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FOREIGN DIRECT INVESTMENT AND REGIONAL DEVELOPMENT IN THE CONTEXT OF REINDUSTRIALIZATION AND GREEN TRANSITION

STRANA IZRAVNA ULAGANJA I REGIONALNI RAZVOJ U KONTEKSTU REINDUSTRIJALIZACIJE I ZELENE TRANZICIJE

Summary: *Global economic restructuring, intensified by geopolitical uncertainty and sustain ability requirements, has reshaped the determinants of foreign direct investment (FDI). In the European context, reindustrialization and green transition have become central development priorities, particularly for transition economies seeking structural modernization and stronger integration into regional value chains. This paper examines the role of foreign direct investment in regional development in Bosnia and Herzegovina within the broader framework of Central and Eastern European (CEE) economies. The research is grounded in Dunning's eclectic paradigm and integrates macroeconomic, institutional and structural indicators in order to assess national investment attractiveness. Using a composite index methodology inspired by UNCTAD and World Economic Forum data, the study compares Bosnia and Herzegovina with selected*
CEE countries based on updated empirical evidence for 2024. The findings indicate that while Bosnia and Herzegovina retains cost-based advantages, including competitive labour costs and energy availability, structural constraints persist in the form of institutional fragmentation, administrative inefficiencies and limited innovation capacity. In the context of reindustrialization
and green transition, modern FDI allocation increasingly depends on regulatory predictability, sustainability alignment and technological readiness. The paper contributes to understanding how foreign direct investment can support regional development, provided that institutional reforms and strategic modernization policies are effectively implemented.
Keywords: *growth, competitiveness, foreign direct investment, globalization, regionalisation, Central and Eastern European countries.*
JEL Classification: *F23, F21*

Rezime: *Globalno ekonomsko restrukturiranje, intenzivirano geopolitičkom neizvjesnošću I zahtjevima održivosti, preoblikovalo je determinante stranih izravnih ulaganja (FDI). U europskom kontekstu reindustrijalizacija i zelena tranzicija postale su središnji razvojni prioriteti, osobito za tranzicijske ekonomije koje teže strukturnoj modernizaciji i snažnijoj integraciji u regionalne lance vrijednosti. Ovaj rad analizira ulogu stranih izravnih ulaganja u regionalnom razvoju Bosne i Hercegovine u širem okviru zemalja srednje i istočne Europe (CEE). Istraživanje se temelji na Dunningovoj eklektičnoj paradigmi te integrira makroekonomske, institucionalne i strukturne pokazatelje s ciljem procjene nacionalne investicijske atraktivnosti. Primjenom kompozitne metodologije indeksa, inspirirane podacima UNCTAD-a i Svjetskog gospodarskog foruma, uspoređuje se Bosna i Hercegovina s odabranim zemljama CEE na temelju ažuriranih empirijskih podataka za 2024. godinu. Rezultati ukazuju na to da Bosna i Hercegovina i dalje zadržava određene troškovne prednosti, uključujući konkurentne troškove rada i dostupnost energetskih resursa, no istodobno su prisutna strukturna ograničenja u obliku institucionalne fragmentiranosti, administrativne neučinkovitosti i ograničenih inovacijskih kapaciteta. U kontekstu reindustrijalizacije i zelene tranzicije, alokacija suvremenih stranih ulaganja sve više ovisi o regulatornoj predvidivosti, usklađenosti s načelima održivostii tehnološkoj spremnosti gospodarstva. Rad doprinosi razumijevanju načina na koji stranaizravna ulaganja mogu potaknuti regionalni razvoj, pod uvjetom da se provedu učinkovite institucionalne reforme i strateške politike modernizacije.*
Ključne riječi: *strana izravna ulaganja, regionalni razvoj, reindustrijalizacija, zelena tranzicija, zemlje srednje i istočne Europe*
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INTRODUCTION

Internationalisation of business refers to the process by which firms expand their activities across national borders, whereas globalisation and regionalisation describe the broader state or outcome of cross-border integration. These concepts are complementary but analytically distinct. Internationalisation emphasises the dynamic process of expansion, while globalisation reflects the achieved level of interconnectedness across markets and economies. Moreover, internationalisation is inherently a two-way process rather than a unidirectional movement (Dubrovski 2006).

Enhancing societal well-being is a key objective pursued through improved national competitiveness. Foreign direct investment (FDI) plays a significant role in this context by contributing to capital formation, productivity and structural transformation.

The second section presents the theoretical foundations of the study, while the third section reviews the existing literature on determinants of FDI. Recent debates on global governance models - whether based on delegation, networks or corporate social responsibility - raise important questions regarding the future trajectory of globalisation (Rodrik 2011).

The findings and recommendations for further research are presented in the sixth section.

This study investigates the relationship between institutional quality, competitiveness structures and foreign direct investment attractiveness in the Western Balkans (WB6). The central research question is: How do institutional quality and competitiveness structures influence foreign direct investment attractiveness and regional development patterns in Western Balkan economies?

The paper focuses particularly on Bosnia and Herzegovina and compares its performance with other WB6 economies.

1. THEORETICAL CONCEPTS

Porter's diamond model of national competitive advantage remains one of the most influential frameworks (Daniels et al. 2007; Hämäläinen 2003). It identifies four key determinants: factor conditions, firm strategy, structure and rivalry, demand conditions, and related and supporting industries. Together, these determinants create the competitive environment in which firms operate and develop. National competitiveness depends on innovation capacity and the ability to adapt to changing conditions (Garelli 2006). Institutional quality, cultural characteristics and economic structures also influence competitiveness (Czinkota et al. 1995). Porter later introduced government and chance as additional external determinants. Government influences competitiveness through fiscal policy, taxation, subsidies and regulatory frameworks, while chance events include wars, technological breakthroughs and shifts in demand.

Modern trade theories complement traditional approaches by incorporating technological change, economies of scale and strategic interaction (Krugman and Obstfeld 2006). Strategic trade theory highlights the interaction between large firms, innovation (R&D) and government policy (Svetličič 1996). More recent international business theories explicitly address FDI, including Hymer's theory of firm-specific advantages, Vernon's product life-cycle theory and internalisation theory (Coase 1937; Buckley and Casson 1976; Henisz 2003; Piggott and Cook 2006).

Another group of theories focuses on the internationalisation process itself rather than solely on trade patterns. These include the network approach and transnational theory (Jaklič and Svetličič 2005). Dunning's investment development path model explains the dynamic

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relationship between economic development, FDI flows and the role of government (Buckley and Castro 1998).

In his eclectic paradigm (OLI framework), Dunning (1993) integrates ownership-specific, location-specific and internalisation advantages. Ownership advantages are necessary but not sufficient for internationalisation; firms must also identify favourable location conditions and internalisation benefits. Other complementary perspectives include the international financing hypothesis, the currency areas hypothesis and the diversification hypothesis under barriers to international capital flows.

The Uppsala model conceptualises internationalisation as a gradual learning process consisting of sequential stages: pre-export activities, exports via independent agents, establishment of a sales subsidiary and establishment of foreign production (Barkema et al. 1996; Jaklič and Svetličič 2005). Kojima's macroeconomic perspective emphasises the relocation of production from high-labour-cost to low-labour-cost economies, illustrated by the "flying geese" pattern of industrial development (Svetličič 1996).

2. LITERATURE OVERVIEW

Empirical research identifies several determinants of FDI inflows in transition economies, including market size, institutional quality, human capital and infrastructure (Henisz 2000; Sethi et al. 2003). Previous studies also suggest that inward FDI can generate productivity spillovers and enhance domestic competition, although these effects depend on absorptive capacity and governance quality (Buckley et al. 2002; Lall and Narula 2004; Wei and Liu 2006).

The attractiveness of countries for foreign direct investment (FDI) is often assessed in a manner similar to competitiveness analysis: microeconomic location decisions are inferred from macroeconomic indicators. This approach is grounded in Dunning's theoretical framework (Dunning 1993). Although investment decisions are ultimately firm-specific (Buckley et al. 2007), selected macro-level indicators can be used to estimate relative investment attractiveness. Such assessments remain comparative and are subject to methodological and substantive limitations (Foster 2000).

FDI trends represent a complex, multidimensional phenomenon shaped by intertwined economic, institutional and structural variables. Frequently cited determinants include market accessibility, liberal government policies, technological infrastructure, an educated labour force and cultural openness to foreign investment (Sethi et al. 2003). The present analysis is conducted on a panel of Central and Eastern European (CEE) countries. Competitiveness indicators are derived from the World Economic Forum database (Schwab 2009).

Empirical studies on FDI determinants emphasise the importance of market size, institutional quality, macroeconomic stability and infrastructure (Bevan, Estrin and Grabbe 2001; Sethi et al. 2003). Research focusing on transition economies highlights the role of structural reforms and EU integration processes in attracting foreign investment (Grabbe and Hughes 1998; Galego et al. 2004; Basar and Tosunoglu 2006).

In the Western Balkan region, FDI inflows are closely linked to institutional reforms, governance quality and proximity to EU markets. However, significant differences remain among WB6 economies in terms of investment attractiveness and competitiveness performance.

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3. METHODOLOGY

3.1. Research design

This study applies a *comparative benchmarking approach* to examine the relationship between competitiveness structures and foreign direct investment (FDI) attractiveness in the Western Balkans (WB6). The analysis focuses on structural determinants of competitiveness and evaluates how these factors may influence the ability of economies to attract and absorb foreign investment.

The research is based on secondary data sources and combines competitiveness benchmarking with descriptive comparative analysis of FDI inflows. The objective is not to establish causal econometric relationships but to identify structural patterns and divergence among WB6 economies.

3.2. Sample selection

The empirical analysis focuses on the six Western Balkan economies: Bosnia and Herzegovina, Serbia, Montenegro, Albania, North Macedonia and Kosovo*[1].

These countries were selected because they share several structural characteristics:

- post-socialist economic transition
- relatively small domestic markets
- strong dependence on foreign capital inflows
- geographical proximity to the European Union

At the same time, they exhibit significant differences in institutional quality, economic reform progress and competitiveness performance, which allows for meaningful comparative analysis.

3.3 Data sources and indicators

The empirical framework is based primarily on the OECD Western Balkans Competitiveness Outlook 2024 (OECD 2024a–f), which provides comprehensive benchmarking of economic and institutional performance across policy domains.

To complement the competitiveness benchmarking results, the analysis also includes FDI inflow data from UNCTAD (2025) and the World Bank (2025), allowing for comparison of investment dynamics across the region.

Four structural dimensions of competitiveness are considered:

1. Institutional governance and investment policy
2. Digital transformation and innovation capacity
3. Access to finance and financial system development
4. Sectoral competitiveness and industrial structure

These dimensions reflect key factors influencing investment attractiveness and long-term competitiveness.

[1] In line with United Nations Security Council Resolution 1244.

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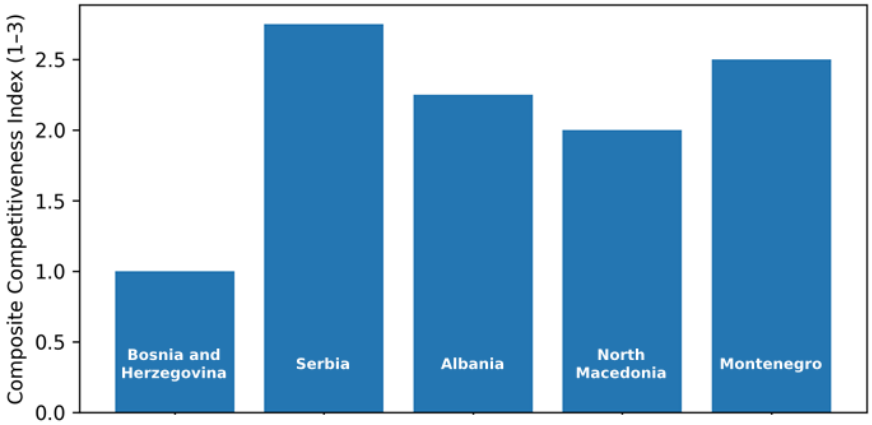
4. EMPIRICAL RESULT AND DISCUSSION

To facilitate cross-country comparison, qualitative benchmarking results from the OECD country profiles were operationalised into an ordinal scoring framework:

- 3 – above regional average / leading performance
- 2 – around regional average
- 1 – below regional average

The scores were assigned based on relative country performance across the four structural competitiveness dimensions identified in the OECD reports.

Figure 1. OECD WB6 Composite Competitiveness Index (2024)



Source: Authors' calculations based on OECD 2024a–b; 2024d–f

A composite competitiveness index was then constructed by aggregating the scores across the four dimensions. This simplified benchmarking framework allows identification of structural divergence patterns within the Western Balkans.

The empirical analysis proceeds in two steps.

First, competitiveness structures across WB6 economies are compared using the composite benchmarking index. This provides an overview of relative performance across institutional, innovation and financial dimensions.

Second, these competitiveness patterns are interpreted in relation to FDI inflow dynamics in the region. The comparison enables identification of potential relationships between institutional quality, reform progress and investment attractiveness.

Table 1 FDI inflow WB6, 2024 (UNCTAD, mio USD)

Country	FDI inflow 2024 (mio USD)	% WB6
Serbia	5,635.49	49.7%
Albania	1,715.57	15.1%
North Macedonia	1,358.35	12.0%
Bosnia and Hercegovina	1,113.38	9.8%
Kosovo*	926.87	8.2%
Montenegro	598.07	5.3%
Total WB6	11,347.73	100%

Source: Authors' calculations based on UNCTAD 2025

Almost 50% of FDI Inflow Amount in 2024 had Serbia. Positive economic policy toward FDI, industrial infrastructure, improvement in infrastructure and available skilled workers are main factors. We want to evaluate FDI value as % of GDP.

Table 2 FDI net inflows as % of GDP, WB6, 2024 (World Bank)

Country	FDI as % GDP (2024, World Bank)
Albania	6.3 %
Bosnia and Hercegovina	3.4 %
Kosovo*	7.7 %
Montenegro	7.2 %
North Macedonia	6.2 %
Serbia	6.2 %

Source: World Bank 2025

Particular attention is given to Bosnia and Herzegovina, whose competitiveness and investment performance is analysed in comparison with other WB6 economies.

The study has several limitations. The benchmarking approach relies on secondary data sources and simplified ordinal scoring, which may not capture the full complexity of institutional and economic structures. In addition, the analysis does not attempt to establish econometric causality between competitiveness indicators and FDI inflows.

Nevertheless, the comparative framework provides useful insights into structural differences among Western Balkan economies and highlights policy areas relevant for improving investment attractiveness and long-term competitiveness.

The comparative analysis indicates that Serbia demonstrates the most consistent above-average positioning across institutional governance, digital transformation, and access to finance. Montenegro exhibits strong sectoral and innovation-related performance, while Albania shows broad-based reform progress. North Macedonia maintains stable mid-level performance without a dominant structural pillar. Bosnia and Herzegovina remains structurally below the regional average across all four aggregated dimensions, which suggests systemic institutional constraints rather than isolated sectoral weaknesses.

The composite index reinforces this divergence pattern, placing Serbia at the top of the regional ranking, followed by Montenegro and Albania. The results support the argument that governance coherence and digital reform sequencing constitute the primary differentiators of competitiveness upgrading in the Western Balkans.

CONCLUSION

Despite increasing attention to foreign direct investment in transition economies, substantial differences in investment attractiveness and competitiveness remain among Western Balkan countries. The analysis presented in this paper suggests that institutional quality, governance coherence and structural reforms represent key determinants of foreign direct investment attractiveness in the region.

This study therefore addresses the following research question: to what extent do competitiveness structures and institutional factors influence foreign direct investment attractiveness and regional development patterns in the Western Balkans (WB6)? Particular attention is given to Bosnia and Herzegovina, whose economic performance is analysed in comparison with other economies in the region.

The study contributes to the literature by linking competitiveness benchmarking with foreign investment dynamics in small post-transition economies. Using OECD competitiveness indicators and FDI data from international sources, the analysis identifies structural factors that may influence the ability of Western Balkan economies to attract and absorb foreign investment.

The remainder of the paper is structured as follows. The next section presents the theoretical framework and key concepts related to competitiveness and foreign direct

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investment. This is followed by a review of empirical literature on FDI determinants in transition economies. The methodology section explains the comparative benchmarking approach used in the analysis. The subsequent section presents the empirical results and comparative analysis of WB6 economies. The final section concludes and outlines policy implications and directions for future research.

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