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**RETROSPECTIVE OVERVIEW OF FOREIGN DIRECT INVESTMENTS IN B&H  
DURING THE PERIOD 2008-2009, WITH THE FOCUS ON KOSOVO**

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**Abstract:** Foreign direct investments, as one of the most important instruments of national economy, represent an opportunity to increase production, increase employment, accelerate structural reforms, improve external financial situation of a country, increase foreign currency reserves, less restrictions in current balance, and get a more favorable credit rating. Taking into account that in less developed countries, and the countries in transition, such as Bosnia and Herzegovina or the Republic of Kosovo, the lack of capital is the crucial limiting factor, the inflow of foreign direct investments is a necessary and indispensable condition for their dynamic growth, development and resolution of many inherited problems of the past. The aim of this paper is primarily to evaluate the changes in the perception of foreign direct investments, which nowadays represent a part of a broader economic reform of the developing countries, including the opening up of the economy towards foreign trade, as well as the emphasis on becoming competitive on international scale.

Following the end of aggression on Bosnia and Herzegovina, the country faced a number of complex challenges, not only political but also economic challenges, deriving from a confusing and undefined Dayton Accord, intended most likely to break up the foundations of Bosnia and Herzegovina as a state, by weighing down on the economic perspective of the country. And only when the Dayton anomalies are removed from the legal, political, economic and other segments of the Bosnian society, it could count on the prosperous development and, consequently, on significant investments of foreign capital.

At the end of this paper, the importance of foreign direct investment for the Republic of Kosovo was also presented.

**Keywords:** direct investments, greenfield investments, economic growth, Dayton Agreement, Bosnia and Herzegovina, Republic of Kosovo.

## 1. INTRODUCTION

An important element necessary to understand the history of foreign direct investments is international trade, which dates back to Mesopotamian time when everything was traded. Trade did not change significantly until the 16th century, when the first trade enterprises were set up in Europe, with their representative offices being set up in all major shopping centers of that time. At the same time, international financial centers to monitor the development of trade were created.

The establishment of modern enterprises started in the 19th century, during the Industrial Revolution, accelerating their development. Capacities of the enterprises increase, new organizations are established, thus entering stronger into the world market. The technical and legal opportunities laying in front of the enterprises led to the quick establishment of multinational companies. An important role in increasing investments played the geographical distance, the similarity of cultures and languages, and the politics of that time. In the period between the two world wars, investments were constantly growing. Multinational companies began to invest heavily in oil resources, particularly in their colonies and protectorates. Multinational companies started also to develop in other areas, leading to a greater flow of the capital. The economy during this period was characterized by a major economic crisis, and its negative effects were reflected on the world flow of the capital. The period after the end of the Second World War was characterized by the renewal of the European economy and powerful expansion of the American economy which had been preserved during the war. Investments in the development of new technologies, knowledge management were done, thus conquering new markets. In the period until 1960, a strong US investment dominance was noted, due to the fact that about 3/4 of the investments came from the USA. That was the time when the world economy needed US financial assistance, and newest research, particularly in the field of computer technology. After 1970, European multinational companies were strengthened and their investments in the world increased. The beginning of the '80s was characterized by the significant investments of multinational companies in developing countries, particularly in Mexico, and in a number of East Asian countries. The main motive of investors was cheap labor force. During this period, foreign direct investments were intensified in a number of Asian countries

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(Malaysia, Thailand, China, South Korea, Tajwan, Singapour), leading to their development and a significant level of foreign direct investments.

## 2. FORMS OF MOVEMENT OF INTERNATIONAL CAPITAL

In theory there are three forms of international capital movement: international crediting or movement of loan capital, international portfolio investments and direct investments abroad.

*International movement of loan capital* is financial mediation in realization of financial surplus of one sector in financing the deficits of other sectors. It started with classic loans, and continued through lending of long-term capital by issuing bonds. However, in developing countries, financial market is not developed, so even today the main form of inflow of international capital is still loan capital. Lately, portfolio investments are treated as purchase of securities, up to the level of not giving the right of control over the entities it was invested in.

Therefore, the main difference between the international direct investments and portfolio investments is in control and management function. *Portfolio investments* represent capital investment in ownership, while the management and, to a great extent, control functions have been transferred to managers. Unlike them, in international direct investments, ownership, management and control functions are merged and are in the hands of the investors. *Foreign Direct Investment (FDI)* is an investment where the investor ensures the right of ownership, control and management over the company in which the funds are invested, in order to achieve some long-term economic interest. According to the definition of World Trade Organization (WTO) foreign direct investment occurs when an investor from one country acquires an asset in another country. When analyzing foreign direct investments, it is necessary to consider three aspects: motive of investment (investment management), investment time horizon (unlimited), as well as the type of investor.

Considering that in the less developed countries, and also in the countries in transition, lack of capital is the most important limiting factor, then the inflow of foreign direct investments is a necessary and indispensable condition for the dynamization of their growth and resolution of many problems inherited from the past. These countries must base their growth on significant import of foreign capital, which brings along knowledge, technological solutions, management and marketing experience, raising the efficiency of the economy as a whole, and especially the increase of exports. For most countries, foreign direct investments are an important channel for activating their own economic potentials. Therefore, it is obvious that direct investments abroad are the safest way towards globalization and internationalization. Developing countries are helped through economic integration into global economic flows, and their importance and role are growing alongside the processes of liberalization of world trade

## 3. THEORETICAL CONSIDERATIONS OF FOREIGN DIRECT INVESTMENTS

Foreign direct investments occur when residents of one country take over the management control over certain economic activities in another country. According to the definition of International Monetary Fund, foreign direct investment occurs when an investor (non-resident) acquires 10 % or more of ownership share of the economic entity (resident). (Babić et. all..., 2001: 1)

Foreign direct investment enterprise is defined as a shareholder or non-shareholder enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting rights over a shareholder enterprise or the equivalent in a non-shareholding enterprise. The required condition to own at least 10 % of the shares in an enterprise where investments are done, gives the right to the direct investor influence or participate in the management of the enterprise, however, it does not imply one hundred percent (absolute) control by the foreign investor. (Unković and Kordić, 2001: 16.)

Direct investment in foreign market requires from enterprises to establish branch offices in foreign markets, which is achieved in the following ways:

- establishing new enterprises in international markets (by undertaking green-field investments some enterprises become multinational companies).
- taking over (purchasing) the existing enterprises in international market.

Recipient and provider of foreign investments should have an interest in foreign direct investment. In other words, if the principles of market economy are applied also to the foreign direct investments, in the direct investment market, the supply and demand should be equalized in order to achieve a balance between the quantity and price of foreign direct investments. The theory of foreign direct investment arises from the explanation of motives and behavior in the market – motives and behavior of providers (*foreign multinational companies and countries that are exporting goods and services through foreign direct investments*), and motives and behavior of the recipients (*enterprises*

*created by foreign direct investments and their governments*), as well as their expectations and economic policy measures that attract those investments. In the following units, we are going to elaborate in more detail the motives of providers and recipients of foreign direct investments.

### 3.1. MOTIVES OF PROVIDERS AND RECIPIENTS

#### 3.1.1. Motives of providers

The main goal of all investments is profit. The most important sub-goals, which basically aim to vitalize the engaged capital, are:

- conquering new markets,
- lower labor costs,
- ensuring regular supply sources, etc.

Tendency to conquer new markets is one of the most important motives of foreign investors. If entry of one company into an interested market is hampered by the country's macroeconomic policy or competition activities in that market, it will try to enter that market through investment strategy.

Lower labor cost as a factor of investment has prompted multinational companies to use low-cost labor to organize production at a significantly lower cost, which contributed to making their products even more competitive on the world market.

In order to ensure regular supply of its production with the necessary raw material, foreign investor invests in a foreign country, and at the same time acquires cheaper and better quality raw materials, which ultimately impacts on the reduction of total costs, i.e. making the final product cheaper, thus acquiring a better position in the market.

*Table 1. Motivi stranih direktnih investicija i atributi zemlje domaćina*

| MOTIV ZA INVESTIRANJE | ATRIBUTI ZEMLJE DOMAĆINA  |
|-----------------------|---|
| Resursi ili imovina   | – Sirovine i primarni proizvodi   |
| Tržišta               | – Veličina tržišta i prihod po stanovniku,<br>– Rast tržišta,<br>– Pristup regionalnim tržištima i tržištima trećih zemalja,<br>– Preferencije potrošača koje su specifične za posmatranu zemlju,<br>– Blizina strateških klijenata,<br>– Struktura tržišta.  |
| Efikasnost            | – Jeftina radna snaga,<br>– Kvalifikovani kadrovi,<br>– Troškovi ostalih inputa (npr. transporta i komunikacija prema i iz zemlje porekla) i troškovi poluproizvoda,<br>– Članstvo u regionalnoj integraciji pogodnoj za sporazum o uspostavljanju regionalne korporativne mreže.   |
| Stratejska imovina    | – Stvorena imovina koja je bazirana na tehnologiji ili inovacijama (npr. brend),<br>– Stvorena imovina koju predstavljaju pojedinci, preduzeća, industrijski klasteri i sl. (npr. istraživačko-razvojne sposobnosti),<br>– Fizička infrastruktura (putevi, luke, aerodromi, elektroenergetska i telekomunikaciona mreža). |

Source: Branko Rakita, Miloš Šipragić, *Marketing lokacije u funkciji privlačenja resursa*, Pregledni rad, Časopis za marketing teoriju i praksu, Quarterly Marketing Journal, No. 4, Beograd, 2010, p. 224.

#### 3.1.2. Motives of recipients

Attracting foreign capital in developing countries dates back to the middle of 20<sup>th</sup> century. In the early 1960s, developing countries have attracted \$2.4 billion of foreign capital. Up to 1980, foreign direct investments have grown 4.5 times, and up to 1990 three times. In period from 1990 to 2001, foreign investments have raised up to \$224 billion. (Klapić and Nuhanović, 2011: 91)

The advantages of foreign direct investment for recipient countries are the following:

- increase in employment (especially in greenfield projects);
- preserving jobs in joint-ventures with domestic enterprises;
- modernization of production equipment and transfer of new technologies and knowledge;
- an increase in exports considering that the majority of foreign investors will be interested in a wider market;
- positive contribution to GDP and trade balance;
- increased consumption in the local economy;
- filling up the state budget through tax on profit, income tax, and paying of employee contributions;
- improving corporate culture
- increase of exports considering that the majority of foreign investors will be interested in a wider market.

#### 4. FOREIGN DIRECT INVESTMENTS IN BOSNIA AND HERZEGOVINA

After the end of aggression on Bosnia and Herzegovina, this country has faced complex challenges, not only economic, but also political, which resulted in the undefined and confused *Dayton Agreement*, intended most likely to break up the foundations of B&H as a state, its historic past and future, disrupting the economic perspective of this country. Its economic recovery was primary and one of the conditions for joining the European Union. Factors for economic development were initiated, mainly from the context of this agenda:

- population (return to B&H),
- natural and energy resources (putting them into function again and further economic development),
- technological changes (application of modern technological standards),
- basic resources and infrastructure (standardization and development),
- organization and entrepreneurship (European levels and standards),
- information and knowledge (as key development resources).

In this context, the importance of investing in the development of science and technology is emphasized, certainly with quality investments that guarantee overcoming the crises and achieving stable socio-economic development in the system of economic European Union. The concept of the role of science and technology in the development of economic system of B&H will be a long-term process, but it will surely guarantee a long-term stable economic growth in B&H.

Below is a chart and graphical presentation of the flow of foreign direct investments in B&H, listed according to the country of the foreign investor:

**Table 1. Tokovi direktnih stranih ulaganja u BiH klasifikovani prema zemlji stranog ulagača - u milionima KM**

| Jan -<br>Dec | Austrija | Holandija | Hrvatska | Slovenija | Ostale | Ukupno |
|--------------|----------|-----------|----------|-----------|--------|--------|
| 2008.*       | 272      | 89        | 190      | 247       | 45     | 843    |
| Jan<br>Dec   |          |           |          |           |        |        |
| 2009.*       | -105     | -5        | 141      | 80        | -5     | 106    |

Source: Centralna Banka Bosne i Hercegovine, *Godišnji izvještaj*, 2010, p. 193.

Based on the data shown in the Table 2, we carry out the following formulas for 2008 and 2009.

**Average value:**

$$\bar{x} = \frac{x_1 + x_2 + \dots + x_n}{n}$$

**for 2008:**

$$\bar{x} = \frac{272 + 89 + 190 + 247 + 45}{5} = \frac{843}{5} = 168,6$$

*for 2009:*

$$\bar{x} = \frac{-105 + (-5) + 141 + 80 + (-5)}{5} = \frac{106}{5} = 21,2$$

*Mean Standard Deviation:*

$$S_{x_i} = \sqrt{\frac{1}{n} \sum_{i=1}^n (x_i - \bar{x})^2}$$

$$S_{\bar{x}} = \frac{S_{x_i}}{\sqrt{n}}$$

*for 2008:*

$$S_{x_i} = \sqrt{\frac{1}{5} \sum_{i=1}^5 (x_i - \bar{x})^2}$$

$$= \sqrt{\frac{1}{5} [(272 - 168,6)^2 + (89 - 168,6)^2 + (190 - 168,6)^2 + (247 - 168,6)^2 + (45 - 168,6)^2]}$$

$$= \sqrt{\frac{1}{5} [(103,4)^2 + (-79,6)^2 + (21,4)^2 + (78,4)^2 + (-123,6)^2]}$$

$$= \sqrt{\frac{1}{5} [10691,56 + 6336,16 + 457,96 + 6146,56 + 15276,96]}$$

$$= \sqrt{\frac{1}{5} [38909,2]} = \sqrt{7781,84} = 88,21474$$

$$S_{\bar{x}} = \frac{88,21474}{\sqrt{5}} = 39,4508$$

*for 2009:*

$$S_{x_i} = \sqrt{\frac{1}{5} \sum_{i=1}^5 (x_i - \bar{x})^2}$$

$$= \sqrt{\frac{1}{5} [(-105 - 21,2)^2 + (-5 - 21,2)^2 + (141 - 21,2)^2 + (80 - 21,2)^2 + (-5 - 21,2)^2]}$$

$$= \sqrt{\frac{1}{5} [(-126,2)^2 + (-26,2)^2 + (119,8)^2 + (58,8)^2 + (-26,2)^2]}$$

$$= \sqrt{\frac{1}{5} [15926,44 + 686,44 + 14352,04 + 3457,44 + 686,44]}$$

$$= \sqrt{\frac{1}{5} [35108,8]} = \sqrt{7021,76} = 83,7959$$

$$S_{\bar{x}} = \frac{83,7959}{\sqrt{5}} = 37,4747$$

**Mean Absolute Deviation:**

$$S_o = \frac{\sum_{i=1}^n |x_i - \bar{x}|}{n}$$

**for 2008:**

$$S_o = \frac{|272 - 168,6| + |89 - 168,6| + |190 - 168,6| + |247 - 168,6| + |45 - 168,6|}{5}$$

$$S_o = \frac{103,4 + 79,6 + 21,4 + 78,4 + 123,6}{5}$$

$$S_o = \frac{406,4}{5} = 81,28$$

**for 2009:**

$$S_o = \frac{|-105 - 21,2| + |-5 - 21,2| + |141 - 21,2| + |80 - 21,2| + |-5 - 21,2|}{5}$$

$$S_o = \frac{126,2 + 26,2 + 119,8 + 58,8 + 26,2}{5}$$

$$S_o = \frac{357,2}{5} = 71,44$$



**Mathematical expectation:**

For a random variable  $X = \begin{pmatrix} x_1 & x_2 & x_3 & x_4 & x_5 \\ p_1 & p_2 & p_3 & p_4 & p_5 \end{pmatrix}$   $p_1 + p_2 + p_3 + p_4 + p_5 = 1$

$$\bar{X} = M(X) = \sum_{i=1}^n x_i p_i$$

then the medium standard deviation is:

$$SSO = \sum_{i=1}^n p_i |x_i - M(X)|$$

for 2008:

$$M(X) = (x_1 p_1) + (x_2 p_2) + (x_3 p_3) + (x_4 p_4) + (x_5 p_5)$$

$$M(X) = (272 \times 0,3227) + (89 \times 0,1056) + (190 \times 0,2254) + (247 \times 0,2930) + (45 \times 0,0533)$$

$$M(X) = 87,7744 + 9,3984 + 42,826 + 80,282 + 2,3985$$

$$M(X) = 222,6793$$

for 2009:

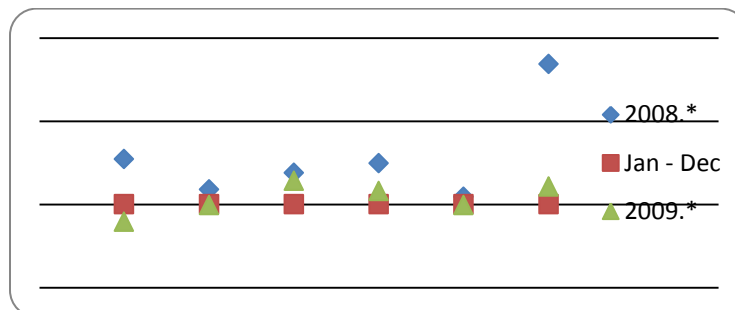
$$M(X) = (x_1 p_1) + (x_2 p_2) + (x_3 p_3) + (x_4 p_4) + (x_5 p_5)$$

$$M(X) = (-105 \times 0,3125) + (-5 \times 0,0149) + (141 \times 0,4196) + (80 \times 0,2381) + (-5 \times 0,0149)$$

$$M(X) = -32,8125 - 0,0745 + 59,1636 + 19,048 - 0,0745$$

$$M(X) = 45,2501$$

**Graph 1. Tokovi direktnih stranih ulaganja u BiH klasifikovani prema zemlji stranog ulagača - u milionima KM**



Source: Centralna Banka Bosne i Hercegovine, *Godišnji izvještaj*, 2010, p. 193

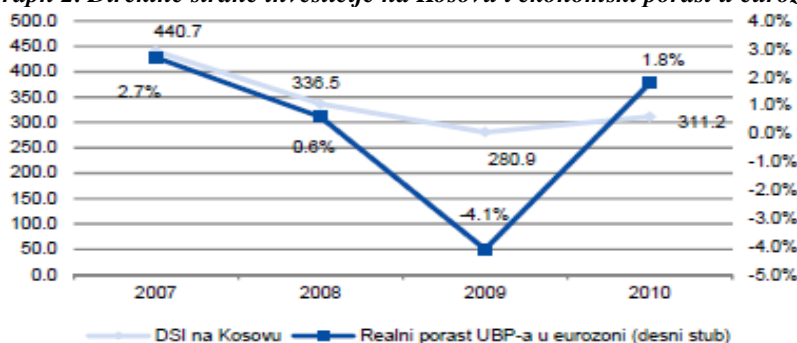
Since democratic transformation encourages liberalization, and liberalization encourages economic growth, democracy in B&H is, although not decisive, an important factor of economic prosperity. Weak preference for political and economic freedoms arises primarily from the inadequate structure of *Dayton Agreement* and the lack of a coherent vision of political forces in relation to the country's future. So, economic reconstruction of B&H and its future development are hardly feasible within the existing economic and political system. In creating the environment for attracting foreign direct investment, B&H passed the Law on the Policy of Foreign Direct Investment. According to Article 2 of that Law, direct foreign investment means acquiring, creating or expanding any existing business venture, which allows one or more foreign investors to acquire or increase control over a company that is conducting industrial, agricultural, commercial and financial affairs and real estate affairs, services or other activities or facilitates the expansion of a company already under the control of a foreign investor.

Concept of economic development, which must be adhered to by following *Dayton Agreement* and guidelines of the International Community on one hand, and the lack of capital on the other hand, eliminate the possibility of building economic prosperity in large companies and economic activities that have so far been the carriers of development. According to previous analysis, serious investments in state-owned enterprises have been missing in B&H, at the request of the international community representatives who insist on faster implementation of macroeconomic reforms and, in particular, on the effective implementation of the privatization program. Implementation of the *Dayton Agreement* shows the inadequacy in achieving an efficient economy, since, first and foremost, the confusing goals of implementing the privatization have been neglected and, second, the principles of transparency in the privatization process have been neglected, thus creating a possibility for various types of corruption and fraud.

## 5. BRIEF OVERVIEW OF THE IMPORTANCE OF FOREIGN DIRECT INVESTMENTS FOR THE REPUBLIC OF KOSOVO

Foreign direct investments have an important role in the development of Kosovo's economy. Potential positive effects on the economy provide a wide spectrum, from the development of the whole region, creation of new jobs, transfer of new technologies and promotion of domestic investments. For example, the potential for trade and exports of domestic products and services is growing as the country is building its reputation as a preferred location for foreign direct investment. The following chart shows the trend of foreign direct investment in Kosovo as well as economic growth in the Eurozone.

**Graph 2. Direktno strane investicije na Kosovu i ekonomski porast u eurozoni**



Source: MMF (2011) and CBK (2011), *Godišnji izveštaj*, 2010, p. 56.

Geographical position of Kosovo makes this country very favorable for foreign investment. Besides, advantages for investing in Kosovo are: low taxes, abundance of resources, young population (70 % below 35 years of age), existence of natural resources (lignite, zinc, lead, ferronickel and arable agricultural land), free access to the market of the European Union and neighboring countries, modern institutions for business support, simple and fast procedure for registering businesses (in three days), safe banking system, as well as modern legal infrastructure in accordance with the EU.

After the proclamation of independence, in Kosovo there is noticeable increase of political stability, increased level of security, stable economy with continuous growth, completion of legislation, etc. A stable macroeconomic environment and sustainable financial system were created, and fiscal policy reform has been implemented in order

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to apply the lowest tax rates in the region. Also, a progress has been made in building modern infrastructure, both in Kosovo and in relations with the region, while the increase in the competitiveness of the domestic economy in the regional market is among the most important goals of Kosovo.

Republic of Kosovo provides great opportunities for investing in different sectors, such as agriculture, energy, viticulture, tourism, metal processing, etc. All this makes Kosovo a very attractive destination for foreign investment.

## 6. CONCLUSION

By analyzing the basic variations of direct investment infiltration into foreign markets, we come to the conclusion that in today's globalization environment, the world economy has resulted in increase of the importance of foreign direct investment. On the other hand, multinational companies have had numerous positive effects on the growth and development of the host country, which is reflected in the possibilities of transferring technology, knowledge, skills, capital inflow, etc. By engaging in international integration processes, possibilities for faster and more stable development are created for Bosnia and Herzegovina, as well as Kosovo, where the role of foreign direct investments in enhancing this development can be invaluable.

Excluding possible war conflicts between certain countries in the region, which are possible (especially in B&H), the most important task for the countries in the region remains transition, with the privatization of economy being in the first place. It must be carried out in a satisfactory manner, if assistance and support is sought from the International Community, transparently and with the exclusion of unsocial phenomena, corruption, bribe, etc. In this discourse, in the absence of a market environment, attracting foreign direct investment is possible only through the process of privatization, and in order to complete this process, it is necessary to pass transitional laws (*Law on Property, Law on Denationalization, Law on Investment Funds, Law on taking over Joint Stock Companies, etc.*), thus providing conditions for faster and better restructuring of public enterprises, health care, and pension funds. Revitalization of many state institutions also has a significant place, especially establishment of an independent and efficient judicial and administrative function, without which it is useless to talk about the rule of law. It is well known that economic development in BiH has been prevented in the past and even today, prevented by many factors of objective and sub-characteristic character, which is reflected in its slowed socio-economic development and approximation to the EU. In assessing foreign direct investments, political instability is a very important factor, which, in the case of economy of Bosnia and Herzegovina, is particularly associated with political monopolies, corruption, discrimination, or weak economy and investment activities.

In conclusion, all those who are well acquainted with the situation in B&H agree in their assessment that the main problem of this country is a political one, emphasizing national aspect. Only when the aforesaid limitations are overcome, namely when the Dayton anomalies in the legal, political, economic and every other segment of this society are resolved, the country will be able to count on prosperous development. Therefore, the constitutional model must be changed.

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