

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

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## Abstract

This study treats the relationship of economy size of Western Balkan countries with Foreign direct investment (FDI) for ten years' period. Through knowing the FDI importance in economic development is measured the impact of economy size of Western Balkan countries in attracting foreign direct investments. Data to realize this study were taken from World Bank, in yearly frequency for 2005 to 2014 period. After using Pearson Correlation technique for empirical analysis which is realized with SPSS v. 21.0, statistical program. Results showed that there is a positive relationship that is not statistically important. From this result is clearly shown that factors for foreign direct investment attracting is not economy size, but FDI attraction is influenced more from specific policies of places and trade liberalization.

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*Index terms*— FDI inflow, GDP growth rate, economic development, western balkan, trade liberalization.

## 1 Introduction

oreign 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 commercial 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 environment 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 besides market seeking FDI. The size of the market or per capita income are indicators

## 4 LITERATURE REVIEW

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44 of the sophistication and breath of the domestic market. Market size is an important factor determining FDI  
45 as it provides potential for local sales, greater profitability of local sales to export sales and relatively diverse  
46 resources, which make local sourcing more feasible (Wang, Z. Q., & Swain, N. J. 1995).

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

### 55 2 a) Study objectives

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

58 -Express empirically the impact of economy size of places of Western Balkan in attracting FDI inflow for 2005  
59 to 2014 period.

60 -To show the long-term relationship in between economy size of places with FDI inflows (for ten years' period).

61 -To show politic factors for attracting of foreign direct investments.

## 62 3 II.

### 63 4 Literature Review

64 With foreign direct investment have dealt a lot of authors that studied and analyzed their relationship with legal,  
65 politic, geographic factors in order to clarify their role in developing host place as well as identifying different  
66 factors to attract foreign direct investment. The literature suggests that FDI improves raises national welfare  
67 by raising the volume and efficiency of investment through a rise in competitiveness, technological diffusion,  
68 accelerated spillover effects and the accumulation of human capital (Adolfo Maza, et al. 2013; Keller & Yeaple,  
69 2009; ??lomtsrom & Kokko, 2003). Therefore, a lot of places create policies that favorize attracting foreign direct  
70 investments. Whereas, a lot of authors made research with the purpose to identify correctly the factors which  
71 make the host place convenient to be invested from foreign investitors.

72 Before starting literature review should give a definition for FDI, with the purpose that the readers to  
73 understand clearly their concept. "Foreign direct investment (FDI) refers to long term participation by country  
74 A into country B. It usually involves participation in management, joint-venture, transfer of technology and  
75 expertise" (Agrawal, G., & Khan, M. A. 2011). According to Choe, J. I. (2003) in order for FDI to have a  
76 positive impact on economic growth, the country must have achieved a level of development that enables it to  
77 take advantage of the benefits of high productivity. For FDI attraction in South-East European countries talks  
78 even the rapport (UNCTAD 2013) which claims that South-East European countries are following a twopronged  
79 strategy: First, they have been upgrading their institutions and investment policies to bring them in line with  
80 EU standards. Investment policy is one of the most advanced dimensions of policy reform in South-East Europe.  
81 All countries have created a liberal regime to attract FDI, providing equal treatment of foreign and domestic  
82 investors (national treatment), guarantees against expropriation and the free transfer of funds. Second, South-  
83 East European countries have joined regional agreements such as CEFTA, which opened to most of these countries  
84 in 2006 (with the exception of Croatia, which had joined in 2003). This agreement, which contains an important  
85 investment chapter, represents a significant accomplishment along the path to EU accession and an important  
86 stepping stone to sustainable long-term growth. Indeed, South-East European countries and the EU both  
87 consider CEFTA an important mechanism of preparation for prospective EU membership. EU-supported regional  
88 integration has proved to be a particularly efficient instrument for advancing policy reform in all areas, including  
89 investment through, for example, the Stabilization and Association Agreement (SAA) 1 a) Study hypothesis .  
90 Even for economy and trade size influence in attracting FDI inflow have been dealt by a lot of authors. Kurecic,  
91 P. et al (2015) analyzed the impact of economy size and European integration in pulling foreign direct investment  
92 for 1994-2013 period. Results showed that neither in EU and in non-Eu places, the size of the place does not  
93 have impact in pulling foreign direct investments. Also, (Wei, S. J, 2000; Asiedu, E., 2002) finds that there is  
94 no significant impact of growth or market size on FDI inflows and that market size and growth impact differ  
95 under different conditions, in these studies the total real GDP introduces trade size. Whereas opposite results  
96 are expressed by ?? Hypothesis zero ( $H_0$ ): Economy size of Western Balkans does not impact in attracting FDI  
97 inflows.

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## 5 III.

## 6 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 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) (2006) (2007) (2008) (2009) (2010) (2011) (2012) (2013) (2014).

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

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 crossborder 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. IV.

## 7 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. 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). 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.

## 8 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.

## 9 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 predetermined 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 investors 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

## 11 CONCLUSION

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155 facilitate and help create a conducive investment environment so that FDI inflows become consistent with the  
156 economic potential. Sound macroeconomic fundamentals, along with other factors such as high and sustained  
157 growth, macro-economic stability, and world-class infrastructure, and pro-reform policies influence the decision  
158 of investors in a host country (Sahoo, P. 2012).

159 -Creating suitable conditions for foreign investors (inside and outside region) has to do with state or region  
160 integration inside one huge organization of trade. Liberalization of trade place of place that offers free trade  
161 functioning is considered as main factor that opens the doors of minds of foreign investors and considered the  
162 possibility of investment in that place. That trade size is included in Regional trade agreements (RTA) has an  
163 apparent positive effect in FDI inflows, see for example (Jaumotte, M. F. 2004). -Human capital of host place is  
164 considered as pulling factors for foreign investors. In Western Balkan places have huge scale of unemployment  
165 this decides foreign investors before two different situations. In one side of higher unemployment norms makes  
166 places of Western Balkan attractive to invest as a result of free employee power. Employ is a constituent part of  
167 product costs, free power of employee that offers investor to produce products with lower cost. On the other  
168 side, a huge rate of unemployment norm lowers the power of buying in that place. Lowering the power of buying  
169 means low request for produced products from foreign investor. Therefore, placed before these two dilemmas  
170 investor decides to invest in that country only if his products can be exported (traded) outside the host country.  
171 -Market liberalization of the host country reduces investment risk for foreign investors, enabling a broader base  
172 of customers and a higher probability of profit which is the main goal of the investor.

173 Aiming to liberalize investment in some industries must remove investment restrictions or reduce the costs  
174 of transactions. We ask the question, when an investor invests in another country? Answer, an investor  
175 (multinational company) invests in the host country where the cost of investment in that country in the long  
176 term is lower than the cost of exporting the product in the host country and region. For example, an American  
177 company which manufactures a product having sufficient market in Western Balkan countries and whether the  
178 cost of transportation and special rates are higher than the cost of building a production plant in any country  
179 in the region, it will make this investment. This form of investment is known as horizontal investments. For  
180 reasons of horizontal FDI and vertical FDI, see for example (Dunning, J. 1993). According to (Islami, Xh. et  
181 al 2016) great importance for foreign investors has trade integration of the host country for the main goal of  
182 investors is profit, so if an investor has to contain costs to market its product in the host country and in countries  
183 around the host country he will invest in the country. To see the benefits and costs of countries involved in  
184 regional trade agreements, see for example (??) It is considered that trade liberalization is a key to attracting FDI  
185 inflows, because all other factors which are considered by many authors as important for attracting FDI inflows  
186 without functioning of the free trade are ineffective. It should be pointed out that market liberalization reduced  
187 transaction costs and perceived risk as a result of harmonization of the rules for investment between countries.

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

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

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

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

## 212 10 VII.

## 213 11 Conclusion

214 This study treats the relationship of economy size of Western Balkans with foreign direct investments (FDI) for  
215 ten-years period. According to literature FDI has an important role in economy size of host places. The data to

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216 realize this study are taken from world Bank for the period of 2005 to 2014. The results of this study show that  
217 there is a positive relationship in between economy size and FDI attracting but this relation is not important  
218 statistically. Which means that economy size of Western Balkan does not have an important relationship in  
219 long-term period to attract FDI inflows. From this result is expressed clearly that factors for attracting foreign  
220 direct investment is not economy size but attracting FDI is more influenced from specific policies of the  
221 places. Trade liberalization for Western Balkan places are considered as important factor for foreign direct  
222 investment attraction. Besides orientation from trade liberalization Western Balkan places must create a wide  
223 range of facilities and conditions for foreign investors. To offer same treatment of foreigners with the native, to  
224 offer free transferring of product equipment, to guarantee non-ownership, to leave aside not necessary autocratic  
225 procedures, to implement transparent strategy of investments and to adopt convenient legal infrastructure that  
226 does not discriminate foreign investors. Besides that, some other policies should be taken even some favorable  
227 policies for foreign investors with the purpose of their temptation as: changes in tax structure, to offer free  
228 from taxes for a period of time (grace period in taxes), to offer importation of productivity equipment without  
229 costumes, to implement some of priorities that are offered from host place, to implement guide for credit and  
230 value exchange, to allow unlimited employment of foreign employee. This study makes a significant contribution  
231 to the scientific and academic value, to the impact of economy size of Western Balkan in attracting FDI inflows,  
in the region and beyond. <sup>1 2 3 4</sup>



Figure 1:

2016  
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Volume XVI Issue IV Version I  
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Global Journal of Management and Business Research

Figure 2: B

## 11 CONCLUSION

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1

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.

[Note: Source: AmitSaini et al (2015) ]

Figure 3: Table 1 :

2

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Economy	%	%	%	%	%	%	%	%	%	%
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

Figure 4: Table 2 :

3

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Economy	%	%	%	%	%	%	%	%	%	%
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

B

Figure 5: Table 3 :

4

Economy	Average Growth rate	GDP	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.

Figure 6: Table 4 :

5

Parameters	Correlations	FDI inflow	GDP growth rate
	Pearson Correlation	1	.642
FDI inflow	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<sub>0</sub>) is accepted

Figure 7: Table 5 :

6

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

Figure 8: Table 6 :

[Note: 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 key role]

Figure 9:

2016  
 Year  
 22  
 Volume  
 XVI  
 Issue IV  
 Version I  
 Global Baldwin, R.E., & -An important factor which foreign investors have in  
 Journal T. Venables, 1995) mind during the decision making process for invest-  
 of Man- ing is the functioning of law and fair competition in the host country.  
 agement Economic overview of the country for fair competition and the function-  
 and ing of the law is to fight informalities. At this point the Western Balkan  
 Business countries do not stay well where according to (Strategjiskombtarete  
 Research RepublikëssëKosovës 2014-2018,p.5,2014) in Western Balkan countries  
 ( ) B 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

Figure 10:

Chart 4 :

Participation of Western Balkan states in GDP				Participation of Western Balkan states in FDI			
Bosnia and Hercegovina	Serbia	Kosovo	Albania	Bosnia and Hercegovina	Serbia	Kosovo	Albania
14%	14%	16%	13%	8%	15%	13%	15%
Croatia				9%			
8%	16%	19%	Montene gro	Macedonia 8%			Montene gro 32%
	Mace- donia						
	Chart 1						Chart 2

Figure 11:

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<sup>1</sup>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

<sup>2</sup>© 2016 Global Journals Inc. (US) 1 Does the Economy Size Affect FDI?-Evidence from Western Balkan Countries (2005-2014) 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.

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## .1 Data Appendix

In this part are presented some charts that give basic information for Western Balkan places. This page is intentionally left blank

[World] , <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD> *World*

[Strategjikombtarete Republikësse ()] , Kosovës Strategjikombtarete Republikësse . 08.02. [http://www.kryeministri-ks.net/repository/docs/Strategjia\\_Kombetare\\_e\\_Republikes\\_se\\_Kosoves\\_per\\_Parandalimin\\_dhe\\_Luftimin\\_e\\_Ekonomise\\_Joformale,\\_Pastrimin\\_e\\_Parave\\_2014-2018](http://www.kryeministri-ks.net/repository/docs/Strategjia_Kombetare_e_Republikes_se_Kosoves_per_Parandalimin_dhe_Luftimin_e_Ekonomise_Joformale,_Pastrimin_e_Parave_2014-2018). 2014. 2016. p. .

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## 11 CONCLUSION

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