

The effect of foreign investment on the economic growth with a special focus on Kosovo

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Abstract

The main aim of this scientific work is to show in concrete way the role and impact of foreign direct investment on the economic development, where Kosovo will be analyzed with a special focus. Through this study, we will investigate the correlation between Foreign Direct Investment and the Economic Growth in Kosovo during the time spam from 2005-2016. To test the data and results, we will use different econometric models and methods in order that the results have a higher scientific significance, such as the Narrative Method, Comparative Method, as well as the Econometric Method. Testing of the data and the building of the econometric model will be realized by using the econometric method, concretely by using the method of Pooled OLS and the analysis of Correlation. The source of the data will be quite diversified and multifarious, based on data from the Central Bank of Kosovo, the Agency of Statistics, the International Monetary Fund, as well as the Macroeconomics Indicators of The World Bank. The main finding of this study is the existence of the positive relation between the Foreign Investment and the Economic Growth, more concretely, according to the results from the Econometric Model, we see that if the Foreign Direct Investment in Kosovo grows by 1%, it will affect positively the Economic Growth by (67.27%). Some of the limits of this study are that other countries of the West Balkans are not included, as other explanatory variables. Therefore, in future it must be supported by other specific studies that treat the connection between the Economic Growth and Foreign Investment. The data and results from this research could be used by different users and parties.

Keywords: Foreign Direct Investment (FDI), Gdp Per Capita, Economic Growth, Econometric Models.

Introduction

Foreign Investment is understood as an engagement of financial means in order to gain monetary means out of the investor's original country, thus affecting the economic growth of the country where the investment is made. Regarding the Foreign Direct Investment there is as considerable number of definitions according to (Moosa, 2002) Foreign Investment presents the process of gaining the ownership right of assets from the country of origin, aiming the production control, distribution and other enterprise activities in another country, respectively in a foreign country. Foreign Investment is more preferred in the countries which are in process of development, more concretely in the countries on transition for e.g. the West Balkan countries among them Kosovo too, than in the countries where the economic development

is much bigger for e.g. the countries of Central Europe. All the countries which had a centralized economy through various barriers and restrictions drew in the some way the foreign capital in the form of foreign investment, but the beginning of the transition process resulted in a full change of the foreign investment policies. The changes of policies have resulted in situations where all the transitory economies competed actively to absorb FDI. There are many studies which treated the role and impact of the Foreign Investment on Economic Growth in the developed countries. If we refer to theoretical empiric literature, we can see that foreign direct investment has had a great role in the economic development of countries in general, especially the countries in transition (Trojette, 2016, Zisi and Anamali, 2016, Estrin and Uvalic, 2016).

However, there are some studies which, according to empiric findings, point out that there isn't a strong connection between foreign investment and the economic growth, arguing that the increase of investment has not positively affected the economic growth of West Balkan countries during the observing period from 2002-2012 (Mencinger, 2003, Estrin dhe Milica , 2016, Jacimovic and Joćović,2014). The countries which are still in the cycle of economic transition try that through stimulating policies to gain as much foreign investment as possible in certain industries, in this way helping their countries in the social and economic aspect. Political stability, a favorable business condition and the improvement of infrastructure are some of the stimulating policies that host countries follow to absorb a high amount of foreign direct investment. Kosovo is in a steady effort to create developing policies and other important measures in order to create a suitable business environment and a favorable investing condition. Kosovo has the law for Strategic Investment which protects the potential investors and gives them guarantee. The Law for Strategic Investment enables investors to cooperate directly with the Government.

This Law helps to bring other investors to Kosovo and it also offers those that operate in Kosovo security for their investment, where its main focus will be on the fields of energy, infrastructure and mines, transport and telecommunication, tourism, and manufacturing industries (The Law Nr.05/L-079 for Strategic Investment in the Republic of Kosovo). This study contains several West Balkan Countries, more concretely Kosovo during the years 2005 and 2016, where the effect of Foreign Investment on the Economic Growth will be treated. The main scientific contribution of this study is to determine the connection, or better said, the correlation between the investment and the economic growth, showing that if the Foreign Investment increase how it affects the Economic Growth. The findings in this study indicate that if the Foreign Direct Investment is Kosovo grossly 1% it can affect positively the Economic Growth by (67.27%). These findings have been obtained through the analysis of "Pooled OLS", testing the data for the period 2005-2016. The thesis and material that this study contains have been based on the data directly obtained from financial institutions such as The Central Bank of Kosovo, Kosovo Statistical Agency, The World Bank, the International Monetary Fund, as well as many other relevant prestigious institutions. For confirmation and reliability of hypothesis we will use different economic models and methods as well as econometric ones e.g. The Analysis of Regression through the method of small squares " Pooled OSL ". The

structure of this Scientific Study is as follows: the first starts with an Introduction and definition of the research, the identification research questions, as wells making hypothesis; in the second we will set The Literature Review; the third part presents The Methodology used and The Econometric Models; in the fourth part The Findings and Results will be put; whereas in the fifth part and the last one we will put The Conclusions and The End.

In order to treat this scientific matter, we have presented several research questions which will help us solve the problem in this study.

1. What is the role and the importance of FDI, in the Economic Growth of countries?
2. How can the possible growths of FDI, affect the Economic Growth of Kosovo?

In order to address these research questions, we have put a Statement as flows:

H1/1. Foreign direct investment affects positively the economic growth of Kosovo.

1. Literature Review

During reviewing and analyzing of the theoretical and empiric literature regarding the Foreign Direct Investment and the Economic Growth, we see numerous studies done in the developed countries as well in the developing countries for e.g. countries in Transition. Regarding the Foreign Investment there are a number of definitions from various authors (Moosa, 2002, Bannock et al, 1998, Ethie, 1995, Lawler and Seddighi, 2001, Globerman and Shapiro, 2002). According to OECD¹, Foreign Direct Investment presents certain long term connections between the residents of an economy and investors resident of foreign economy. Foreign Direct Investment presents the process of gaining of the ownership right for the assets from the country of origin, aiming the production central, distribution and other enterprise activities in the other country, respectively in a foreign country (Moosa, 2002). According to a scientific study made by (Trojette, 2016), we can see the effect of the indirect impact of the Foreign Investment on The Economic Growth through leading institutions of countries. The analysis was done during the time period 1984-2013. The main findings in this scientific study indicate that the higher the quality of institutions of the countries, the higher is the effect of the Foreign Investment on the Economic Growth. However, the effect of foreign investment in some countries can be high, whereas in some other countries lower. This difference comes because of the institutional development level and the level of in come the countries possess in general.

Also, an investigation about West Balkan countries points out that the foreign Investment is very important for an economic development and economic growth of these countries; however there is still a challenge to attract foreign investors. However, a bigger challenge for these countries is the admission to EU, therefore these countries have a need for a close cooperation between each-other for better opportunities for an economic growth and an economic development (Zisi and Anamali, 2016). (Estrin and Uvalic, 2016) analyzed the base of some certain indicators in West Balkan countries such as: institutional features, economic features, as well as political ones which have limited possible spread of FDI in these countries. Also, this study points out that FDI, went to the sectors mainly non-intensive, and this can

¹ The Organisation for Economic Co-operation and Development (OECD).

explain the weak effect that it had on the increase of employment in these countries. The foreign investment will bring a long term economic development in West Balkan countries, but they need to improve the law and its effective application.

According to these authors, these countries have to create conditions of a liberal environment that opens the way to the foreign direct investment, but at the same time they point out the need to protect the legal security in the whole system of foreign investment (Jacimovic and Joćović, 2014). In the scientific study made by (Alfaro, 2003) is proved that the Foreign Direct Investment has various implication on the economic growth of a country. According to the empiric measurements and findings, it has resulted that if the Foreign Investment is more present in the private sector, it tends to have a negative impact on the economic growth, whereas the presence of the Foreign Investment in the production sector can positively affect the economic growth. (Mencinger, 2003) points out that the Foreign Investment has a bigger impact on imports than exports of that if the foreign and the native capital are complementary to each-other, the final impact of the Foreign Direct Investment will be much higher affecting in this way the norm of the economic growth in countries in general. Also, what is worth pointing out is that the Foreign Investment also affects the labor market by creating new jobs. A recent study by (Bruno and Campos, 2013) shows that 50% of empiric studies show that FDI, has positive effect on the economic growth, whereas 11% find a negative effect between FDI, and the Economic Growth, and finally 39% find the Economic Growth as independent from the Foreign Direct Investment.

2. Study Methodology and the Data

2.1. Study Methodology

In according with the main objectives and aims of this scientific study, in order to answer the research questions, as well to prove or disprove the presented hypothesis in the beginning of the study, we will use advanced scientific methods and models as for e.g. the Narrative Method, which enables us various analyses of different indicators and synthesizing of results: the comparative Method, which is one the most used methods when analyzing different indicators in different time periods. Whereas, the testing of the data and the building of the econometric model will be done using the Econometric Method, such as for e.g. The Method of Small Squares (Pooled OLS) and The Analysis of the Correlation. The main aim of this material is the study of the Foreign Investment in developing countries such as countries in Transition (West Balkan Countries), with a special focus on Kosovo. Whereas the main purpose in this research will be the effect of the Foreign Direct Investment on the Economic Growth of Kosovo, during the period from 2006 until the year 2016, more concretely, we will analyze if the Foreign Investment grew during this period, and how it affected the Economic Growth in Kosovo.

The data that will be used to investigate the connection between the Foreign Direct Investment and the Economic Growth in Kosovo are based on the data from The Central Bank of Kosovo, The Agency for Statistics, the sources from The World Bank, and The International Monetary Fund. Below we will present the building of the

Econometric Model.

Specification of the Econometric Model as follows:

$$GDP_{i,t-1} = \mu_t + B_1 FDI_{i(t-1)} + B_2 Exports_{i(t-1)} + B_3 FINAL_CONSUM_{c,i(t-1)} + B_4 BRUTO_SAVING\delta_i + B_5 FINAL_GOVERNMENT\gamma_i + \varepsilon_i \tag{i}$$

In this econometric model, the GDP- per capita is a dependent variable. Through this dependent explanatory variable, it is tried to treat that there are some dependent variables that affect the Economic Growth in countries in transition with a special attention in Kosovo. In the econometric model presented above, six variables are included, from which five are independent variables also known as exogenous variables. Such as: Foreign Direct Investment, Export, Final Consumption, Government Expenditure, and Gross Savings. The dependent variable is the Gross Domestic Production (Gdp Per Capita), also known as Regressant. The building of the Econometric Model is also based on other studies which have treated the role and effect of the Foreign Direct Investment on the Economic Growth (Trojette, 2016, Estrin and Uvalic, 2016). The Gross Savings and the Government Expenditure are put at the end of the Model, both of which are independent variables, where we will test their impact on the Economic Growth in countries in transition with a special attention in Kosovo. When treating the Government Expenditure, we will rely on the study made by (Stephen G Cecchetti, MS Mohanty dhe Fabrizio Zampolli, Shtator 2011).

2.2. Descriptive Statistics

In the previous part we did the treatment and evaluation of the Research Methodology of this study, as well the explanation of the methods and the models that will be used to test the variables. Now we will present the description of the variables included in the econometric model. To realize and elaborate this research with the thesis "The impact of the Foreign Investment on the Economic Growth with a special attention in Kosovo, we have used the data from Financial Indicators from the sources of Central Bank of Kosovo, and then using these data the Econometric Model has been built, where we will comment and interpret the gained results.

Nr	Variables	Code
1	Gross Domestic Production	Gdp_lag
2	Export	Eksport
3	Consumption Final	Final_consup
4	Foreign Direct Investment	FDI
5	Gross Savings	Bruto_saving
6	Government Expenditure	Final_goverment

Table .1. Description of variables, as well as their identification.

Sources: Calculated by Authors

Variables	OBS	Std.Dev	Min	Max
Gdp Per Capita	107	9.6838	-12.1466	88.9577

Export	87	10.39864	-10.2	88.9577
Final_consump	107	25.92949	18.71	202.807
FDI	107	9.203267	9.85325	49.3784
Bruto_Saving	107	19.00817	-9.99257	180.22
Final_Government_Expenditure	107	4.808863	6.48292	29.9406

Table 2. Statistical description of Exogenous and Endogenous variables.

Source: Calculated by Authors.

3. Empirical Results and Findings

3.1. The Trends of Macroeconomic Indicators Movement in Kosovo

Vitet	FDI	Exports	Gdp Per capita	Final - Consump	Final - Government Expenditure	Bruto_Saving
2005		624,812,302.16	1,977		886,705,633	
2006	0.17	750,453,088.85	2,050	4,424,162,589	915,594,028	664,672,663
2007	0.27	990,595,267.05	2,182	5,292,909,937	955,516,014	853,650,123
2008	0.64	1,137,718,179	2,222	6,111,542,405	966,456,715	979,780,994
2009	0.26	1,169,819,263	2,277	5,864,823,562	928,174,492	1,258,913,778
2010	0.86	1,400,000,930	2,334	5,982,251,655	956,688,741	1,238,526,479
2011	0.11	1,922,812,606	2,421	6,675,701,973	1,114,956,908	1,420,131,965
2012	0.31	1,795,717,086	2,469	6,583,451,111	1,081,973,532	1,505,785,582
2013	0.56	1,848,574,730	2,528	7,078,199,681	1,146,972,915	1,716,713,402
2014	0.48	1,949,955,554	2,562	7,604,351,864	1,207,907,655	1,394,032,080
2015	0.64	1,660,295,753.	2,696	6,546,301,430	991,349,672	1,175,035,132
2016	0.71	1,733,329,169	2,766	6,717,666,666	982,000,000	1,234,644,414

Table 3. Exports, Final Consumption, Government Expenditures, Gross Savings in Kosovo during 2005 to 2016 expressed in Millions. As to Foreign Direct Investment and Gross Domestic Product data are presented in percentages. **Source:** World Bank, Central Bank of Kosovo. Made and Calculated by Authors.

Figure.1. Foreign Investments Trend, Gross Domestic Product, Export, Final Consumption, Gross Savings, and Government Expenditures during the period 2005-2016.

Source: World Bank, Central Bank of Kosovo. Made and Calculated by Authors.

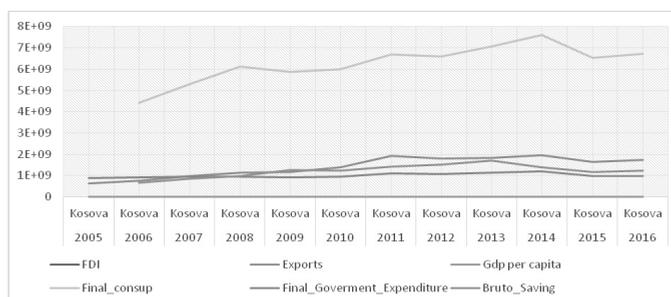


Figure.2. Gross Domestic Product Per Capita in Kosovo during 2005 to 2016.
Source: World Bank, Central Bank of Kosovo. Made and Calculated by Authors.

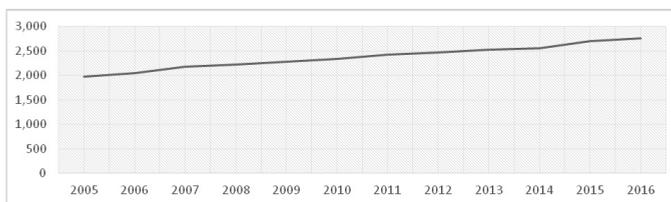
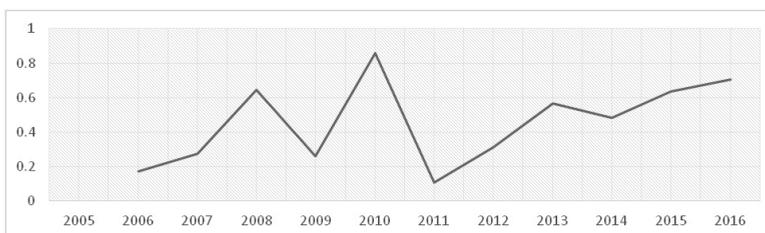


Figure.3. Direct Foreign Investments (in% of GDP per capita) in Kosovo during 2005 to 2016.
Source: World Bank, Central Bank of Kosovo. Made and Calculated by Authors.



4. Results from the Econometric Model

Dependent Variable	Constant Coefficient	Independent variables FDI		Independent variables Export	Independent variables Final_consump	Independent variables Bruto_Sa Brung	Independent variables Final_Government_Expenditure
Gdp Per Capita							
According Regression	2481.80	67.27	6.57	1.1		-2.61	-1.44
SE(STANDARD ERROR)	540	191.2	2.59	1.38		2.29	7.78
T- STATISTIKA	4.59	0.35	2.53	0.82		-1.14	-1.84
P>[T]	0.006	0.739	0.052	0.450		0.305	0.124
Number of i Variables	6						
R- SQUARED	0.88						
ROOT MSE	104.93						
RIZIDUAL MODEL	489386.456						
Fredom Degre	10						
SS	1.0022						
MS	6.6811						
Number of i Observations	16						
F(4, 67)							
Adj R-Squared	0.77						

Table 4. Results from the Econometric Method (Pooled OLS)

Source: Calculated by the Author

In (Table 4) are presented the obtained results using the Analysis of Regression, also we can see the effect of the Macroeconomic Indicators tested in this analysis using the econometric program Stata. More concretely, according to the previous Table, commenting the data obtained with the OLS method (The Method of Small Squares), we can conclude that if the Foreign Direct Investments increase by 1% in Kosovo, it can positively affect the Economic Growth by (67.27). This result also has the Se (Standard Error) which (191.23). Also, this result statistically has a reliability of a level 5% (0.355), which according to the empiric literature: the lower this coefficient is, the higher is the reliability of the results presented. Therefore, through this result, we prove the hypothesis presented in the beginning of the study, which states that:

Hypothesis.1. Foreign direct investment positively affects the economic growth in Kosovo.

Some other independent variables are also part of the Econometric Model, which will be commented below. If the Export as a part of the economy in Kosovo grows by 1%, then its effect on the Economic Growth will be (6.57), whereas the Se (The Standard Error), which measures the reliability of the result in our case, is (2.59). Also, this result statistically has a reliability of the level 5% (3.533), which according to the empiric literature- the lower is this coefficient, the more credibility the presented result has. Referring to the data obtained with the OLS Method (Pooled OLS) in Table.4, we see that if the Final Consumption increase by 1%, this will affect positively the Economic Growth by (1.1), also the Se (Standard Error) is given (1.38). This result has also a statistic credibility of the level 5% (0.822). Whereas, if the Gross Savings grow by 1% within the economy of Kosovo, then their effect will be negative by (-2.61), the SE is (2.29). Also, this result has a statistic reliability of the level 5% (-1.14), which according to the empiric literature- the lower is this values, the more credibility the result has. In the Econometric Model, we have also tested the connection between the Government Expenditure and the Economic Growth, where according to the data, we see that if the Government Expenditure grows by 1%, then its effect will be negative on the Economic Growth in Kosovo by (-1.44). Also, the Se (Standard Error) is given (7.78). This result too has of statistic credibility of the level 5% (-1.84). In the previous part, we have commented on the results based on the data obtained with the Method of Pooled OLS. However, in this Scientific Study we have also made the Correlation Analysis, which presented the relation and association between the two variables in an econometric model. Using this method, we will see the association of the two main variables that are part of this study, which means the relation between the Economic Growth and the Foreign Direct Investment. According to the results presented in (Figure.4), we see that the Foreign Direct Investment has an effect and are associated with the Economic Growth in Kosovo. The Correlation means the relation between these two variables and is (0.45%), which means that these variables associate very well with each-other.

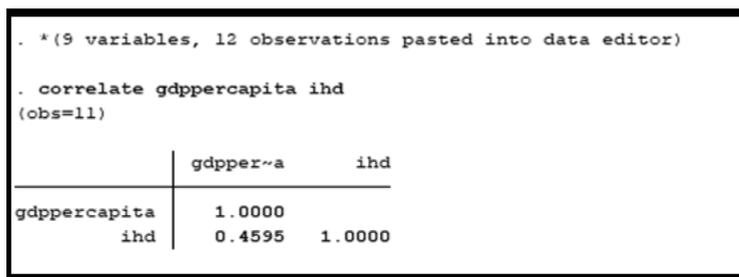


Figure.4. The calculation of the Correlation between the Economic Growth and the Foreign Investment.

Source: Calculated by Authors using Stata.

Conclusions

As a conclusion in this scientific research titled “The effect of foreign investment on the economic growth with a special attention in Kosovo”, we have tried to investigate the connection, or better said the relation between Foreign Investment and the Economic Growth in the countries that are in an Economic Transition for e.g. Kosovo. The foreign investment is understood as the engagement of financial means in order to win norms of interest out of the investors country, in that way affecting the economic growth of the country where the investment is made. Foreign Direct Investment are more preferred in the countries that are in the process of development, more concretely, countries in Transition for e.g. West Balkan Countries and among them Kosovo, than in the countries where the economic development is much bigger for e.g. (The United States of America, the Countries of the European Union). Testing of the data in this study has been done using sophisticated scientific methods such as: the Method of Small Squares “Pooled OLS”, and the Correlation Analysis. Data organization has been done using the Econometric Model, where six variables have been included; five of them have been independent, whereas one depended. The source of the data has been using the reports from the World Bank and the Central Bank of Kosovo. From the data presented above through (Figure.2), we notice that the trend of movement of the Gross Domestic Product from the year 2005 until the year 2016 has been positive, that is to say, it had positive values, and more concretely in 2016 the Gross Domestic Product was (2766.05).

According to the index of the Foreign Investment in (Figure.3), we see that Kosovo had a high FDI, during the post war period; it experienced a more considerable increase during the year 2008 as a result of independence declaration, which was about (0.64) in the percentage of the Gross Domestic Product Per Capita. Two years later, more precisely in 2010 the Foreign Direct Investment recorded even higher values, about (0.85) in the percentage of the GDP Per Capita, whereas in the beginning of 2011, Kosovo had a drastic fall regarding the FDI, precisely (0.10) in the percentage of GDP Per Capita. The results from (Table.4) show the relation between FDI and Economic Growth. According to the data from “Pooled OLS” we can conclude that if the Foreign Direct Investments in Kosovo increase by 1%, it can positively affect the

Economic Growth by (67.27). This result also has the Se (the Standard Error), which is (191.23). Also this result has a statistic reliability of the level 5% (0.355), which according to the empiric literature- the lower this coefficient is, the more credibility the presented result has. Kosovo has a great potential to be a pleasant country for Foreign Investment as well as to attract the capital, information and technology.

The degree on which the foreign investment can help the Economic Growth depends on several factors. Kosovo has The Law for Strategic Investment, which protects the potential investors and offers them guarantee. Its main focus will be on the fields of energy, infrastructure and mines, transport and telecommunication. The Law for Strategic Investment enables the investors to cooperate directly with the government.

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