CHALLENGES AND THE IMPACT OF FOREIGN INVESTMENTS ON ECONOMIC DEVELOPMENT: EVIDENCE FROM SOUTHEAST EUROPEAN ECONOMIES

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Abstract

The main aim of this research is to assess the challenges and implications of foreign direct investment (FDI) on GDP growth in Southeast European countries (SEE) (Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, and Serbia). Documents from various sources comprising official reports, scientific articles, and statistics of international institutions were employed to support this analysis. Specifically, panel data used as a secondary source, respectively from the World Bank, were extracted and then processed according to the required format. Panel data includes the period 2010-2022, which in total are 78 observation periods. The Generalized Method of Moments (GMM) is an econometric approach employed for analyzing whether FDI and various additional variables affect GDP growth. The GDP growth is specified as a dependent variable, while the independent variables are FDI, personal remittances (PR), and gross savings (GS). The econometric outcomes discovered that FDI and gross savings have a significant impact on economic growth for SEE, whereas personal remittances have turned out to have an insignificant positive effect. These discoveries can serve in some spheres, starting as a guide to identify the importance of each factor included in the research and the undertaking of concrete measures that can influence the improvement or redesign of policies. Likewise, it aims to provide a solid basis for opening discussions between scholars, students, and policy-making bodies.

Keywords
Impact, GDP growth, foreign direct investment (FDI), remittances, gross savings.

Introduction

Foreign direct investments have had different impacts on the GDP growth of South-Eastern European countries. One of the biggest impacts is the growth of the private sector and the creation of new jobs. FDI has brought new technologies, advanced management, and growth productivity. This has improved competition and helped integrate the local market into the global market. As well, foreign investments have helped in the evolution of certain economic sectors, improving the infrastructure and industrial capacities, depending on the stimulating policies of the state receiving the investments. According to, Moura & Forte (2013, p. 58) who researched the association between FDI and economic growth in some developing and developed countries argued that the effect of FDI depends on the internal situation of the host country.

One of the main factors related to the growth in the level of FDI is the improvement of international business cooperation and economic cooperation between countries. The decisions of developing states to articulate and implement policies that boost the attraction of FDI through the engagement of private capital in the economy are an expression of their strong orientation towards macroeconomic advancement. Another research done by KASTRATI (2013, p. 5)   on the same topic, found that although FDI in general has a positive effect on GDP growth, they are not all good or all bad in the meantime the possible negative effect may exist.

The infusion of FDI in these countries has presented opportunities and challenges, shaping the path of their economic development. One of the main challenges is related to the structure of local economies, which may still be at an early stage of development. FDI, meanwhile, can bring challenges in managing risks and adapting to the demands of the international market. In addition, lack of transparency, political instability, and security issues are other challenges that make investors feel insecure about their investments. Policymakers as well as researchers frequently contend that obtaining FDI would help underdeveloped countries' GDP growth faster by giving local businesses access to capital and the advantageous externalities that correspond with increased productivity (Alfaro & Johnson, 2012).

Based on the discussions specified above, the research aims to examine how FDI, PR, and GS influence GDP growth. Starting from this, the research has presented the research question "What impact do FDI, PR, and GS have on the economies included in the analysis". The verification of the research question will be concluded based on the results of the GMM approach, in reality, the expectation is that all variables should have a significant positive effect.

The research is designed in several segments, starting with the introduction, literature review, methodology, and data processing, and finally, the discussions and conclusions of the research are reflected.

Literature Review

Foreign direct investment and its impact on economic growth has been an important and often attractive topic for consideration in the economy of Southeast Europe. This region has experienced great changes in the field of finance and economic development in recent years. The challenges and impact of FDI in this context have been part of an in-depth analysis by economists and researchers, shedding light on the advantages and challenges that accompany this process. Global companies (MNCs) perform a significant portion of the FDI in these countries. Both of these are marketed as possible drivers of continued development and are key parts of FDI. Abor & Harvey (2008) have examined according to the Stolper-Samuelson proposal the effect of FDI flows in countries that have comparative advantages in labor-intensive divisions. The results of the investigation demonstrated that foreign direct investment (FDI) inflows had a positive effect on employment by raising average incomes, which subsequently in turn lowers poverty rates. The dynamics of globalization, together with aspirations for integration into European and global markets, have led these countries to actively seek foreign investment as an accelerant for development. The overall hypothesis of the literature that observes the connection between FDI-s and economic growth and how they influence

poverty improvement is that economic growth is an instrument to moderate poverty but its results can vary from country to country and its effectiveness can differ (Hanim, 2021).

However, attracting FDI has its own complexities that manifest in issues such as regulatory frameworks, political stability, and the ability to leverage foreign capital for inclusive growth. Sethi, Guisinger, Phelan, & Berg (2003, p. 34) advocate that multinational enterprise activity is higher in countries where the number of determinants that attract FDI inflow outweighs the number of determinants that discourage it.

On the other hand, according to Topalli, Papavangjeli, Ivanaj, & Ferra (2021), the countries of Southeast Europe began to attract FDI after the start of the process of privatization of state enterprises, where in the framework of these investments from foreigners, various economic sectors are included, such as the real estate sector, construction, and the financial sector, followed by from the transport and telecommunication sectors.

In addition to FDI, remittances or money transfers sent by immigrants to their countries of origin have a considerable impact on the economies of recipient nations of remittances. However, they are mainly oriented towards assistance to cover the needs of the family and to improve the level of consumption, respectively the reduction of poverty. This contributes to the growth of domestic demand, stimulating the economy through the distribution of money at the local level. Further, Mallick (2008) argued that if remittances are mainly spent on private consumption, then these represent a low impact on growth.

However, it is important to mention that remittances are not a long-term solution to economic challenges. Moreover, this can create a high level of dependence on these transactions and make it difficult to develop other economic sectors. To achieve long-term economic development, countries such as those in the Western Balkans must focus on diversifying the economy, improving infrastructure, increasing productivity sectors, and developing internal markets. In addition, Williams (2017, pp. 1-6) claimed that the positive effect of remittances on growth depends on the level of democracy in developing countries.

Southeastern European countries compete to attract FDI, which is a vital source of capital, given the large lack of domestic savings in these countries and the economic challenges they face. Saving or keeping a certain amount of money or assets instead of immediate spending can have a significant impact on the GDP growth of Southeast European countries. Some ways in which savings can affect the economic growth of these states are: if that money is kept in banks or invested, it affects the increase in the capacity of financial institutions to grant loans and support economic activity.

Similarly, the growth of personal investments, which include investments in the property market, shares, or other constructions can help create wealth and increase capital. According to Aghion, Comin, & Howitt (2006), average saving is related to FDI and equipment import intensity, especially in poor countries where both FDI and equipment imports enter positively and significantly in the panel growth regressions.

The increase in the standard of living and the improvement of the economic and geopolitical conditions, have been accompanied by other factors such as the liberalization of trade between countries, the free circulation of services, goods, and capital, the genuine processes of privatization, the improvement of the climate of doing business, as well as deeper economic ties with the EU, were the main reasons behind the increase in FDI.

However, saving in a country's economy is complex and influenced by many factors including domestic economic policies and changes in the international situation. Therefore, saving alone cannot constitute a sustainable model of economic development, but it can be an important element in this process.

On the one hand, the effects of gross savings can have different impacts depending on economic situations as well as fiscal and monetary policies, and some other factors. In difficult economic times, individuals and businesses tend to increase savings more due to uncertainty and the need for financial reserves, but this can affect demand and have adverse effects on economic growth. Furthermore, according to Rasmidatta (2011) more savings, especially in developing countries, will be followed by less consumption, but in a greater amount of capital investment and ultimately a higher rate of economic growth.

Methodology and results

The quantitative approach that is used is the Generalized Method of Moments as a dynamic approach, as more outcomes are dependable. This approach, grounded in an analysis of numerous empirical studies, is deemed suitable and yields sustainable outcomes, given that the utilized data are acknowledged dynamic. Therefore, first, in the framework of the quantitative analysis, some general statistics are presented, starting from the descriptive statistics. These statistics will provide general evidence of the movements of the variables starting from the mean value, minimum, maximum, and standard deviation. Then, continuing is the correlation analysis, to identify the relationship between the dependent and independent variables.

More specifically, this analysis will also serve to identify if the applied data has a problem with multicollinearity since the dynamic data has such a tendency. Also, the analysis performs the Fisher test for the stationarity of the data as a necessary step to identify if the data has a unit root. Then, this test will examine the data if they are integrated within the first level - first order I(1). Finally, the GMM approach is applied, as well as the diagnostic tests AR1 and the Sargan test for fitting the instruments within the model.

The general formula according to GMM is:

$$Y_{it} = \sum Y_{i,t-1} + X'_{i,t}\beta + \alpha_i + \varepsilon_{i,t}$$

Meanwhile, substituting our concrete variables in the formula, we will obtain the following equation in the first difference:

$$\Delta\textbf{GDP growth}_{i,t} = \boldsymbol{\varphi} + \boldsymbol{\mu}\left(\Delta\textbf{GDP Growth}_{i,t-1}\right) + \boldsymbol{\beta_1}\left(\Delta\textbf{Foreign Direct Investment}_{i,t}\right)$$
$$+ \boldsymbol{\beta_2}\left(\Delta\textbf{Remittances}_{i,t}\right) + \boldsymbol{\beta_3}\left(\Delta\textbf{Gross Savings}_{i,t}\right) + \Delta\boldsymbol{\alpha}_{i,t} + \Delta\boldsymbol{\varepsilon}_{i,t}$$

Where: GDP growth$_{i,t}$ - symbolize the dependent variable, β_1 to β_3- symbolizes the parameters used in the estimation, i - symbolizes the individual effects in the context of the economies, t - the period 2010-2022, α_i- symbolize unobserved captures of country-specific issues, and ε_{it}- symbolizes the expected error.

In this part of the research, the results will be discussed starting from the descriptive statistics.

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
GDP Growth	78	2.734	3.662	-15.310	13.040
FDI	78	6.295	3.686	.060	18.300
PR	78	10.155	3.989	2.810	18.837
GS	78	18.623	7.543	1.170	32.720

Source: Author's calculations

All variables are expressed in percentages. Based on the results generated by the statistical model used, from 78 observations, the GDP Growth showed an average value of 2.73 percent, with a standard deviation of 3.66 percent, while the maximum value reached is 13.04 percent and the minimum value is -15.31 percent. The maximum value reached was in 2021 at 13.04% in Montenegro, while the minimum value was -15.31% also in Montenegro in 2020.

Foreign Direct Investment from 78 observations has an average value of 6.29% and, a standard deviation of 3.69%, while the minimum value is 0.06% and the maximum value is 18.30%. The minimum value was 0.06 in 2020 in North Macedonia, while the maximum value was 18.3 in Montenegro in 2010. Regarding the other variable, the personal remittances have an average value of 10.16, a standard deviation of 3.99%, a minimum value of 2.81 percent and a maximum value of 18.84 percent. The minimum value was 2.81 in North Macedonia in 2019, while the maximum in Kosovo in 2010. The Gross savings have an average value of 18.62 with a standard deviation of 7.54%, while the minimum value is 1.17 and the maximum value is 32.72. The minimum value is 1.17 in Montenegro, while the maximum was 32.72 in North Macedonia in 2018.

Table 2. Correlation analysis

	GDP Growth	FDI	PR	GS
GDP Growth	1.000			
FDI	0.074	1.000		
PR	0.151	0.243	1.000	
GS	0.257	-0.427	-0.215	1.000

Source: Author's calculations

Correlation analysis is employed to examine the association between the dependent variable, GDP Growth, and various independent variables. The findings suggest a positive correlation between GDP Growth and all independent variables. Detailed correlations are presented in Table 2, revealing a full correlation of 0.257 between GDP growth

and GS. Additionally, the analysis indicates a moderate correlation between GDP growth and PS. Furthermore, there exists a low positive correlation between FDI and GDP growth, as per the results.

Among other things, this analysis is used to evaluate if the data have any problems with diversity (multicollinearity). From the result, we see that the coefficient does not have a value ≥ 0.75. Gujarati (2004) has underlined that if any coefficient has a value ≥ 0.75, then we have problems with the diversity of variables. Moreover, Nguyen (2020) offered mathematical and statistical arguments that show that a multicollinearity problem can lead to an unstable final result if the data from this analysis have a coefficient $\beta \geq 0.8$.

Table 3. Levin-Lin-Chu and Pedroni test

Variables	GDP Growth	FDI	PR	GS
At level				
Statistic	-3.8503	-3.4746	-1.7910	-0.9727
ρ - value	0.0001	.0003	0.0366	0.1654
At first difference				
Statistic	-3.4422	-5.1251	-3.3163	-5.7499
ρ - value	.0003	0.0000	0.0005	0.0000
			Statistic	*ρ - value*
Kao test		Modified Dickey-Fuller t	-1.9749	0.0241
		Dickey-Fuller t	-5.9503	0.0000
		Augmented Dickey-Fuller t	-1.4355	0.0756
		Unadjusted modified Dickey-Fuller t	-8.4757	0.0000
		Unadjusted Dickey-Fuller t	-8.7746	0.0000

Source: Author's calculations

Finally, proceeding further to verify the data, we performed the Kao test, to analyze if each observation is properly integrated, and also to identify if there is a long-term correlation between GDP growth and other variables included in the research. Based on the value of the Kao test, the results give us indications that the data have been adequately integrated since the p-value is significant. This discovery shows us that the data included in the analysis have a relationship in the long term.

Table 4. Regression analysis-Arellano-Bover/Blundell Bond Estimation – GMM

	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
GDP Growth	-0.3438	0.0786	-4.37	0.000	-.4978	-.1897
FDI	0.4090	0.1872	2.18	0.029	.0421	.7760
PR	0.2811	0.2837	0.99	0.322	-.2750	.8373
GS	0.3979	0.0862	4.61	0.000	.2289	.5671
_cons	-9.2691	3.5591	-2.60	0.009	-16.2448	-2.2933
Wald chi2(4)			47.090	0.000		
Sargan test			68.922	0.227		
Obs						78

Source: Author's calculations

FDI, predicated on the results of the GMM model, respectively (β= 0.409; p=0.029), consists that the support of FDI positively affects GDP Growth. This conclusion is based on the confidence interval of 99.9%. In a study done by Zekarias (2016) on the impact of FDI on GDP growth with panel data, he confirmed a significant positive relationship between FDI and GDP growth in the long term.

Personal remittances, based on the results of the GMM model, respectively (β=0.281; p=0.322), consist that PR has positively affected GDP Growth, but in statistical terms, it turned out to be insignificant. According to Rao & Hssan (2011) who made a panel analysis of 40 countries, found that the effects of remittances on economic growth are insignificant.

Gross savings, predicated on the results of the GMM model, respectively (β=0.397; p=0.000), consist that GS positively affects GDP Growth. This conclusion is based on a confidence interval of 99.9%. The conclusions of our analysis also agree with the results of the study by Bayar (2014), the results of their research show a positive relationship between GDS and GDP Growth. Since $p \leq 0.05$, then the model is correctly defined and the instruments are adequately fitted.

Conclusions

The challenges and ramifications of foreign investments in economic development stand as significant subjects garnering the focus of policymakers, economists, and researchers in the Southeast European region. Challenges characterized by political instability, corruption, and security issues make investors feel insecure about their investments.

Nevertheless, from the study, we have observed that foreign investments have brought progress in several sectors, including the progress of the business sector, the modernization of technology, and the progress in employment. In this way, to achieve economic growth, the countries of Southeast Europe must address their challenges to improve the investment climate, taking steps to overcome these challenges.

In the framework of this research, we analyzed theoretically and empirically some of the factors that can influence GDP growth with the dependent variable: GDP growth (annual percentage growth), and the independent variables: foreign direct investment (FDI) as a percentage of GDP, remittances as a percentage of GDP and gross savings, covering the period 2010-2022. Based on the results of our research, it is concluded that FDI has a positive effect on GDP growth, a conclusion that is based on a confidence interval of 99.9%. Personal remittances, based on the results of our research consist of having a positive effect on GDP growth, but in statistical terms, it turned out to be insignificant.

Also, gross savings based on our results consist of having a positive impact on GDP growth, with a confidence interval of 99.9%.

As a general conclusion of this study, it turns out that other studies are needed in this field, including other potential factors that can have an impact on GDP growth. Correspondingly, in these countries, respectively, the decision-making authorities should take appropriate actions to overcome the challenges and implement sustainable policies that would affect economic growth, respectively, in attracting foreign investments.

Also, regional cooperation and the implementation of sustainable policies can be essential in this process, despite the challenges, foreign investments have the potential to contribute to the advancement of the economic structure of SEE countries.

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