DOI: 10.28934/ea.20.53.2.pp109-120

SCIENTIFIC REVIEW

Western Balkan Countries as an Attractive Investment Destination

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ABSTRACT

Foreign direct investments are potentially very important for each country as they could significantly contribute to its economic development. The importance of foreign direct investments reflects in their ability to contribute to development of comparative advantages and competitiveness. In the last 20 years, WB countries have tried to attract as many foreign investors as possible using various policy incentives. Foreign direct investment inflows followed the pace of economic transformation and reforms towards a market economy, leading to economic growth. The aim of this paper is to analyse characteristics of the inflow of foreign direct investments in the Western Balkans (WB) countries, as well as the impact they might have on their economic growth and development. In order to determine the amount of foreign direct investments, but also the position, i.e. competitiveness of each of the observed countries, there have been used secondary data from the official UNCTAD reports. The paper will also present an analysis of the greenfield investments for selected economies, as a very important type of foreign investments that probably have the largest positive spillovers. The time period covered by this research was from 2010 to 2019. The results of the conducted research indicate that Serbia is the most attractive investment destination, considering that in the observed period, more than 60% of the total amount of foreign direct investments that were directed to the countries of the Western Balkans ended up on its territory.

Key words: *Foreign direct investments, Western Balkans, investors, economic development*

JEL Classification: F21, P33, P45

INTRODUCTION

In the single European Union market, characterized by fierce competition and free movement of capital, labor, goods and services, member states and international organizations strive to create the most competitive economic environment. In that context, tax policy instruments are very important. The realization of comparative advantages by using tax policy instruments was especially obvious at the beginning of the 21st century, when the new members from Eastern Europe joined the European Union, and the „race" in attracting foreign investments additionally intensified. In line with the accession of these countries to the European Union, the issue of tax competitiveness shifts to the countries of the Western Balkans (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia) that remained outside the European Union. All these countries generally do not have sufficient domestic capital, and therefore not enough investments to stimulate economic activity. This is one of the main reasons to explain

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why these countries strived to be as much competitive as possible, since they will be in a position to attract foreign investors not only from Europe, but from all over the world as well.

The competitive economic environment of a country is a clear investment signal for multinational companies. Favourable environment results with larger amount of investments and consequently leads to the opening of new production facilities as well as the employment of the local labor force. Factors often present in transition and less developed countries and particularly beneficial for the foreign capital are, above all, the high unemployment rate as well as privatization which has led to the closure and restructuring of a large number of companies. High unemployment rate sometimes leads to lower labor costs, whereas destroyed local companies cannot be enough strong competition for large multinational businesses. All of the aforementioned favours foreign capital. Countries that have gone through the transition towards market economies are in a position to attract foreign capital with low tax rates, trying at the same time to eliminate high unemployment rate, increase GDP, etc. (Feld, 2005). The most important factors that guide multinational companies in deciding which country to invest in are lower income tax and income tax rates (Donath & Slavin, 2009).

FDI accumulation in the Western Balkans has been associated with an increase in production given that multinational companies usually have better operational solutions and know-how that transfer to the targeted economies. In this case, multinational companies can benefit not only from the increased revenues but also from increased production and efficiency. FDI are often based on the new innovative technologies educating employees for the particular business, and bridging the gap between developed and developing countries. FDI contribution often results in the promotion of foreign trade, given that increased efficiency, economy of scale and product quality will contribute to greater export opportunities for domestic companies, previously unable to participate in foreign markets. A favorable investment climate is very important for all investors in these countries, given that the state, when creating an adequate investment climate for foreign investors, also provides domestic companies with additional opportunities and support.

LITERATURE REVIEW

Foreign direct investments are very important form of international capital movements, significantly influencing national economic development (Musabegović et al., 2015). The Western Balkans could be an attractive investment destination in the following period (Sanfey et al., 2016). For that to happen, it is necessary for these countries to increase their production, export and achieve overall economic stability (Domazet & Marjanović, 2017a). Foreign direct investments might significantly contribute to the economic growth, reduce unemployment and result in inflow of new technologies (Zdravković et al., 2017).

Foreign direct investments are one of the factors of success of the national economy in the global market (Marjanović & Domazet, 2018). Although decisions related to FDI inflows/outflows are primarily an economic consideration driven by market forces, they are also deeply shaped by the economic, political, and legal rules governing investment in the host country (Meunier, 2017). One of the main tasks for the Western Balkans countries is to attract as much foreign direct investment as possible. It is very important that there is available, but not limitless capital on the world market, which lead to countries competing with each other for investors and their capital (Marjanović, 2018; Stošić et al., 2011).

The country features such as size, openness, skill levels, and institutional stability not only set the pace of FDI, but that they also influence both the network structure and the power positions of each node (Bolivar et al., 2019). The findings of research Paul & Jadhav (2019) indicate that infrastructure quality, trade cost measured by tariff and non-tariff barriers, institutional quality measured by effective rule of law, political stability, regulatory quality and control on corruption are significant determinants of FDI in emerging markets.

If state aims to be an attractive destination for foreign investors, it is necessary for tax policy makers to pay special attention to tax rules. Precisely these rules and the adopted measures in the field of tax policy will significantly influence the decision of investors to invest capital (Domazet & Marjanović, 2018). Tax incentives tend to attract efficiency-seeking FDI motivated by lowering production costs than other types of investment. Developing country governments can take unilateral steps to use tax incentives in a more targeted and cost-efficient manner by (1) targeting incentives at those investors whose decision to invest is most likely swayed by incentives and (2) improving the design, transparency, and administration of incentives to reduce indirect costs and avoid unintended consequences (Andersen et al., 2018).

In the process of globalization, states are trying to reduce tax rates and / or expand tax bases with an aim to attract foreign capital. This is also called a "race to the bottom", which is based on two predictions: (a) multinational companies invest in countries that do not have high standards and grant additional benefits to investors, (b) countries undermine each other's standards to achieve the main goal and that is attracting foreign capital (Olney, 2013).

According to Cazzavillan & Olszewski (2012), non-financial FDI is positively affected by financial services FDI and by market potential and FDI crowds out domestic investment in the manufacturing sector. According to Li & Tanna (2019) FDI has a strong and positive impact on TFP (total factor productivity) growth after accounting for the roles of human capital and institutions. Institutions are found to be more important than human capital in realizing productivity gains from FDI.

If the Western Balkans countries succeed in attracting foreign investors, it will automatically mean that the state has provided a safer and more favorable economic environment in the country compared to competitors (Domazet & Marjanović, 2017b). However, it does not necessarily mean that the FDI will result in economic development.

Western Balkan countries generally have a certain level of skills and knowledge, which might contribute to a higher inflow of foreign direct investment in these countries. This could also lead to the growth and development of the host countries and result in increase of the country's competitiveness as well (Redžepagić & Richet, 2008).

Corruption is one of the major issues the Western Balkans is facing, challenging both domestic and foreign companies in doing business. According to Zeneli (2015), high levels of corruption negatively affect the economic development of the Western Balkans countries. Corruption is negatively correlated with the level of income, given that a higher level of corruption affects the reduction of per capita income. It also negatively affects the current account balance, stimulate tax evasion, reduce competitiveness, also discouraging innovation activities.

Analyzing the inflow of foreign direct investments, Đukić and Bodroža (2011) come to the conclusion that all Western Balkan countries should invest more efforts in solving potential problems that might negatively affect the attraction of greenfield investments, since these investments can significantly contribute to the development of these economies.

DATA ANALYSIS AND FINDINGS

Western Balkan countries still lag behind developed EU economies in terms of their overall economic development. They cannot obtain sufficient capital from the internal sources of their own accumulation. Therefore, FDI represent very important channel of capital accumulation for these countries. One of the main goals for these countries is to attract as much foreign capital as possible bridging the gap between available and desired amount of investments. Inflow of the new investments is supposed to have significant impact on their economic growth.

FDI in the Western Balkan countries

Over the last ten years, FDI in the Western Balkan economies has been mainly focused on the manufacturing sector, which recorded significant improvement in productivity and the profitability if compared to the previous period. This is one of the reasons behind the transfer of resources from the industrial sector with small comparative advantages, towards industrial sectors that may have comparative advantages comparing to more competitive regions, primarily neighbouring Balkan countries.

There are numerous reasons why companies seek to expand their business to other countries, with particular emphasis on (a) lower operating costs, (b) availability of raw materials, (c) cheaper labor, (d) avoidance of customs and other export costs when exporting to targeted markets, (e) lower transport costs, (f) takeovers of companies - direct competitors operating in targeted markets, etc.

FDI has had a significant impact on catch-up processes in developing countries. Western Balkan countries (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia) are also the ones that might experience economic benefits from the FDI inflow. The aim of this paper is to present recent trends in the FDI inflow, as well as to explore the impact of FDI on the development of selected economies. In addition, the paper will present an analysis of greenfield investments (amount and total number of implemented projects). The analysis covered the period from 2010 to 2019. Data from the official United Nations Conference on Trade and Development (UNCTAD) were used.

Table 1. FDI inflows in Western Balkan countries, 2010-2019. (Millions of US dollars)

Country	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Albania	1 050	876	855	1 265	1 111	945	1 100	1 148	1 289	1 281
Bosnia and Herzegovina	406	496	394	276	550	361	349	449	472	528
Montenegro	760	558	619	447	497	699	226	558	489	452
North Macedonia	212	478	142	335	272	240	374	205	725	365
Serbia	1 686	4 932	1 298	2 053	1 998	2 347	2 352	2 878	4 127	4 280

Source: UNCTAD (2020)

Over the period from 2010 to 2019, about $ 51,805 million of foreign direct investments entered the Western Balkan region. The main sources of the attracted investments are the EU countries, China, Russia and the USA. Table 1. shows that 2012 was extremely unfavorable in terms of attracted investments. As a result of the reduced FDI inflow, it was hard to achieve strong economic growth in the period after 2012. However, since 2013 it could be noticed relatively favorable trend in FDI, particularly in Serbia and Albania. By conducting stimulative fiscal policy towards foreign investments, Serbian authorities have created a relatively competitive economic environment, which resulted in positive results measured in the amount of attracted foreign capital.

If we consider the overall level of investments in the Western Balkans, it could be noted that Serbia has significantly larger inflows of foreign direct investment if compared to other countries in the region. If per capita FDI are taken into account, Montenegro takes the first position followed by Serbia and Albania. However, the Western Balkans region lags significantly behind EU countries in terms of FDI inflows per capita. Average FDI stock per capita in the Western Balkans is around €2,600 while in the European Union it is around €14,300 (Sanfey et al., 2016).

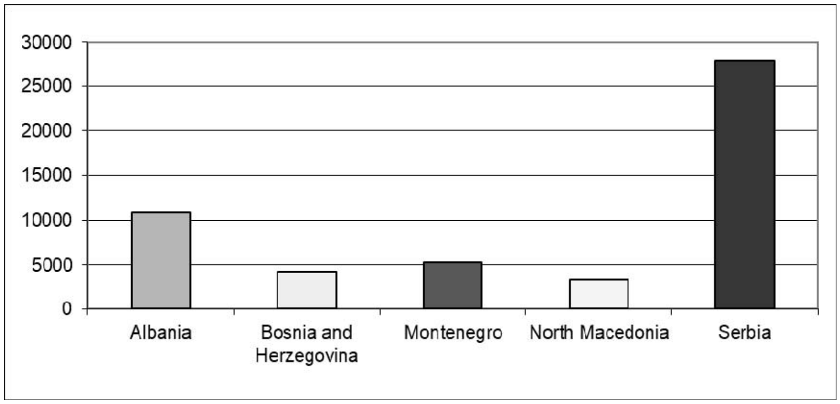

Figure 1. FDI inflows in Western Balkan countries, 2010-2019. (Millions of US dollars)

Source: Authors based on the UNCTAD (2020)

The largest single recipient of the regional FDI is Serbia, which received about $27,951m in the analysed period, which is 54% of the total amount of foreign direct investment that ended up in the Western Balkans. It is followed by Albania with $10920m (21%), Montenegro with $5305m (10%), Bosnia and Herzegovina with $4281m (8%) and North Macedonia with $3348m (7%).

At first glance, it can be concluded that in the observed period, out of the total amount of FDI attracted, more than half arrived in Serbia. This is not surprising, since besides the fact that Serbia is the largest economy in the region, Serbian policy makers put special emphasis on creating conditions for attracting foreign investors. Other countries received much less FDI in relative terms if compared to Serbia.

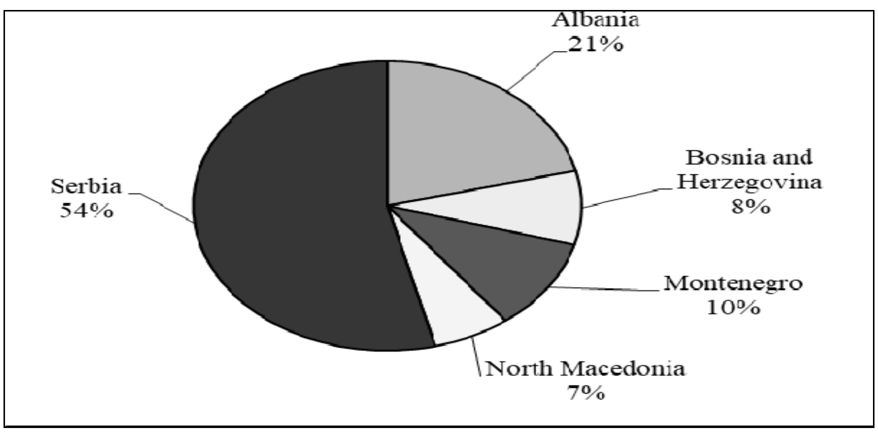

Figure 2. Share of FDI attracted by Western Balkan countries (2010-2019), in %

Source: Authors based on the UNCTAD (2020)

In the first half of 2019, compared to the same period 2018, FDI fell by 1 percentage point. However, we inflow of FDI to the countries of the Western Balkans is still solid, mostly due to the favourable geographical location, relatively cheap and skilled labour as well as lower labour costs.

The contributions of foreign direct investment (FDI) to the Western Balkan economies have been relatively important over the last years, providing support for economic growth, job creation, innovation and technological progress. EU companies are the biggest investors in the Western Balkans: over €10 billion of Foreign Direct Investments in the past five years.

Western Balkan countries are not yet members of the European Union which, to a certain extent, can be a limiting factor for attracting foreign investors. If the total FDI inflow in the EU countries with the total FDI inflow in the Western Balkans is compared, we can derive conclusion that Western Balkan countries significantly lag behind in terms of FDI inflow compared to EU.

Table 2. FDI inflows, 2010-2019. (Millions of US dollars)

	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
European Union	394082	488712	397392	366738	312030	645445	591331	465076	415116	446896
WB countries	4114	7340	3308	4376	4428	4592	4401	5238	7102	6906

Source: UNCTAD (2020)

Although the share of FDI in the Western Balkans has increased significantly in the recent years, it is still insufficient compared to other EU countries. If the inflow of FDI in EU countries is compared over the same period, it could be noted that the Western Balkan countries receive between 0.7 and 1.8% of the total FDI recorded in the EU countries.

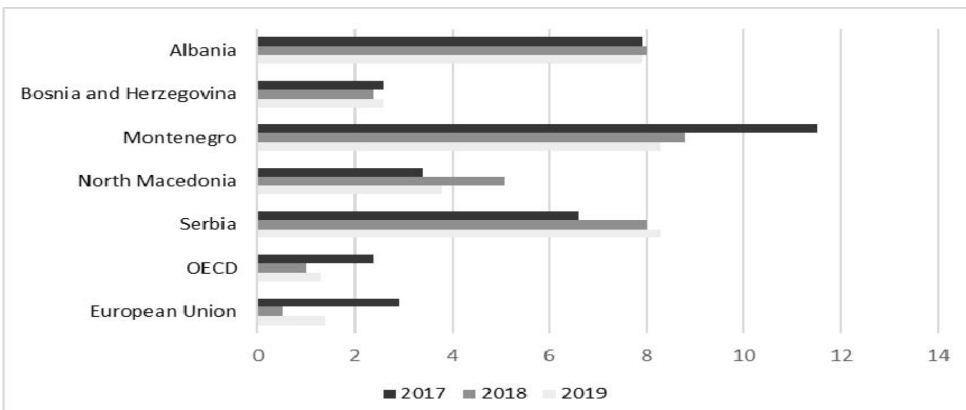

Figure 3. Foreign direct investment in Western Balkan countries, net inflows (% of GDP)

Source: World Bank data URL: https://data.worldbank.org/indicator/bx.klt.dinv.cd.wd

The contributions of foreign direct investment (FDI) to the Western Balkan economies have been relatively sizeable over the last years (Figure 3), providing support for economic growth, job creation, innovation and technological progress.

Greenfield investments in the Western Balkan countries

One of the most important sources of business development of multinational companies refers to investing in other regions, i.e. other countries. It is motivated by a legitimate interest aimed at ensuring economic benefits and increasing profits. By entering foreign markets, they have the opportunity to invest capital in one of the following ways: (a) greenfield investments, (b) M&A (merger and acquisition) and (c) joint ventures. The most common form of foreign investment is through greenfield investments. This form of investment is typical for companies that invest their own capital in a foreign country, where they do not have pre-built infrastructure, space or labor force for their business. Therefore, to have the characteristics of a greenfield investment, the company has to build completely new plants and facilities, and agreed location in the specific market, to activate a new business as a new market player, to enrich the offer of products and services in the target market, as well as to hire new workers.

Table 3. Number of announced greenfield FDI projects in Western Balkan countries, 2010-2019.

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Albania	6	8	12	4	6	5	2	3	6	5
Bosnia and Herzegovina	23	30	29	31	21	25	16	26	29	28
Montenegro	10	6	7	9	8	4	3	2	17	10
North Macedonia	15	26	31	27	32	20	20	11	13	10
Serbia	79	111	113	125	79	75	86	112	157	114

Source: UNCTAD (2020)

Over the period between 2010 and 2019, the largest share of greenfield investments arrived in Serbia. Other Western Balkan countries have recorded significantly lower share of greenfield investments. The reason for this lies in the fact that Serbia has significantly improved its policy towards greenfield investments, which has been also recognized by foreign investors.

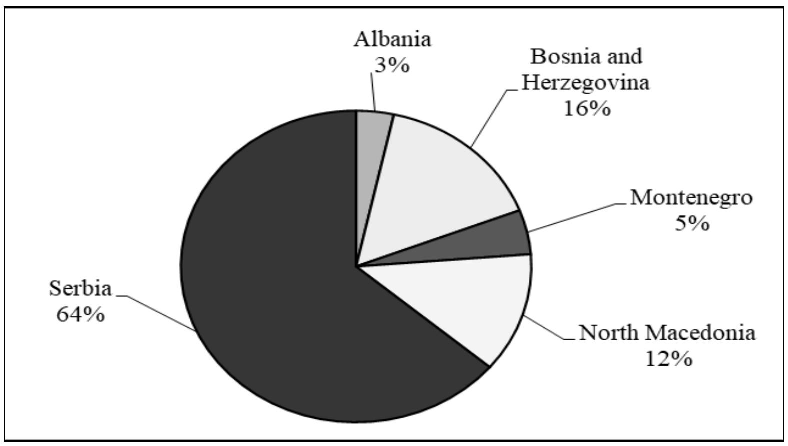

Figure 4. Share of greenfield investments in Western Balkan countries (2010-2019), in %

Source: Authors based on the UNCTAD (2020)

Out of the total number of greenfield investments attracted by the Western Balkan economies, Serbia leads with 64%, whereas in other countries there were significantly lower amount of this type investments. Serbia is followed by Bosnia and Herzegovina (16%), and by North Macedonia (12%), while the other two countries have a very small number of these investments (Montenegro - 5%, Albania - 3%).

Table 4. Value of announced greenfield FDI projects, by destination, 2003-2019. (Millions of US dollars)

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Albania	58	431	302	62	51	139	36	12	188	183
Bosnia and Herzegovina	291	1 235	1 210	888	975	3 140	936	552	701	558
Montenegro	510	388	343	850	1 136	44	615	47	1 988	582
North Macedonia	414	811	966	555	854	342	291	111	855	237
Serbia	3 710	3 785	4 387	4 006	1 977	4 470	2 068	3 842	6 699	4 172

Source: UNCTAD (2020)

Many companies have recognized the Western Balkans as an ideal place to invest their capital. Hence, it is not surprising that a significant amount of greenfield investments in the last decade arrived in these countries, where Serbia stands for the largest recipient. During 2018, the Western Balkans recorded the largest inflow of greenfield foreign direct investments over the observed period 2010-2019, amounting to approximately $ 9 billion. Although Western Balkans have attracted significantly fewer greenfield FDI projects than other countries in Central, Eastern and Western Europe, the region's performance has been relatively solid if the share of global GDP is considered. Serbia attracts almost 12 times more foreign investments compared to similar economies of its size. The main reasons for such a significant attraction of FDI lies in the economic incentives, solid labor force and relatively generous tax policy, but also trade agreements and other political agreements signed with other countries.

DISCUSSION

Western Balkan countries use different strategies aiming to attract FDI. It is very important to create a good investment climate, and one of the prerequisites for creating favorable business environment is the adequate tax policy. The establishment of investor support agencies as well as the conclusion of bilateral agreements related to capital investment can significantly contribute to the opening of the market for foreign investors resulting in capital inflows. Therefore, FDI could be a significant source of economic development, modernization, growth of production, exports and employment.

Since the early 1990s, Albania experienced a steady inflow of the FDI. Choosing Albania as an investment destination provides foreign investors with significant competitive advantages over the neighbouring Balkan countries - geographical location, low tax burden, very cheap labor as well as natural resources (oil, gas, copper, iron, chromium), including solid penetration of the regional market. In recent years, the Albanian government has aimed to increase the inflow of FDI through tax reform. Measures have also been taken to improve the overall business climate in the country by improving business procedures as well as undertaking comprehensive structural reforms, primarily in legislation while reducing the fiscal burdens. Albania offers equal treatment to foreign and domestic investors, but has also signed bilateral agreements aiming to promote and protect investments. The focus of the policy makers in the future period should be to attract foreign direct investments in sectors where the potential of the Albanian economy has not been exploited, particularly in exploitation of the natural resources, development of tourism and the agribusiness sectors.

Although Bosnia and Herzegovina has competitive tax rates compared to other Western Balkan countries, the level of foreign direct investment is still far from the expected level. The authorities aim to improve their competitive position by introducing numerous tax and other incentives for foreign investors. One of the problems for business development, being also a significant barrier for the FDI inflow, is the complex state administration and several levels of governance. Inadequate and inefficient administration as well as the complex legal framework are coupled with non-transparency of the state policy. Foreign investors are particularly concerned about of political instability, high levels of corruption, the gray economy and inadequate workforce skills. In order to attract FDI and improve competitiveness, it is important for Bosnia and Herzegovina to carry out the necessary political reforms, reduce corruption, improve administrative efficiency, and develop a strategy for attracting FDI. One of the steps towards creating a system for attracting FDI refers to the strategic decision about the country's development priorities that could result in advantages over neighboring countries.

Foreign direct investments are one of the important factors in achieving sustainable economic development and increasing the competitiveness of Montenegro. The legal framework in Montenegro is very liberal and favors the FDI attraction. However, it should be borne in mind that fierce competition in the world market and the presence of liberal regulations are typical for almost all countries worldwide that aspire to attract foreign investments. It is important to note that an attractive legal framework has been created in the country, i.e. foreign investors have the national treatment and there are no restrictions on profit repatriation. Additionally, Montenegro has very simple legal procedures for establishing a company. Montenegro has an extremely high potential for attracting FDI, but in the following period, the implementation of major projects will largely depend on the economic situation at the global level. In the forthcoming period, the inflow of foreign direct investments could be negatively affected by lower interest of foreign investors in the implementation of large projects in the field of tourism, outflow of foreign capital, slow administrative procedures and delays in privatization. Therefore, it is very important for Montenegro to complete the privatization process in the coming period (through simplification of procedures and acceleration of the privatization process) and change the investment structure in terms of increasing the share of greenfield investments. It is also very important to increase investment in new production programs that will inevitably lead to job creation.

One of the main goals of the Macedonian government in the coming period is to attract as much as foreign direct investments as possible, which will contribute to the creation of a safer and more favorable economic situation in the country, resulting in creation of new jobs. In addition to low tax rates, Northern Macedonia has made efforts in other segments of the economic policy in order to be competitive with neighboring countries. This is reflected in various benefits for starting a business, reducing costs and time for a company registration, strengthening regulations and investors' protection, simplifying the process of obtaining building permits and electricity, etc. All these efforts have been rewarded by increasing foreign direct investment in Macedonia over the last decade.

After 2012 and the recorded sharp decline of FDI in Serbia, the period that followed led to significant economic stability in the country, which resulted in an increase in FDI inflows from both EU countries and China. Greenfield investments in Serbia have grown over the past 6 years, where 2018 stands out, in which over 100 individual projects have been implemented. It should be particularly emphasized that Serbia, according to the FDI Intelligence list for 2019, is ranked first in the world as a country receiving greenfield investments, taking into consideration the level of GDP. With a score of 11.92 Serbia attracts almost 12 times the amount of greenfield FDI compared to the amount that could be expected given the size of its economy. The implemented reforms have significantly contributed to the fact that foreign investors are increasingly interested in Serbia as an investment destination, with EU countries (Germany, Italy, the Netherlands and Austria) leading the way. Economic perspectives of Serbia in the following period will dominantly depend on its readiness to deal with high level of corruption and strengthen rule of law which have been stressed as the main challenge in most of the reports of the international institutions and organizations (i.e. European Commission report, 2020).

To summarize, it is obvious that the Western Balkan countries are favourable investment locations for foreign investors. All these countries have implemented economic reforms and greatly simplified the criteria for attracting foreign investors. Well-implemented tax reform is also crucial for attracting foreign direct investment, which primarily refers to tax incentives that will largely determine the future strategies of multinational companies and their choice to invest capital. However, it is important to note that FDI should not be considered only as a whole, since the structure of the attracted FDI is also important. FDI that bring new technologies, and result in producing higher added value products are particularly important for the sustainable economic development.

CONCLUSION

Size of the market and the market growth rate are the key parameters that investors are taking into consideration when entering the particular market. If the market is large and the growth rates are high, management will seriously consider diverting resources to the particular market, analysing possibilities to establish its own branch or acquire a majority stake in a joint firm. The decision about entering enter a new market also depends on other market conditions such as trade barriers (tariffs, quotas, customs duties). FDI are very important for those countries where there are underdeveloped regions, as they could significantly change the business conditions helping these regions to grow and develop much faster if compared to regions relying only on their own resources. The positive impact of FDI is often pronounced in industry, service development, trade, trade relations and the transfer of new technologies. Industries in developing countries which succeeded in attracting foreign capital, often achieve good business results. Foreign capital plays a stimulative role in the overall economic recovery of a country.

Western Balkan countries have established investment agencies in charge of promotion of their economic potentials, so that the number of concluded bilateral agreements, agreements on avoiding double taxation as well as free trade agreements are increasing every day, aiming to improve the investment climate in these countries. Bilateral agreements typically involve developed countries on the one hand and developing countries on the other, with the aim of protecting companies from developed countries from political risks while helping developing countries to attract FDI. Double taxation agreements are essential to prevent a multinational company from being taxed twice on the basis of the same business activity. It is very important for investors to have adequate conditions for unlimited and equal participation in the market.

When making a decision on investing in a certain country, special attention is paid to the Index of Economic Freedoms, which serves to measure economic freedoms in world economies. According to the results for 2020, on a scale of 0 to 100, where the maximum value represents a perfectly free country, Western Balkans countries score 65.3 on average. According to the Index of Economic Freedom, all the countries of the Western Balkans are classified in the third level - moderately free.

The effects of potential foreign investments on the Western Balkan economies are mainly positive, and the key evidence lies in their dynamic growth over the last 10-15 years. Western Balkans is experiencing an increase in FDI during the European Union accession process. It is important for all the Western Balkan countries to ensure an adequate environment in the following period creating an appropriate investment policy framework and providing political stability and favourable business climate.

The competitiveness of the Western Balkan economies has significantly improved in the previous period, since countries are competing to each other when applying specific measures offered to potential investors. Macroeconomic stability, strategic geographical position, favorable tax regime as well as low labor costs are important determinants of the attractiveness of particular country for the FDI inflow. In order to attract investors, it is very important to provide investors with attractive fiscal incentives. One of the benefits is the establishment of economic zones, business parks, trade zones and other similar measures, through which countries offer tax exemptions as a significant benefit. In the following period, it is very important for the Western Balkan countries to design adequate investment and tax policies, so to be even more oriented to the attraction of free capital, which could significantly contribute to their economic growth and development.

ACKNOWLEDGEMENTS

This paper is financed by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

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Article history:	Received: October 18, 2020
	Accepted: November 15, 2020