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Original Article

FOREIGN DIRECT INVESTMENT AND DOMESTIC ECONOMIC GROWTH: A COMPARISON OF THE WESTERN BALKAN COUNTRIES AND THE EU

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Abstract: *The paper examines the effects of inflation, unemployment, economic openness, and economic growth on the inflow of foreign direct investment in the countries of the Western Balkans and the European Union. The analysis is based on data obtained from the World Bank and UNCTAD databases for the period 2020–2024. In addition to descriptive statistics, OLS regression analysis, fixed and random effects models, and the Pearson correlation test are applied. A detailed analysis leads to results showing that economic growth has a very weak positive impact on the inflow of foreign direct investment, but the effect is not statistically significant. OLS regression indicates that only unemployment has a statistically significant impact among the analyzed factors, while in the fixed effects model inflation has a significant impact on foreign direct investment; the difference in results can be explained by different model specifications. The analysis compares the countries of the Western Balkans and the European Union in order to demonstrate how fluctuations and economic challenges affect the development of the observed economies, which are at different levels of development. Different development levels, institutional frameworks, and descriptive statistics have led to the conclusion that the effects of foreign direct investment and economic growth are greater in the European Union.*

Key words*: foreign direct investment, gross domestic product, unemployment, inflation, Western Balkans, European Union, economic openness.*

JEL classification*: F21, O40*

1. INTRODUCTION

The classical definition of foreign direct investment refers to investments made by foreign investors in newly established or existing enterprises with a lasting interest. Foreign investments do not imply only material gains, but also contribute to modernization and the promotion of the host country's economy through the transfer of necessary knowledge, technological innovations, as well as through opportunities to operate in other, more distant markets. The research in this paper aims to answer the question of whether the movements of the analyzed variables in the countries of the Western Balkans differ from the average values of the European Union. The objective of the study is to present and explain the effects that foreign direct investment has in less developed economies such as Bosnia and Herzegovina, Serbia, Montenegro, Albania, and North Macedonia, in comparison to the European Union. The analysis of the paper is based on a descriptive explanation of the extent to which foreign direct investment has helped the

countries of the Western Balkans cope with numerous economic challenges, such as inflation caused by the war between Ukraine and Russia, unemployment rates as a consequence of large migration flows, or the decline in gross domestic product due to the COVID-19 pandemic. At the beginning, a theoretical framework is presented regarding the concept and importance of foreign direct investment, as well as economic growth and development, alongside the current economic conditions in the observed countries. This provides a solid basis for the empirical part, which is based on correlation and panel analyses, with results presented in both tabular and graphical form. The paper concludes with a discussion of the obtained results.

2. LITERATURE REVIEW

Foreign direct investment (FDI) and domestic economic growth is a topic that has attracted significant attention from researchers worldwide. Various studies have examined this relationship using different methodologies and analytical approaches, providing valuable insights into the factors influencing the effectiveness of FDI.

Živković, in his paper, analyzes the importance of foreign direct investment for the economic development of the Western Balkan countries, considering that the development process in these transition economies began later than in other European countries. Special attention is given to the conditions of the business environment that influence the attraction of foreign investments, such as strengthening institutions, investing in education, and developing infrastructure (Živković, 2020).

Tomić discusses the importance of foreign direct investment as a significant segment of the international economic and financial system and one of the key drivers of economic growth in transition economies. The paper analyzes the trends and importance of FDI as a channel for integrating Western Balkan countries into modern economic flows, with a particular focus on Montenegro. Both positive and negative macroeconomic effects of foreign investment are considered, concluding that there is potential for attracting foreign capital, but its realization largely depends on political and economic conditions (Tomić, 2023).

The Granger causality test, applied to Western Balkan countries and selected European countries, reveals that GDP per capita shows a weak positive correlation with foreign direct investment, suggesting that higher-income countries tend to attract more foreign investment. There is also a strong positive correlation between GDP per capita and trade openness, indicating that more developed economies tend to be more integrated into global trade networks (Yeboah, E., et al., 2025).

Within panel data regression analysis for Western Balkan countries, FDI inflows have a significant and positive impact on domestic investment. It was found that a 1% increase in foreign direct investment raises domestic investment by 0.34%. Moreover, real economic growth has a positive and significant effect on domestic investment, where a 1% increase in real GDP growth increases domestic investment by 0.0074%. These results indicate that FDI has a more pronounced positive effect on domestic investment compared to GDP growth rates (Sucubasi, B., et al., 2021).

Manić and Glišić examine the relationship between institutional quality, FDI inflows, and economic growth in Western Balkan countries. Their analysis covers five countries in the region over the period 2007–2022, using panel data and the generalized least squares method. The results indicate an unexpected positive effect of lower institutional quality on economic growth through the FDI channel, explained by the attraction of investments that, in addition to growth, may generate negative external effects. The study highlights the importance of considering the long-term risks of such a growth model (Manić and Glišić, 2025).

Hurem, in his work, presents three sections analyzing foreign direct investment and its impact on economic growth and development, with a particular focus on transition economies, using Bosnia and Herzegovina as a case study (Hurem, 2019).

Veličković analyzes the flows of foreign direct investment in Western Balkan countries, aiming to identify key factors that, along with relative political stability in the region, have influenced the dynamics of FDI inflows. Based on econometric analyses, the effects of FDI on economic growth, domestic savings, and investment in fixed assets are assessed, as well as their impact on competitiveness and balance of payments stability (Veličković, 2019).

Grahovac and co-authors provide a theoretical and empirical analysis of the volume and structure of foreign direct investment in the Western Balkans and its impact on the economic development of the region. Special emphasis is placed on the role of FDI in reducing trade balance deficits, primarily through its influence on increasing exports, especially in manufacturing and export-oriented service sectors (Grahovac et al., 2015).

Mahmuzić examines the importance of foreign direct investment for economic development, with a particular focus on the positive effects of

greenfield investments on employment, gross domestic product, and production capacity. The analysis focuses on Bosnia and Herzegovina, which, despite a strategic commitment to attracting foreign investment, recorded modest inflows and ranked last in the region during the observed period.

The paper highlights an unfavorable investment climate and low competitiveness, based on comparisons of relevant international indices, and emphasizes that improving political stability and establishing an adequate legal and economic framework are essential for attracting significant foreign direct investment (Mahmuzić, 2014).

3. THEORETICAL FRAMEWORK

In investors intention to generate profit through effective enterprise management and control of investment resources, international capital flows occur in the form of foreign direct investment. Foreign direct investment is entrepreneurial in nature. Driven by investors' long-term profit-oriented plans, it represents a relatively stable external source of financing. For capital-importing countries, FDI is considered the most favorable form of international financing. Although it represents one of the riskiest forms of international capital movement, multinational companies, as carriers of foreign direct investment, prefer this form of investment due to the possibility of achieving high returns (Dašić, 2011).

In economic literature, there are numerous definitions of foreign direct investment. British economist John Harry Dunning defines foreign direct investment as follows: "FDI is a phenomenon whereby an investor located in one country (home country) acquires assets in another country (host country) with the intention of managing those assets, where in most cases both the investor and the foreign-managed assets represent business enterprises" (Dunning, 1994:3–5). Oskar Kovač provides the following definition: "A direct investment abroad is any form of investment in a company through which ownership control is acquired over it" (Kovač, 1994:280).

The Organisation for Economic Co-operation and Development (OECD) defines foreign direct investment as investment where the objective of a resident enterprise in one country is to obtain a lasting interest and control over an enterprise in another country (OECD, 2008).

Murić concludes that economic growth is defined as a quantitative economic variable through which the value of a national economy is expressed over a specific period; economic growth is an important precondition for easier resolution of key economic tasks in any society; it can be observed as a one-dimensional process focusing only on the volume of material production; economic development is a qualitative variable that is not purely an economic phenomenon; it is a multidimensional process that includes structural, institutional, organizational, and technological changes; both growth and development are long-term and slow processes (Murić, 2013).

Kragulj defines economic growth as achieved when production exceeds population growth and when it increases through better utilization of unused resources, optimal resource allocation, capacity expansion, and technology (Kragulj, 2018). Tešić, Božić, and Savić define economic growth as a continuous increase in the production of goods and services in a country, i.e., an increase in GDP compared to the previous period (Tešić, Božić and Savić, 2025).

The definition of development goals of a national economy must be based not only on economic criteria, but also on other factors such as ensuring full employment, a fairer income distribution, and the achievement of cultural and social development. If they are based solely on economic principles, these goals will certainly be in function of achieving dynamic economic growth, but the sustainability of such growth is questionable (Njegovan, Filipović & Pejanović, 2009).

Western Balkan countries, which were late in integrating into Europe and the global economy, have also embarked on a path driven by foreign direct investment in order to increase exports and growth. According to many researchers, FDI in the Western Balkan region has indeed enabled and significantly contributed to capital accumulation, effectively acting as a substitute for insufficient domestic savings (Estrin et al., 2014).

The Western Balkan region is a part of Europe that has been attractive to foreign investors for years. Unlike many developing countries and even transition economies, the countries of this region are primarily destinations for FDI inflows, but not sources of outward FDI to the rest of the world. FDI outflows from the region are very modest and have remained unchanged for a long period.

The geopolitical position of the Western Balkans is quite specific in Europe and also influences who invests in the region. Over the past decades, economic ties between the EU and Western Balkan countries have intensified, in line with the countries aspirations for EU membership (ONB, 2025).

Montenegro achieves FDI inflows thanks to tourism, real estate, and financial services. Serbia maintains strong FDI inflows due to investments in manufacturing and technology, supported by

special economic zones and tax incentives. Albania has recorded fluctuating FDI patterns, with significant interest in energy and infrastructure projects. North Macedonia and Bosnia and Herzegovina lag behind in attracting FDI due to political instability and weaker institutional frameworks. Foreign direct investment (FDI) has become a key source of economic growth for Balkan countries, providing vital financing for development initiatives. Countries the Western Balkans are developing democracies that, over the past decades, have engaged in many aspects of globalization (Bartlett, W., 2007; Bukowski, C., 2005).

4. RESEARCH METHODOLOGY

The empirical analysis examines the effects of economic growth on the inflow of foreign direct investment in the case of Western Balkan countries and the average values at the EU level for the period 2020–2024.

Main (general) hypothesis:

H1: "Economic growth has a positive impact on foreign direct investment in Western Balkan countries, including Serbia, Bosnia and Herzegovina, Montenegro, North Macedonia, Albania, and EU countries, which have greater resilience to crises due to strong institutions."

Auxiliary hypotheses:

H1a: "Inflation has a statistically significant impact on the inflow of foreign direct investment."
H1b: "The unemployment rate has a statistically significant impact on the inflow of foreign direct investment."
H1c: "Greater economic openness has a statistically significant impact on the inflow of foreign direct investment."

A descriptive statistical method is applied to Western Balkan and EU countries in order to present average values and standard deviation, which indicate the degree of variability and stability of foreign direct investment inflows, GDP, and control variables during the analyzed period.

This is followed by a comparative analysis to examine differences in FDI inflows between Western Balkan countries and the EU.

As in most previous studies, we use a panel regression model to investigate the relationship between economic growth and foreign direct investment.

Foreign direct investment is used as the dependent variable, while economic growth (GDP growth) is used as the independent variable. As control variables, we include unemployment, economic openness, and inflation.

Standard regression model in our case:
$FDIit = \alpha + \beta 1GDPgrowthit + \beta 2unemploymentit + \beta 3export \& importit + \beta 4Inflationit + \mu i + \lambda t + \varepsilon it$

$\mu i \rightarrow$ country fixed effects
$\lambda t \rightarrow$ time fixed effects
$\varepsilon it \rightarrow$ model error

Panel regression techniques have two models: the fixed effects (FE) model and the random effects (RE) model. The Hausman test determines the choice between the two techniques, in this case the fixed effects model.

An OLS regression is also applied for comparison of results. The study additionally uses the Pearson correlation coefficient to test the basic relationship between the independent variable and FDI, as well as the impact of other selected variables on FDI.

The data consist of foreign direct investment inflows obtained from the UNCTAD database, as well as GDP growth, inflation, and other macroeconomic indicators obtained from the World Bank database for the period 2020–2024.

The COVID-19 pandemic caused a shock to the global economic system and foreign direct investment, and the degree of recovery of the observed economies is also examined.

5. RESULTS

The analysis assumes that foreign direct investment, as the dependent variable, is related to gross domestic product as the independent variable, while inflation, unemployment, and economic openness are included as control variables.

Differences in foreign direct investment and selected macroeconomic indicators between Western Balkan countries and the European Union are presented.

It should be taken into account that the European Union consists of developed economies with larger markets, higher levels of capital, more developed infrastructure, and a more favorable investment environment, whereas Western Balkan countries are smaller transition economies with limited capacity to attract large investment flows.

Furthermore, the EU includes a larger number of countries, which results in significantly higher total amounts of foreign direct investment compared to individual Western Balkan countries.

Table 1. Foreign Direct Investment Inflows in Western Balkan Countries and the EU (2020–2024)

COUNTRIES	YEAR	2020	2021	2022	2023	2024
Bosnia and Herzegovina		480	716	816	1.048	1.113
Serbia		3.469	4.590	4.598	4.916	5.635
Montenegro		532	699	877	526	598
North Macedonia		230	556	785	625	1.358
Albania		1.108	1.234	1.434	1.622	1.716
European Union		36.259	310.004	-49.827	147.526	267.772

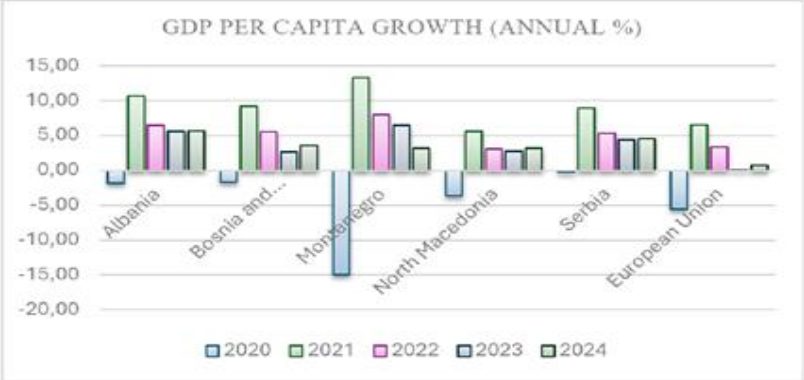
Source: UNCTAD, World Investment report, 2025

Table 1 provides an overview of foreign direct investment for the period from 2020 to 2024. The data show a significant increase in FDI over the years, as well as a pronounced difference between Western Balkan countries and the EU. The differences among countries indicate varying levels of economic resilience to external shocks.In the further part of the research, the movements of GDP growth, inflation, unemployment, and economic openness are presented graphically. Data for 2025 are not fully available for all parameters and are subject to further revision; therefore, they are not included.

Figure 1. GDP Growth (Annual %) in Western Balkan Countries and the EU (2020–2024)

Source: Author's calculation based on World Bank data, 2026

Figure 2. GDP per Capita Growth (annual %) 2020-2024

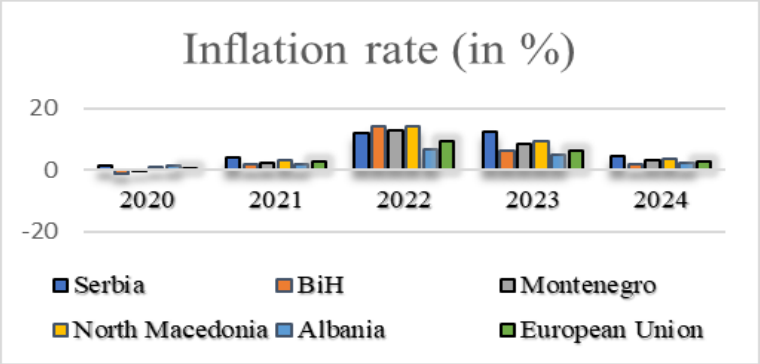


Source: Author's calculation based on World Bank data, 2026

The growth of gross domestic product shown in Figure 1 and GDP per capita growth shown in Figure 2 indicate that, with the onset of the crisis caused by the COVID-19 pandemic, the situation changed significantly. In 2020, a pronounced decline was observed across all analyzed economies. The largest decline in 2020 among Western Balkan countries, as well as the strongest

subsequent recovery, was recorded in Montenegro. Montenegro relies heavily on tourism, which accounts for a significant share of its GDP. On the other hand, Ireland was the only EU country that recorded GDP growth in 2020 year. The recovery in 2021 was observed in all countries that experienced a decline in 2020. After that, a stabilization of growth occurred in the following years, accompanied by moderate improvement.

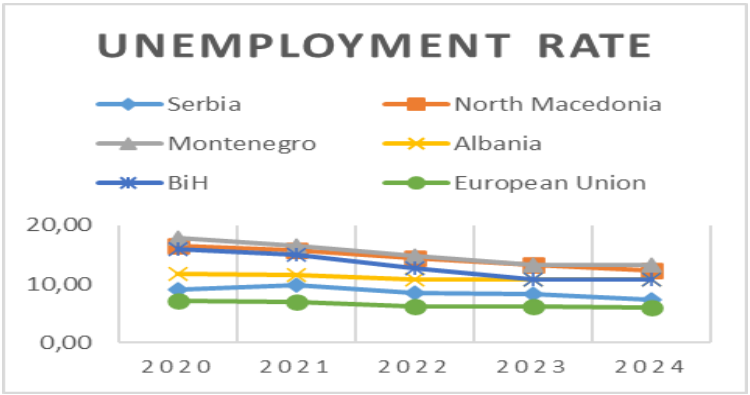
Figure 3. Inflation Rate (%) in Western Balkan Countries and the EU (2020–2024)



Source: Author's calculation based on World Bank data, 2026

Figure 3 shows inflation rates (%) in Western Balkan countries and the European Union from 2020 to 2024. Inflation was low in 2020 due to the economic slowdown caused by the COVID-19 pandemic and reduced demand. In 2021, inflation began to rise as economies recovered, demand increased, and supply chains were disrupted. The highest inflation rates were recorded in 2022, driven by post-pandemic recovery and the war in Ukraine, which caused sharp increases in energy, food, and transport prices. In 2023, inflation remained high but started to decline due to restrictive monetary policies and higher interest rates. During 2024, inflation continued to stabilize, although it remained above pre-pandemic levels.

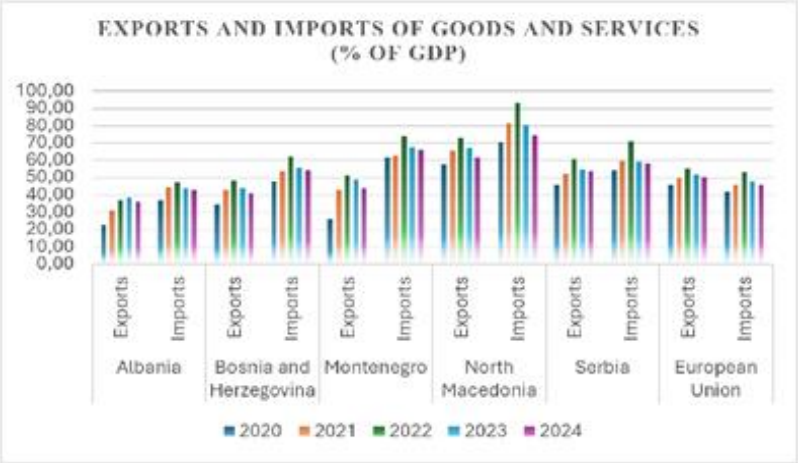
Figure 4. Unemployment Rate (%) in Western Balkan Countries and the EU (2020-2024)



Source: Author's calculation based on World Bank data, 2026

A recent World Bank report highlights a paradox in the labor market: employers are unable to find workers, while unemployment remains in double digits. In its regular economic report for the Western Balkans, the World Bank estimates that the region could face a shortage of more than 190,000 workers over the next five years, while the number of working-age people continues to decline.According to Figure 4, it can be observed that during the COVID-19 pandemic and the recovery period (2020–2022), all countries experienced an increase in the unemployment rate. The most affected country was Montenegro, whose labor market recorded the highest unemployment rate of up to 24.50% (2021). The smallest decline was recorded in North Macedonia, which still has the highest unemployment rate among the countries in the region.It can be concluded that the labor market in Western Balkan countries has improved to some extent, but the region still lags behind the EU.

Figure 5. Economic Openness (Exports and Imports, % of GDP) 2020–2024



Source: Author's calculation based on World Bank data, 2026

Figure 5 shows economic openness, which represents the share of exports and imports of goods and services in gross domestic product. In Western Balkan countries, during the observed period, imports exceed exports, indicating a trade deficit, while the EU shows higher exports than imports. According to the data, the highest import levels among the observed economies are recorded in North Macedonia, which can be explained by its small and open economy, a strong dependence of production on imports, and energy dependence on imported resources. It should be noted that the EU is the leading trading partner of this region.

Table 2. Descriptive Statistics

COUNTRY	AVERAGE				
	FDI	GDP Growth	Inflation	Unemployment	Trade Openness
BiH	834,6	2,71	4,51	12,68	96,85
Serbia	4.642	3,48	6,24	9,82	114,16
Montenegro	646,4	3,09	5,21	18,07	109,16
North Macedonia	710,8	1,62	6,05	15,35	145,05
Albania	1.423	3,71	3,28	11,05	76,32
European Union	142.347	1,17	4,36	6,65	93,12
COUNTRY	**STANDARD DEVIATION**				
	FDI	GDP Growth	Inflation	Unemployment	Trade Openness
BiH	229,44	3,39	4,80	2,07	8,88
Serbia	698,82	2,84	4,32	1,54	10,16
Montenegro	131,05	9,58	4,38	4,64	12,57
North Macedonia	370,64	3,24	4,41	2,82	12,76
Albania	228,26	3,95	1,85	1,77	8,93
European Union	135.685,39	3,97	3,05	0,74	6,46

Source: Author's calculation

Table 2 presents the descriptive statistics for foreign direct investment (FDI), GDP growth, inflation, unemployment, and trade openness in Western Balkan countries and the European Union. The table includes the average values and standard deviations of the selected indicators. The average values show that the European Union records by far the highest FDI inflows, while among the Western Balkan countries Serbia has the highest average FDI inflows and Montenegro the lowest. GDP growth is highest in Albania and Serbia, whereas the European Union and North Macedonia record lower average growth rates. Inflation is highest in Serbia and North Macedonia, while Albania has the lowest average inflation rate. Unemployment is lowest in the European Union and Serbia, whereas Montenegro records the highest unemployment rate. Trade

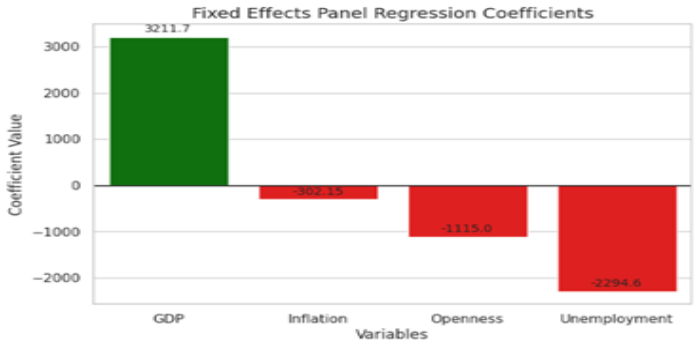
openness is most pronounced in North Macedonia and Serbia, while Albania has the lowest level of openness among the observed countries. The standard deviation indicates the variability of the observed indicators. The European Union shows the greatest variability in FDI due to the large size of its economy and investment flows. Variability in GDP growth is most pronounced in Montenegro, while inflation and unemployment are relatively more stable in the European Union compared to the Western Balkan countries. Overall, the data suggest notable differences in macroeconomic indicators across the region, with the European Union demonstrating greater economic stability.

Table 3. Fixed Effects Panel Analysis

Variable	Coefficient	P-value	Interpretation
GDP	3211.7	0.2367	Positive effect, but not statistically significant. GDP growth is associated with higher FDI inflows, but this effect cannot be statistically confirmed.
Inflation	-302.15	0.9518	Negative effect and completely statistically insignificant. Inflation has no significant impact on FDI in this sample.
Economic Openness	-1115.0	0.6475	Negative and insignificant effect. Trade openness did not show a statistically significant impact on FDI.
Unemployment	-2294.6	0.6217	Negative effect, but without statistical significance. Higher unemployment formally reduces FDI, but the result is not statistically confirmed.

Source: Author's calculation based on analysis results

Figure 6. Panel Analysis – Fixed Effects Model



Source: Author's calculation based on analysis results

The analysis presented in Figure 6 shows that macroeconomic variables have different effects on foreign direct investment (FDI) inflows in the observed sample of countries. The results of the fixed effects regression model indicate that none of the variables are statistically significant at the 5% level ($p > 0.05$), meaning that their individual effects on FDI cannot be statistically confirmed. Gross domestic product (GDP) has a positive coefficient, suggesting a positive relationship with FDI inflows. In contrast, inflation, economic openness, and unemployment all have negative coefficients, indicating that higher values of these variables are associated with lower FDI inflows in this model. Although the coefficients differ in sign and magnitude, none of them are statistically significant, so the results should be interpreted only in terms of direction, not as confirmed causal relationships. GDP shows the strongest positive coefficient, while unemployment has the strongest negative effect. The graph visually illustrates these differences, with GDP shown as the only positive bar and all other variables (inflation, openness, and unemployment) displayed as negative values. Overall, the fixed effects model suggests that the selected macroeconomic variables do not have a statistically significant impact on FDI inflows in the period 2020–2024. However, the F-test confirms the validity of the fixed effects specification, indicating the presence of significant differences between countries that must be controlled for.

R^2 (within): 0.0862
R^2 (between): -6.2389
R^2 (overall): -4.2220

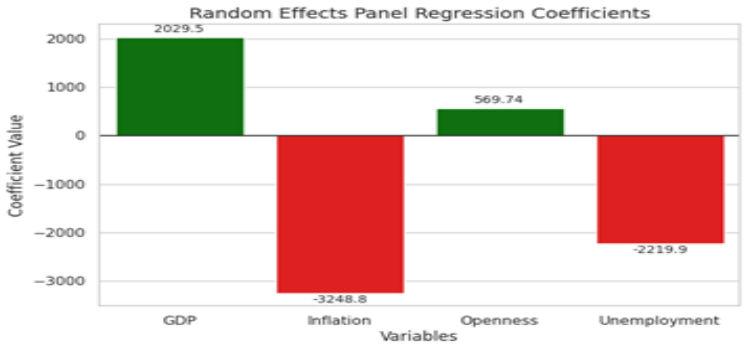
The coefficient of determination R^2 (within) is 0.0862, indicating that the fixed effects model explains approximately 8.6% of the variation in FDI within countries over time. This suggests relatively low explanatory power, although the model still captures a small portion of the within-country dynamics in FDI. In contrast, R^2 (between = −6.2389) and R^2 (overall = −4.2220) are negative, which indicates that the model performs poorly in explaining differences in FDI levels between countries, as well as the overall variation in the sample. These negative values suggest that the included explanatory variables have very limited predictive power in capturing cross-country differences in FDI, implying that important structural, institutional, or external factors are likely omitted from the model. Accordingly, R^2 (within) represents the most relevant measure of model fit in this fixed effects specification, as it focuses on variation within countries over time. Therefore, only the within R^2 is methodologically appropriate for interpreting explanatory power in this context.

Table 4. Random Effects Panel Analysis

Variable	Coefficient	P-value	Interpretation
GDP	2029.5	0.3069	Positive effect, but not statistically significant
Inflation	-3248.8	0.2812	Negative, but insignificant effect
Economic Openness	569.74	0.3612	Positive, but not significant
Unemployment	-2219.9	0.5440	Negative, but not statistically significant

Source: Author's calculation based on analysis results

Figure 7. Panel Analysis – Random Effects



Source: Author's calculation

In addition to the fixed effects analysis, a Random Effects (RE) model was estimated for the period 2020–2024. The results show that GDP and economic openness have positive coefficients, while inflation and unemployment have negative coefficients, indicating different directions of association with FDI inflows. However, none of the variables are statistically significant ($p > 0.05$), so the results should be interpreted only in terms of direction. Compared to the fixed effects model, the RE model focuses more on differences between countries, while the FE model better captures within-country variation. Overall, the FE model is more appropriate for this dataset, as it provides a more reliable explanation of FDI dynamics.

R^2 (overall): 0.0836

The overall R^2 of 0.0836 indicates that the model explains only 8.36% of the total variation in FDI, suggesting very low explanatory power. This implies that the included macroeconomic variables (GDP, inflation, trade openness, and unemployment) do not sufficiently capture the determinants of FDI, and that other external or structural factors likely play a more important role.

Table 5. Regression Coefficients

Variable	Coefficient	Std. Error	t-stat	P-value
GDP	1446.13	2841.01	0.5090	0.6150
Inflation	-5383.56	4021.36	-1.3387	0.1922
Economic Openness	1270.82	497.96	2.5521	0.0169
Unemployment	-6783.03	3155.65	-2.1495	0.0411

Source: Author's calculation

Table 6. OLS Regression Results (Dependent Variable: ln(FDI))

Indicator	Value
Number of observations	30
R-squared	0.556
Adjusted R-squared	0.485
F-statistic	7.837
Prob (F-statistic)	0.000308
AIC	109.7
BIC	116.7
Log-Likelihood	-49.827
Durbin-Watson	0.590

Source: Author's calculation

$R^2 = 0.556$

The model explains approximately 55.6% of the variation in FDI, indicating a moderate explanatory power, while the remaining variation is driven by other factors not included in the model. The log transformation of the dependent variable improves model fit. The regression results show that the model is statistically significant overall ($F = 7.837$; $p < 0.01$). Among the explanatory variables, only unemployment is statistically significant ($\beta = -0.3067$; $p < 0.01$), indicating that higher unemployment reduces FDI. GDP, inflation, and economic openness are not statistically significant in this model.

Table 7. *Pearson Correlation*

Variable	Correlation
FDI–GDP	0.02
FDI–Inflation	-0.12
FDI–Openness	-0.20
FDI–Unemployment	-0.48

Source: Author's calculation

Table 7 presents the Pearson correlation coefficients between FDI and GDP, inflation, unemployment, and economic openness. The coefficients indicate the direction and strength of linear relationships between the variables. The results show that the strongest relationship with FDI is observed for unemployment, which is negatively correlated (-0.48), indicating that higher unemployment is associated with lower levels of foreign direct investment. GDP shows an almost zero correlation with FDI (0.02), suggesting no meaningful linear relationship between these two variables. Inflation also has a weak negative correlation with FDI (-0.12), while economic openness shows a slightly stronger but still weak negative correlation (-0.20). Unlike the original statement, inflation is not strongly correlated with FDI, and the strongest correlation is not positive but negative and linked to unemployment. Additionally, no strong relationship is observed between inflation and unemployment in this dataset in the context of FDI relationships. Overall, the correlation analysis indicates weak linear relationships between FDI and the selected macroeconomic variables, with unemployment emerging as the most relevant factor among them.

6. DISCUSSION

The results provide insight into the application of descriptive statistics, the Pearson correlation coefficient, as well as the estimation of OLS regression analysis and fixed and random effects analysis within the observed group of countries. It can be concluded that the relationship between the variables is most noticeable during periods of economic crisis, when the economy is the most sensitive. The Hausman test suggested the fixed effects model as the most appropriate for this analysis. Economic growth has a positive impact on the inflow of foreign direct investments in the countries of the Western Balkans and the European Union, meaning that the main hypothesis cannot

be completely rejected, but it also cannot be fully confirmed due to insufficient statistical evidence supporting the existence of the relationship. The test applied to the Western Balkan and EU countries reveals that there is no positive correlation between FDI and inflation, therefore hypothesis H1a is not accepted. On the other hand, the results also indicate a negative relationship between FDI and unemployment, leading to the rejection of hypothesis H1b, as well as hypothesis H1c, where a negative relationship between FDI and trade openness was identified. High inflation can reduce purchasing power and create uncertainty, discouraging investment and economic growth. In contrast, trade openness emphasizes the importance of international trade within a country, implying growth in the export of goods and services aimed at increasing economic growth. The regression analysis results show that an increase in the unemployment rate statistically significantly reduces the inflow of foreign direct investments, while an increase in trade openness statistically significantly increases FDI inflows. Furthermore, the regression analysis with a logarithmic transformation of the dependent variable shows that the coefficient of determination ($R^2 = 0.556$) indicates that the model explains 55.6% of the variation in FDI. This suggests a moderate to relatively strong explanatory power of the model, while the remaining variation is driven by other factors not included in the model.The regression results show that the model is statistically significant overall ($F = 7.837$; $p < 0.01$). Among the explanatory variables, only unemployment is statistically significant ($\beta = -0.3067$; $p < 0.01$), indicating that higher unemployment reduces FDI. GDP, inflation, and economic openness are not statistically significant in this model. According to the descriptive statistics analysis, the effect of economic growth and FDI is stronger in the EU because a more developed institutional framework (rule of law, efficient administration, stable policies) allows foreign investments to be more effectively transformed into productivity, technological transfer, and long-term growth. In Western Balkan countries, weaker institutions reduce these positive effects.Furthermore, during the pandemic and war-related shocks, countries with stronger institutions and more stable systems were better able to absorb crises and maintain investor confidence, while Western Balkan countries were more vulnerable to these disturbances, which weakened the developmental effect of FDI. This research is consistent with previous findings, which indicate that higher-income countries attract more foreign investment. The analysis is limited by the time period and data availability, as well as the limited number of macroeconomic variables. Accordingly, future research could focus on sectoral analysis in order to determine which sectors contribute most to attracting investment. It would also be useful to extend the model by including additional variables such as institutional quality or education level, as well as to expand the analysis to a longer time period and to examine EU countries individually in order to obtain more reliable results.

CONCLUSION

Foreign direct investment, as a key driver of development, according to the conducted analyses, shows that economic growth in the European Union is continuous and stable. In contrast, economic growth in Western Balkan countries is significantly more dynamic and unstable, which creates a gap between these economies.It can be observed that economies such as Serbia and Montenegro stand out in this process of progress. Their economies have recorded significant growth in recent years, which is also reflected in gross domestic product, with an average growth rate of 4% for Serbia and 3% for Montenegro. This is further supported by the degree of openness of these economies towards the world and international partners.Economies such as Bosnia and Herzegovina and North Macedonia have not created a sufficiently adequate environment to attract investors to the same extent as Serbia and Montenegro. It can be concluded that the effects of foreign direct investment are visible only in those countries that are prepared to provide the necessary conditions for attracting them.

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