and FDI inflows

In table 5. Is seen that GDP growth rate does not have statistical relationship with FDI inflow variable, for significance level (0.05).

So tested variables are positively related with a scale of correlation from 0.642, but are not statistically important for significance level 0.05 (sig. 0.120 > 0.05).

Hypothesis zero (H_0) is accepted (see table 6).

Table 6 : Confirmation of hypothesis zero for p=0.05

Place	Pearson Correlation value (r) between the average GDP growth rate and the average share of FDI in GDP	P-value	NULL Hypothesis at p=0.05
Western Balkan	.642	.120	Confirmation H_0

Source: Authors, data are taken from world bank, for GDP at market price and FDI inflows

In table 6, can be seen that hypothesis zero is accepted which showed that economy size of Western Balkan is not an important factor for FDI inflows attraction. Which means that economy size of Western Balkan does not have an important relationship for long-term period of attracting FDI inflows.

VI. Discussion

Discussions of the study will be focused in finding the potential factors that attract foreign direct investments. Based on the results from empirical analysis is expressed that economy's size is not a pre-determined factor for FDI inflows attraction. Through not showing GDP growth rate as statistically important variable. Same results are shown even from the other studies (Wei, S. J, 2000; Asiedu, E., 2002; Kurecic, P. et al 2015).Therefore, in the preceding will be treated the factors that influence in investitors decision to invest in host place.

Before making an investment, investors look at certain major economic policy issues particularly relating to trade, labor, governance and the availability of physical and social infrastructure. However, some of the fundamental determinants of FDI, such as geographical location, resource endowment and size of the market, are largely outside the control of the national policy (UNCTAD, 2003).Nevertheless, national economic policies can facilitate and help create a conducive investment environment so that FDI inflows become consistent with the economic potential. Sound macroeconomic fundamentals, along with other factors such as high and sustained growth, macro-economic stability, and world-class infrastructure, and pro-reform policies influence the decision of investors in a host country (Sahoo, P. 2012).

- Creating suitable conditions for foreign investitiors (inside and outside region) has to do with state or region integration inside one huger organization of trade. Liberalization of trade place of place that offers free trade functioning is considered as main factor that opens the doors of minds of foreign investitors and considered the possibility of investment in that place. That trade size is included in Regional trade agreements (RTA) has an apparent positive effect in FDI inflows, see for example (Jaumotte, M. F. 2004).
- Human capital of host place is considered as pulling factors for foreign investitors. In Western Balkan places have huger scale of unemployment this decides foreign investitors before two different situations. In one side of higher unemployment norms makes places of Western Balkan attractive to invest as a result of free employee power. Employ is a constituent part of product costs, free power of employee that offers investitor to produce products with lower cost. On the other side, a huge rate of unemployment norm lowers the power of buying in that place. Lowering the power of buying means low request for produced products from foreign investitor. Therefore, placed before these two dilemmas investor decides to invest in that country only if his products can be exported (traded) outside the host country. According to Singh, H., & Jun, K. W. (1995), export orientation is a powerful variable for attracting FDI. Even in this case trade liberalization for the Western Balkan countries has a

Global Journal of Management and Business Research (B) Volume XVI Issue IV Version I Year 2016

key role in attracting FDI because trade agreements reduce transaction costs. The impact of market size on the reduction of tariffs and deportation in more trades as a factor in attracting FDI, see for example (Asiedu, E. 2006; Kok, R., & Ersoy, A. B. 2009).

- Market liberalization of the host country reduces investment risk for foreign investors, enabling a broader base of customers and a higher probability of profit which is the main goal of the investor. Aiming to liberalize investment in some industries must remove investment restrictions or reduce the costs of transactions. We ask the question, when an investor invests in another country? Answer, an investor (multinational company) invests in the host country where the cost of investment in that country in the long term is lower than the cost of exporting the product in the host country and region. For example, an American company which manufactures a product having sufficient market in Western Balkan countries and whether the cost of transportation and special rates are higher than the cost of building a production implant in any country in the region, it will make this investment. This form of investment is known as horizontal investments. For reasons of horizontal FDI and vertical FDI, see for example (Dunning, J. 1993). According to (Islami, Xh. et al 2016) great importance for foreign investors has trade integration of the host country for the main goal of investors is profit, so if an investor has to contain costs to market its product in the host country and in countries around the host country he will invest in the country. To see the benefits and costs of countries involved in regional trade agreements, see for example (Baldwin, R.E., & T. Venables, 1995)
- An important factor which foreign investors have in mind during the decision making process for investing is the functioning of law and fair competition in the host country. Economic overview of the country for fair competition and the functioning of the law is to fight informalities. At this point the Western Balkan countries do not stay well where according to (Strategjiskombtaretë RepublikëssëKosovës 2014-2018,p.5,2014) in Western Balkan countries informality ranges from 23- 38.8 % of GDP countries. This does not reassure foreign investors to efficiently implement the law and does not guarantee that the host country will be developed towards the market competition
- Infrastructure Facilities of the host country is also a factor which calculate foreign investors. In the competition between countries to attract foreign investors is the quality of infrastructure which is offered by countries such as transport infrastructure and telecommunications, electricity, water, and other services which make a convenient location to do business and enable normal functioning of the business. Even at this point some Western Balkan countries have shortcomings and it certainly is one of the reasons why FDI inflows do not mark a huge increase in recent years. The role of infrastructure in FDI inflows, see for example (Asidu, E. 2002; Ang, J. B. 2008; Sahoo, P. 2012).

It is considered that trade liberalization is a key to attracting FDI inflows, because all other factors which are considered by many authors as important for attracting FDI inflows without functioning of the free trade are ineffective. It should be pointed out that market liberalization reduced transaction costs and perceived risk as a result of harmonization of the rules for investment between countries.

But trade liberalization for Western Balkan countries where the goods will move freely without customs barriers and special charges within the Balkan states and other states, requires a series of economic and trade reforms, which must make the countries of the western Balkans. Of all the countries in the study only Croatia is a member state of the EU, this means that other countries still not good image for foreign investors and not considered as reliable and safe to invest. According Cviic & Sanfey (2010), the Balkans may still face an image problem "Troubled conjures up images of war and conflict, Rather than Foreign Direct Investment into transition Investment Opportunities and Economic Potential Economies". Political problems that Western Balkan countries among themselves reflect this region as dangerous and unattractive to foreign investors. These are the main factors that are considered as a barrier to the growth of FDI in recent years.

Western Balkan countries therefore need to create pro-reform policies for FDI inflows and to develop effective strategies that promote the country to potential investors.

According to empirical data (UNCTAD, 2013) That suggests REIOs Such membership in CEFTA nor contributes to larger FDI inflows, soft only in Conjunction with other Factors Such as overall in the Investment Reforms and Macroeconomic Stability regime.

Although Western Balkan countries as the majority of other countries in transition focus on key economic policy the promotion of foreign investment has not very positive results. Therefore, the Western Balkan countries in order to be more suitable for foreign investments should enable equal treatment of foreign investors with local judges, allow the free transfer of the means of production, to guarantee the expropriation, to avoid procedures excessive bureaucratic develop transparent investment strategy and adopt appropriate legal infrastructure which does not discriminate against foreign investors. Others already have to take some preferential policies for foreign investors in order to attract them as: changes in the tax structure, allows tax relief for a period of time (grace period in taxes), you allow the importation of duty-free manufacturing equipment, the design scheme offers advantages host country, to develop guidelines for credit and foreign exchange, allowed unrestricted employment of foreign knowledge workers (Islami, Xh. et al, 2016).

VII. Conclusion

This study treats the relationship of economy size of Western Balkans with foreign direct investments (FDI) for ten-years period. According to literature FDI has an important role in economy size of host places. The data to realize this study are taken from world Bank for the period of 2005 to 2014. The results of this study show that there is a positive relationship in between economy size and FDI attracting but this relation is not important statistically. Which means that economy size of Western Balkan does not have an important relationship in long- term period to attract FDI inflows. From this result is expressed clearly that factors for attracting foreign direct investment is not economy size but attracting FDIs that is more influenced from specific policies of the places. Trade liberalization for Western Balkan places are considered as important factor for foreign direct investment attraction. Besides orientation from trade liberalization Western Balkan places must create a wide range of facilities and conditions for foreign investitors. To offer same treatment of foreigners with the native, to offer free transferring of product equipment, to guarantee non-ownership, to leave aside not necessary autocratic procedures, to implement transparent strategy of investments and to adopt convenient legal infrastructure that does not discriminate foreign investitors. Besides that, some other polies should be taken even some favorable policies for foreign investitors with the purpose of their temptation as: changes in tax structure, to offer free from taxes for a period of time (grace period in taxes), to offer importation of productivity equipment without costumes, to implement some of priorities that are offered from host place, to implement guide for credit and value exchange, to allow unlimited employment of foreign employee. This study makes a significant contribution to the scientific and academic value, to the impact of economy size of Western Balkan in attracting FDI inflows, in the region and beyond.

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Data Appendix

In this part are presented some charts that give basic information for Western Balkan places. In *Chart 1*, is presented in percentage the participation of each place in general GDP of Western Balkan for the period 2005-2014. In *Chart 2*, is presented in percentage, the participation of each place in general FDI for Western Balkan for 2005-2014.In *Chart 3*, is presented the general average of investments for Western Balkan places for 2005-2014.In*Chart 4,*is presented The average share of FDI in GDP and the average GDP growth rate in Western Balkan places, for 2005-2014.

Participation of Western Balkan states in GDP

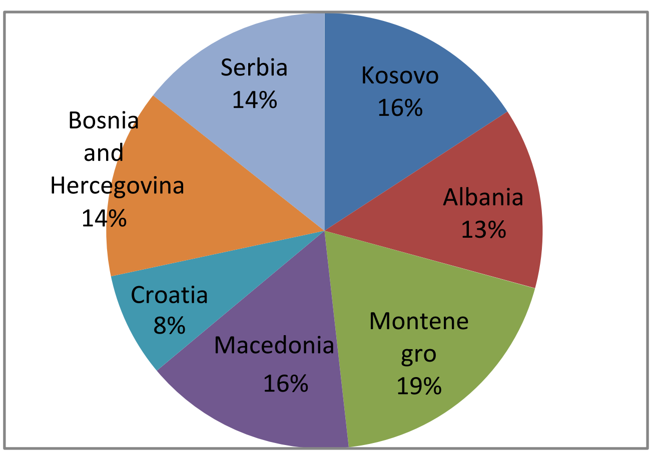


Chart 1

Participation of Westen Balkan states in FDI

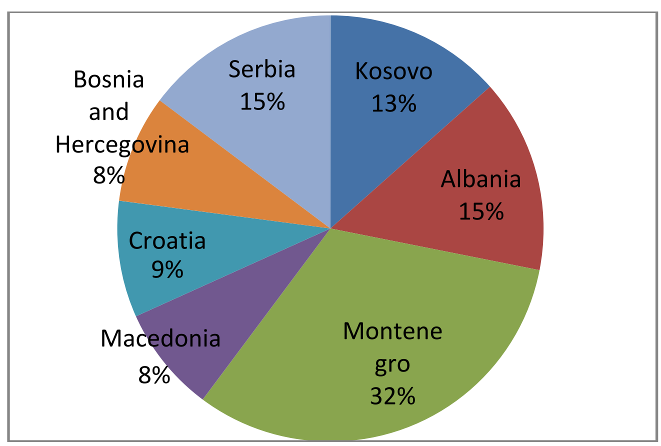


Chart 2

Global Journal of Management and Business Research (B) Volume XVI Issue IV Version I Year 2016

Chart 3 : Investments in Western Balkan from 2005-2014 as an average of all states

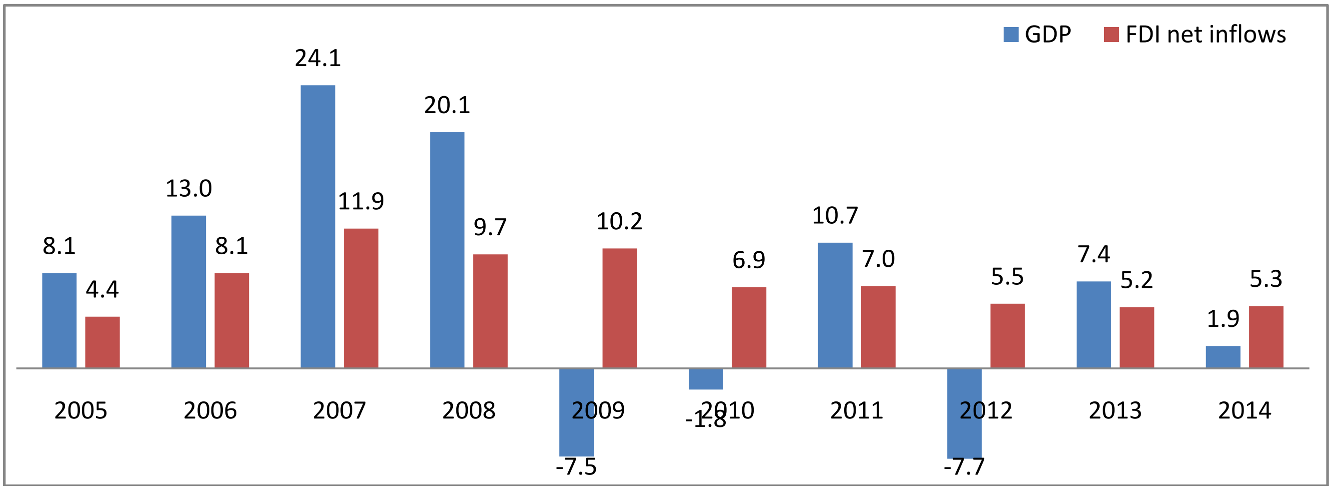
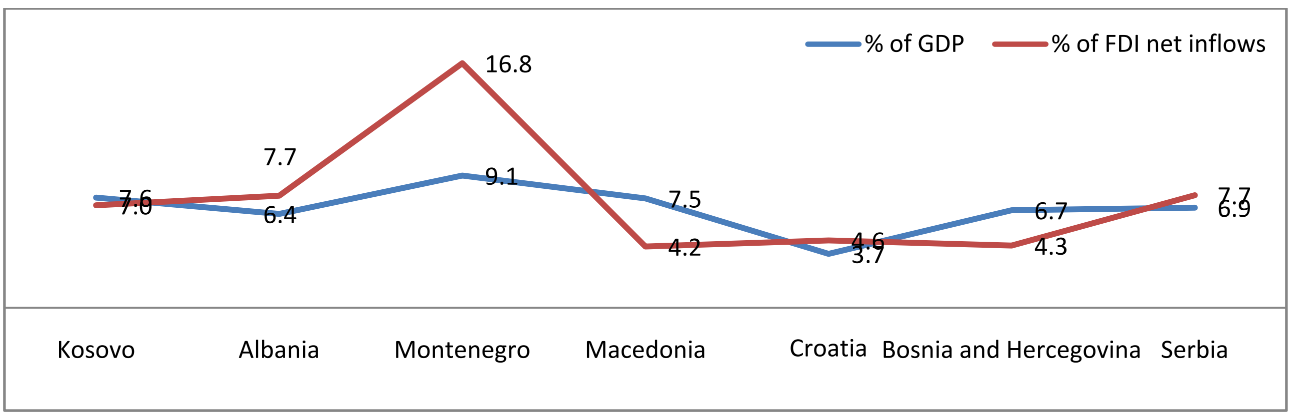


Chart 4 : The average share of FDI in GDP and the average GDP growth rate in Western Balkan places



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