Does Enhancing of the Competitiveness Influence on Foreign Direct Investments in Western Balkan Countries?

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Abstract

Foreign direct investments present a valuable source of national competitiveness as they have attributes of capital flows provide knowledge and technology transfer from one country to target country. In this paper are used variables defined by World Economic Forum which construct Global Competitiveness Index for assessing competitiveness of the country. The purpose of the research is to examine does the national competitiveness increase enhance the level of FDI flows in transition Western Balkan economies that are not yet full members of European Union. The findings claim that larger increase in FDI per capita stocks in majority analyzed countries would have if making infrastructure more competitiveness, accelerate their technological readiness and improve innovation while certain countries should work on health and primary education and higher education and training. According to the results, there is no correlation between FDI flows and macroeconomic environment, institutions, development of financial markets, good market efficiency, labor market efficiency and business sophistication. Applying benchmark method, it is established the most competitive WB country as benchmark value for other transition countries in its neighborhood for enhancing their competitiveness, specially in the regional market. Also, it is obtained what if analysis to detect potential rise of FDI per capita stocks as a consequence of potential changes in some competitiveness variables. It is also calculated the potential increase in FDI/capita due to similar changes in different competitiveness variables.

Keywords: Competitiveness, Foreign Direct Investment, Transition Economies, What If Scenario.

1. Introduction

Significance and scientific researches on the topic foreign direct investment (FDI) have risen during the last twenty years. Knowledge in FDI involves various disciplines such as international economics, international business and management in order to completely comprehensive the phenomena of FDI. FDI represent a crucial factor of national competitiveness because its attributes ensure technological and knowledge transfer to target countries. Positive influence of FDI on economic growth supports the idea to engage significant efforts to attract FDI. Competitiveness is correlated to high living standards, quality standards, reduction of costs, efficiency, productivity, innovations, and so on. Therefore, government policy needs to be directed to attracting FDI inflows. On the other hand, literature indicates that competitiveness presents a significant factor of FDI. The studies regarding relation between competitiveness and FDI are insufficient in the literature mainly because of absence of unique accepted definition of competitiveness of economy (Criste et al., 2008).

The interest of this paper is to find out how rise of competitiveness can attract more FDI inflows. In order to determine potential rise of FDI, it will be used Global Competitiveness Index (GCI) defined by World Economic Forum (WEF) to measure economic competitiveness. This measure of competitiveness is considered to be one which includes wide range of different aspects of competitiveness and it is pretty accepted from foreign investors. Use of this index provides policy makers possibility to identify certain aspects of competitiveness with greater chance for improvement. Also, the potential FDI inflows can be objectively predicted.

The paper is constructed from several parts. In the first part some theoretical background and previous empirical studies regarding relation between competitiveness and FDI are presented. Research methodology for assessment of the potential

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rise of FDI due to rise of certain aspects of competitiveness are shown in the second part. Also, in this part are presented obtained results which are discussed. In the end, there are provided some conclusion of the research.

2. LITERATURE REVIEW

Various studies are more focused on the location factors of competitiveness due to increasing FDI inflows in early '90s (Dunning, 2000). The significance of the location determinants of the competitiveness in domestic country is strongly emphasized with Dunning's eclectic paradigm or OLI paradigm. According to him, international production depends on three types of advantages: ownership, location and internalization advantages. Location factors are mainly defined by local environment and shape by the public policy, other two types of advantages are depending on the multinational companies that are interested into movement their investments into target country. This focus on location characteristic of competitiveness is in great deal the consequence of globalization influence and transition process specially in Western Balkan countries. These characteristic of competitiveness are continuously by the influence of the changes (Popovici & Călin, 2014).

Also, many theoretical and empirical studies give plenty attention to transition of FDI flows, from inherited to created resources. According to Dunning (2008) the ability of the country to attract potential investors lies in its competence to establish a set of difficulty to imitate, distinctive, created assets. This country's competence is determined by its possibility to adapt FDI flows according to its cultural, educational and social system, government policy and market's structure (Wilhelms, 1998). Qualitative variables of the location regarding to quality of life such as violence, corruption, pollution and other unacceptable behaviours have important role too (Dunning, 2003).

Dunnig and Zhang (2008) claim that capabilities, resources and markets which compose the physical environment of the country and human environment composed from institutions are the most important attributes of the competitiveness. These authors include inherited and ceratess resources, educated labour, market knowledge and organizational capacity into category of the physical environment. Human environment is constructed from institutions, law and regulation, cultural and public mechanisms of enforcement.

The policy framework for FDI is constructed from the institutional factors such as entry regulations and operations according to UNCTAD (1998). Market dimension, infrastructure, educated labour force, availability of inherited resources and etc represent economic factors. In the end, business environment related to means for investment to promote and incentives, bureaucracy and low level of corruption.

There is empirical study on the relationship between the international competitiveness of EU15 countries and FDI inflows performed by Anastassopoulos (2007). In this research is used IMD Competitiveness Yearbook to measure competitiveness, designed by IMD World Competitiveness Center. According to him, the competitiveness is constructed from four pillars: economic performance, government efficiency, business efficiency and infrastructure. The obtained results show that there are northern and southern EU countries in regard to factors which influence on attraction of investors. In northern countries, investors pay attention to market characteristics, level of bureaucracy, efficiency and openness of the business sector. On the other hand, in the southern countries, investors focus on the reduction of the investment risk and government efficiency.

Regarding studies on relationship between competitiveness and FDI inflows, Castro and Buckley (2001) provide an analysis of competitiveness and its relation to FDI inflows in Portugal. The main findings of this study are in claim that competitiveness for FDI erodes because of inability of country to compensate higher production costs due to created resources. Study conducted by Narula and Wakelin (1998) emphasizes the technology as engine of the competitiveness. Results indicate that technological capability and availability of human capital influence on FDI inflows. In addition, more innovative countries play important role for investors. Foreign capital will be attracted if investment environment improves through infrastructure development, education and training and provides healthier macroeconomics surrounding (Sass, 2003).

3. RESEARCH METHODOLOGY, RESULTS AND DISCUSSION

In this paper are analyzed Western Balkan countries such as Albania, Macedonia, Serbia and Montenegro. The aim is to test the following hypothesis:

Hypothesis 1: There is relationship between national competitiveness and foreign direct investments in WB countries.

Hypothesis 2: The increase in competitiveness enhances the foreign direct investment inflows in WB countries.

First, it is tested existence of the positive relationship between FDI and competitiveness. In order to measure competitiveness it is used Global Competitiveness Index (GCI) constructed from 12 pillars, designed by World Economic Forum (WEF). The level of FDI is measured by FDI stocks per capita. All these indicators are presented for 2014. Bosnia and Herzegovina as one of the members of WC countries are excluded from sample due to missing value of GCI in examined year. One of the interests of this paper is to determine how increase in certain pillars of competitiveness can contribute to attract FDI. In many studies is shown the positive relationship between FDI pillars of competitiveness. The particular value of this research is in its interest to focus on establishing certain relations on the example of WB countries.

In next *Figure 1* are presented average values of competitiveness and FDI stocks per capita with aim to compare them between EU28 countries and WB countries. As it can be seen, the average value of GCI for EU28 is 4. 73 and it is higher than value of GCI for WB countries, which is 4. 05. The greater gap is recorded in terms of FDI per capita. The average value of FDI stocks per capita in EU28 is cc 11 times higher than in WB countries. During these comparisons it need to bear in mind the number of members in each compared category.
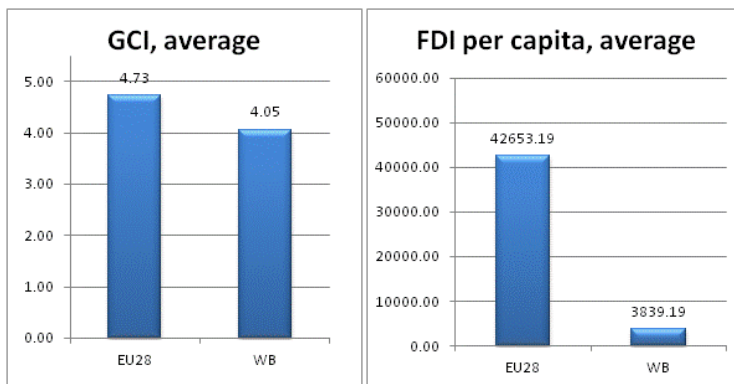

Figure 1: Average values of GCI and FDI per capita stocks in US$, in 2014 (UNCTAD, Eurostat & WEF, 2014)

The main subject of this paper is analysis of WB countries with exception of Bosnia and Herzegovina due to lack of information about observed variables. The main characteristic of these countries is transition economies. So, it is supposed to expect more similarities regarding to FDI attracting and Level of competitiveness.
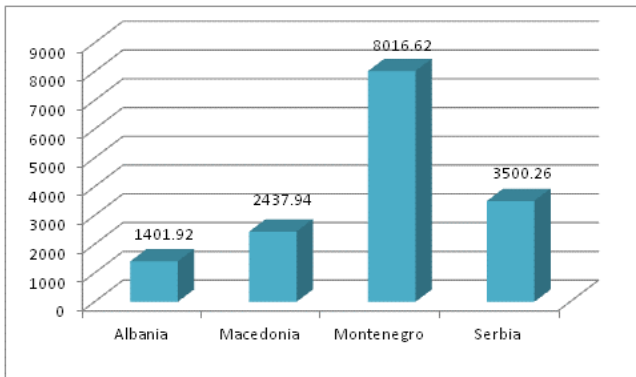
Figure 2: Volume of WB FDI per capita stocks in US$, in 2014 (UNCTAD & Eurostat, 2014)

According to *Figure 2* it can be noticed the difference in FDI per capita in these countries. Montenegro has the highest value of this indicator nearly 5 times more than the last ranked Albania. Conclusion is that Montenegro managed to accumulate faster foreign direct investments. Furthermore, Montenegro provides more public policies and has more positive changes that influence on attracting more and more foreign investors, as result of favorable business surrounding.
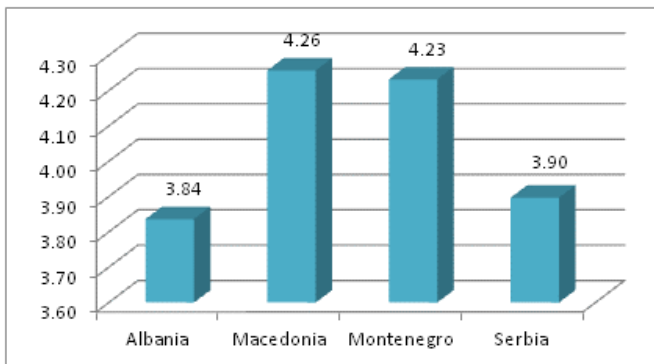

Figure 3: Global Competitiveness Index in WB countries, in 2014 (WEF, 2015)

There is a heterogeneous picture of competitiveness while examining the values of GCI for WB countries in *Figure 3*. Countries like Macedonia and Montenegro managed to increase the level of competitiveness faster than other two. The best ranked is Macedonia and on the last place is Albania. Overall, there are slight differences between the level of competitiveness between Macedonia and Montenegro and also between Albania and Serbia. These findings are not completely consistent with differences among them in terms of FDI per capita stocks. The leading position has Montenegro in both indicators. As to Macedonia, it has low values of competitiveness in following pillars: technological readiness, business sophistication, innovation and infrastructure that are one of the main causes of insufficient attractiveness of the country for foreign investors.

Competitiveness is described using Global competitiveness Index, designed by WEF, which consists from twelve pillars. These pillars of competitiveness are derived into three subindexes of competitiveness: basic requirements, efficiency enhancers and innovation and sophistication factors. Detail structure of GCI is presented in *Table 1*. The weights are attributed to each subindex according to value of GDP per capita that enables classification of each country into certain stage of development. There are three different stages of development: factor-driven, efficiency-driven and innovation-driven in every stage of development. WB countries are in second stage of development called efficiency-driven where first

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two subindexes have equally dominant part in economic development. Detail factors that compose GCI are shown in *Table 1.*

Table 1: Composition of the GCI (WEF, 2015)

Domain	Indicators
Basic requirements	Institutions
	Infrastructure
	Macroeconomic environment
	Health and primary education
Efficiency enhancers	Higher education and training
	Goods market efficiency
	Labour market efficiency
	Financial market development
	Technological readiness
	Market size
Innovation and sophistication factors	Business sophistication
	Innovation

Almost every factor presented in previous table will be used to assess the influence of competitiveness on FDI in WB countries. Only indicator of the market size is excluded from examining because it comprises variables that are difficult to influence on the short and medium term. Chosen indicators have certain level of similarity to other determinants of FDI used in literature. The values of twelve pillars of competitiveness for each WB country are presented in *Table 2.*

Table 2: The values of the 12 competitiveness pillars in the WB countries, in 2014 (WEF, 2015)

Country / Pillar	Albania	Macedonia	Montenegro	Serbia
Institutions	3. 38	4. 26	3. 96	3. 21
Infrastructure	3. 52	3. 73	4. 10	3. 93
Macroeconomic environment	3. 82	4. 93	4. 46	3. 51
Health and primary education	5. 85	5. 64	6. 31	5. 76
Higher education and training	4. 53	4. 32	4. 68	4. 25
Goods market efficiency	4. 15	4. 64	4. 34	3. 78
Labour market efficiency	4. 02	4. 21	4. 24	3. 73
Financial market development	3. 39	4. 49	4. 26	3. 50
Technological readiness	3. 30	3. 99	4. 28	4. 45
Market size	2. 94	2. 91	2. 16	3. 68
Business sophistication	3. 61	3. 78	3. 69	3. 21
Innovation	2. 73	3. 28	3. 37	2. 89

As above mentioned, all 11 competitiveness pillars with exception of the market size are used in further analysis. Therefore, it is examined are these indicators correlated with the FDI stocks per capita, for each WB country. Obtained correlation analysis results are presented in *Table 3.*

Table 3: Correlation analysis results (Author's own calculations)

Pillar	Pearson correlation coefficient
Institutions	*0. 290895661*
Infrastructure	*0. 905439035*
Macroeconomic environment	*0. 216032574*
Health and primary education	*0. 879552461*
Higher education and training	*0. 584486757*
Goods market efficiency	*0. 064627342*
Labour market efficiency	*0. 371393706*
Financial market development	*0. 429293735*
Technological readiness	*0. 617319794*
Business sophistication	*0. 102577047*
Innovation	*0. 687434682*

The values of the Pearson correlation coefficient between 0. 5 and 0. 7 indicate a positive moderate correlation between each competitiveness pillar and FDI. This is the case with higher education and training, technological readiness and innovation. Further, the values of this correlation coefficient greater than 0. 7 indicate existence of the high positive correlation. Based on the obtained results of the correlation analysis, the high correlation is between infrastructure and health and primary education and FDI stocks per capita. According to this, in further analysis are used only indicators that have the strongest relationship with FDI. The first hypothesis regarding the existence of the relationship between FDI and competitiveness is proved.

Obtained results are similar to those presented in literature: it is shown positive relationship between FDI and infrastructure, as well as in Wheeler & Mody (1992), UNCTAD (1998), Cheng & Kwan (2000), Sass (2003), Anastassopoulos (2007), with health and primary education, as in Alsan, Bloom & Canning (2006), Desbordes & Azémar (2009), with higher education and training, as in Egger et al. (2005), Gittens (2006), Zhuang (2008), technological readiness, as in Narula & Wakelin (1998) or UNCTAD (1998), with innovation, as in Baldwin, Braconier & Forslid (1999), Blomstrom & Kokko (1999), Hu & Jefferson (2001), Cheung & Lin (2003).

Considering the competitiveness variables are correlated with FDI per capita, it is assumed that increase in competitiveness will improve FDI per capita in the country. The interest of the paper is to find out what volume of the FDI will be attracted if country increase in separated competitiveness pillars. The next stage of the research is to determine the benchmark level of competitiveness that should be target level for each WB country. In order to determine the benchmark level it is used the highest values of competitiveness pillars for each country. In this case, Montenegro has the best indicator of competitiveness, except for one regarding technological readiness. Benchmark value of each indicator and related country are presented in *Table 4*.

Table 4: The benchmark level of variables (WEF, 2015)

Indicator	Benchmark value	Country
Infrastructure	*4. 1*	*Montenegro*
Health and primary education	*6. 31*	*Montenegro*
Higher education and training	*4. 68*	*Montenegro*
Technological readiness	*4. 45*	*Serbia*
Innovation	*3. 37*	*Montenegro*

Furthermore, it is calculated for each country and percentage difference of obtained indicator from the target value. The calculation results are shown in *Table 5*.

Table 5: The percentage difference of the competitiveness pillars from the benchmark level (Author's calculations)

Country / Pillar	Albania	Macedonia	Montenegro	Serbia
Infrastructure	16. 5%	9. 8%	0. 0%	4. 3%
Health and primary education	7. 9%	11. 9%	0. 0%	9. 6%
Higher education and training	3. 2%	8. 2%	0. 0%	10. 0%
Technological readiness	34. 6%	11. 4%	3. 9%	0. 0%
Innovation	23. 3%	2. 7%	0. 0%	16. 6%

*Values 0 % indicate the benchmark level

Presented percentage differences are used to calculate the potential change of the FDI as a result of positive change in different aspects of the competitiveness. So, in the *Table 6* are shown results obtained by multiplying correlation coefficients with potential increase of the values of the competitiveness pillars. Below are presented the percentage change in FDI per capita if each WB country improves its competitiveness to the benchmark value, respectively to reach at least the competitiveness level of Montenegro in majority of analyzed indicators.

Table 6: The potential percentage change of FDI per capita (Author's calculations)

Country / Pillar	Albania	Macedonia	Montenegro	Serbia
Infrastructure	14. 92%	8. 90%	0. 00%	3. 85%
Health and primary education	6. 96%	10. 43%	0. 00%	8. 42%
Higher education and training	1. 88%	4. 80%	0. 00%	5. 86%
Technological readiness	21. 35%	7. 02%	2. 43%	0. 00%
Innovation	16. 00%	1. 84%	0. 00%	11. 41%

*Values 0% regard to target countries.

If improving the quality and availability of the transport, electricity and communication infrastructure the highest change of FDI per capita will be recorded in Albania, nearly 15%. Then follows Macedonia and Serbia, with nearly 9% and 4% change of FDI per capita, respectively. The highest change of FDI will have Macedonia (10. 4%) as a result of potential enhance of the state of public health, quality and quantity of the basic education. Similar results will be in the case of Serbia (cc 8%) and Albania (cc 7%). Regarding to higher education and trainings obtained results show little need to improve in case of Albania because it would lead to increase in FDI per capita just for 1. 88%. On the other hand, the largest benefit from its competitiveness increase would have Serbia because it would provide her increase of FDI per capita by cc 6%. Better technological adaptation by individuals and business and ICT use will have the best influence on the Albania FDI per capita which will increase by 21. 35%. The leader in this competitiveness area in the WB region is Serbia. Improvement of the capacity for and commitment to technological innovation would have the greatest impact in the case of Albania. The Albania FDI would rise by 16%. Similar increase in FDI per capita is possible also in case of Serbia due to improvements in this competitiveness indicator. According to the positive sigh of the change of the FDI per capita stocks as result of the increase of the competitiveness indicators in the benchmark values, the second hypothesis of this paper is confirmed. It is concluded that increase in competitiveness enhances the foreign direct investment inflows in WB countries.

In *Table 7* are provided nominal values of potential increase in FDI per capita which was obtained as a product of the FDI per capita stocks in absolute terms and percentage change of the FDI per capita as consequence of effort of each country to enhance its competitiveness up to benchmark values.

Table 7: Potential increase in FDI per capita stocks, in US$ (Author's calculations)

Country / Pillar	Albania	Macedonia	Montenegro	Serbia
Infrastructure	209. 10	217. 08	0. 00	134. 86
Health and primary education	97. 59	254. 32	0. 00	294. 57
Higher education and training	26. 30	117. 13	0. 00	205. 02
Technological readiness	299. 30	171. 16	194. 59	0. 00
Innovation	224. 25	44. 96	0. 00	399. 29

*Values 0 regard to target countries.

The largest rise of the FDI per capita is in case Macedonia and Albania as a result of improvement the quality of infrastructure. It could rise by 217 and 209 US$, respectively. In regard to health and primary education its enhancing would bring Macedonia 254. 32 US$ just due to reach the benchmark value of this competitiveness pillar. Better quality of higher education system and training practice could provide Serbia 205. 02 US$. Technological improvements would have the most important influence on Albania FDI stocks (rise by nearly 300US$). Regarding enhancing innovations used by individuals and business Serbia could get additional nearly 400US$ if it reaches the benchmark value of Montenegro. According the provided results the largest FDI per capita increase due to improvements in determined competitiveness pillars would have Serbia. If Serbia reaches the benchmarked Montenegro in these five competitiveness indicator it could get nearly 1,034 US$. Second WB country with the largest benefits from improving competitiveness is Macedonia with potential nearly 805 US$.

4. CONSLUSION

Foreign direct investments present a significant factor of national competitiveness. They provide capital flows in term of technological and knowledge transfer. Some of the variables that are structure units of the mainly used measure of the competitiveness – Global competitiveness Index defined by World economic Forum have significant relationship with FDI in case of WB countries.

In the first part of the paper it is performed the correlation test between eleven competitiveness indicators that construct GCI, provided by WEF, and FDI stocks per capita. On the sample of four WB countries it is found that FDI stocks per capita are significantly correlated to infrastructure, health and primary education, higher education and training, technological readiness and innovation. These results are similar to results obtained in some other studies in literature, as mention before. According to results, there are no correlation with macroeconomic environment, institutions, financial market development, good market efficiency, labour market efficiency and business sophistication.

After determined correlation certain competitiveness indicators and foreign direct investments it is calculated the potential change of the FDI due to change in competitiveness indicators. It is found that majority of countries have the significant increase of FDI stocks if making infrastructure and health and primary education more competitive, by reaching the benchmark values of the Montenegro. Montenegro as a benchmarked competitiveness country needs to improve its technological readiness that could provide FDI stocks increase by nearly 200 US$. In this way, Montenegro would have leading part in all examined competitiveness indicators in the WB region. Regarding enhancing innovations used by individuals and business Serbia could get additional nearly 400US$ if it reaches the benchmark value of Montenegro. This competitiveness needs to play the most important role in foreign investment policy of Serbia. Second WB country with the largest benefits from improving competitiveness is Macedonia with potential nearly 805 US$. Macedonia has to focus mainly to improve the infrastructure and health and primary education competitiveness pillars because these enhancements would

provide the largest FDI increase. Interesting results are found in the case of technological readiness competitiveness. Serbian has the leading part and second place occupies Albania. Albania has to improve infrastructure and health and primary education because these ensure certain volume of FDI stocks. Regarding technological readiness and innovation Albania is the closest to Montenegro benchmarked values in comparison to Serbia and Macedonia.

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