The Impact of Macroeconomic Indicators and FDI Inflows on the Economic Growth

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Abstract: The focus of this paper is to test the relevance of chosen macroeconomic indicators and FDI net inflows on the economic growth stimulation in the sample of Emerging European Economies and sub-sample of Visegrad States in the period 1997-2017. This empirical research comprises from analysis of robust panel data modes on the total sample level and in the two analyzed sub-periods (before and after the Global Financial Crisis - GFC) with the use of a dummy variable for the Visegrad States. The results of robust estimations indicate that greater FDI net inflows are a relevant factor of economic growth on the total sample level and in the Visegrad States after the GFC. Based on the empirical findings, the authors suggest that policymakers in the Western Balkans should introduce the necessary promotion measures in order to attract greater FDI inflows and boost the economic development level.

1. INTRODUCTION

In previous findings, Ercegovac & Beker Pucar (2021) pointed out that the Visegrad States, especially Poland, received the most FDI and Greenfield FDI inflows in the sample of Emerging European Economies (EEEs), with a moderately high positive correlation between FDI and economic growth in Poland and the Czech Republic and a strong positive correlation in Slovakia. On the other hand, Western Balkans received substantially less FDI and Greenfield FDI with a weak correlation FDI – economic growth with the exclusion of Albania that had a strong positive correlation between Greenfield FDI and economic growth. Also, Ercegovac & Beker Pucar (2021a) find that greater Greenfield FDI inflows could be linked with a favorable external balance in the Visegrad group of countries, while Western Balkans have an unbalanced external position that is possibly connected to lower Greenfield FDI inflows. Recent work of Ercegovac & Beker Pucar (2022) indicates that the corona pandemic in the most of analyzed emerging countries had affected the sizeable downfall of Greenfield investments with disturbances in economic growth. Based on the correlation results of a strong and moderately high positive correlation in investigated sub-periods, authors highlight that greater Greenfield FDI inflows are the most significant and stimulating factor of economic development in the analyzed sample of Visegrad and Western Balkan countries, but also that achieved economic growth is a relevant determinant for attracting foreign investors. Mentioned findings of Ercegovac & Beker Pucar (2021, 2021a & 2022) implicate that substantial FDI and Greenfield FDI inflows could produce beneficial effects on the sustainable economic development and external position.

The objective of this panel data analysis is to test the positive impact of FDI inflows together with selected macroeconomic indicators on the economic growth in the selected sample of sixteen ex-transition Emerging European Economies to give some guidance toward economic

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policy creators in emerging economies. The focus of this research is to address the research problem of sustainable economic growth in emerging economies and give a contribution to the literature by observing FDI transmission effects and economic growth models. This research is relevant to the policymakers in emerging economies and especially in the Western Balkan region which received an insufficient level of FDI inflows compared to the Visegrad group of countries.

Minović & Jednak (2021) investigate the Granger causality relationship between economic growth, innovation (R&D expenditure) and FDI for the selected EU members (Bulgaria, Croatia, Hungary, Romania, Slovakia and Slovenia) and EU candidates (North Macedonia, Serbia and Turkey) for the period (2000-2017) with findings of a two-way relationship between economic growth and FDI, economic growth and innovation, and FDI and innovation. Vukmirović et al., (2021) emphasize the importance of FDI for the Serbian economy by analyzing the forecast results that indicate a gradual increase in GDP, FDI, competitive ranks and a decrease in the unemployment rate for the following 5 years. On the other hand, Vasa & Angeloska (2020) perform a correlation analysis covering Serbia in the period (2007-2018) with results of a very weak correlation between FDI inflows and the unemployment rate, a very weak correlation between FDI inflows and increased GDP growth with a strong correlation between GDP growth and industry growth.

In the Western Balkans in the past period, FDI inflows were mostly market seeking and directed in service sectors through privatization and acquisitions. This is in line with Cvetanović, Despotović & Milovanović (2018) that contended that receiving capital inflows in the Western Balkan countries was insufficient and that it is necessary to continue improvements in public institutions and business conditions. The Western Balkan countries need to furtherly improve infrastructure, regulation, government institutions, incentive measures and business environment with the purpose to attract higher volumes of FDI and Greenfield FDI inflows in favorable higher value-added sectors with innovative green technology that will stimulate sustainable development.

After the Introduction section, Section 1 presents the literature review, Section 2 contains information about data and used methodology, while Section 3 discusses the results of the panel data model. Concluding remarks are summarized within the last section.

2. LITERATURE REVIEW

This study investigates the factors of economic growth in Emerging European Economies with the crucial role of FDI inflows. Walkenforst (2004) stresses that multinational companies had a key part in the restructuring and transition of Central and Eastern European economies from socialistic centrally planned regimes to market-oriented economic systems. FDI inflows have numerous positive spillovers on the host economy, like accumulation of necessary capital, foreign currency inflows, new employment, a rise in productivity, better national competitiveness, entrance into Global Value Chains and exports increase, new technology transfer, labor training and overall economic development (see e.g. De Mello, 1999; Noorbakhsh, Paloni & Youssef, 2001; Durham, 2004; Crespo & Fontura, 2007; Denisia, 2010). Darmo, Novak & Lisy (2020) contended that the FDI inflows are related to various positive effects e.g. growing gross domestic product (GDP) and reduced unemployment rate in the host country. Gerschewski (2013) indicates that emerging economies tend to bring more FDI inflows because of potential beneficial
effects such as greater productivity or the transfer of contemporary technology. The empirical research that gives support to FDI’s positive transmission effects on the economic growth are Borensztein, De Gregorio & Lee (1998), Li & Liu (2005), Dabla-Norris et al. (2010), Pegas, 2015; Iamsirarjo & Ulubasoglu, 2015; and Iamsirarjo, 2016. Also, in the relevant literature, there is evidence that Greenfield FDI inflows had a positive impact on the real economy (see e.g. Wang & Wong, 2009; Neto, Brandao & Cerqueira, 2010; Harms & Meon, 2014; Luu, 2016; and Bayar, 2017).

Hanousek, Kočenda & Vozarova (2020) found that FDI inflows can impact the domestic firms through competition and productivity channels and export spillovers, but effects are not always beneficial due to the crowding-out effect on domestic suppliers and intensification of competition level. Geršl, Rubene & Zumer (2007) stated that benefits from FDI spillovers to domestic firms like increased employment and output levels depend on the absorptive capacity of domestic firms. Blomstrom & Kokko (1997) found that positive FDI effects on the economic growth are stronger in countries with high levels of income per capita and that transmission effects differ due to industry characteristics, financial sector development and business conditions in the host country. Colak & Alakbarov (2017) emphasized that FDI spillovers on the economic growth and employment depend on FDI type and investment sector. According to Silajdzic & Mehic (2015), the positive connection between the FDI and economic growth is related to the level of labor knowledge and investors’ motivation for higher efficiency. Namely, foreign investors search for locations that are offering high-quality human capital and a skilled workforce (Klimek, 2020). Javorcik (2020) points out that an FDI-friendly host economy is characterized as stable and transparent. It can be summarized that FDI’s impact on higher economic growth is conditioned by economic development, human capital, the absorptive capacity of domestic firms, the type of FDI and the investment sector in the host country.

The research of Kosztowniak (2016) backed up the assumption of bi-directional relationship between FDI and GDP in the case of Poland, with the conclusion that GDP had a stronger impact on attracting FDI inflows than vice versa. Dorozynski & Kuna-Marszalek (2016) focus on the Visegrad Group of countries as attractive FDI locations with the conclusion that relevant factors for foreign investors were skilled labor, assistance schemes and well-developed infrastructure.

Stančík (2009) investigated the case of the Czech Republic and found that the EU integration process influenced the sign and magnitude of FDI spillover effects and positive forward spillovers were confirmed mainly in the years following the EU entrance. Geršl & Hlavaček (2007) showed that FDI acquisitions in Czech companies increased the profitability of the domestic companies with the benefits of intra-group financing the corporate growth through loans of the parent company. In the example of Baltic countries, Shkabarin (2015) contended that small open economies accessing the EU might have negative forward FDI spillovers combined with positive backward externalities. Skare & Cvek (2020) indicated that a sizeable amount of FDI in the Republic of Croatia had no significant effect on the country’s competitiveness and economic growth, due to FDI sector distribution (mainly services) and lower levels of Greenfield FDI investments. Also, Mencinger (2003) showed evidence of a negative correlation between FDI and economic growth in analyzed transition countries, since FDI was dominant via privatizations and acquisitions without a significant increase in employment and real assets. Brada & Tomšík (2009) researched FDI and reinvested earnings from FDI in the sample of eight transition economies and highlighted a connection with large distortions in their current account deficits. Furtherly, Popescu (2010) added that FDI inflows are related to wage inequalities and growing competition and skill differences.
Zavarská (2022) stated that FDI can have a crucial role in the industrial upgrading and economic development of the Western Balkan countries via FDI inflows in higher value-added sectors and participation in the Global Value Chains through nearshoring. Uvalić & Cvijanović (2018) point out that the macroeconomic situation in the Western Balkans after the GFC has improved, but compared to the Central East European and Baltic countries, Western Balkan countries have still structural weaknesses and foremost more balanced economic development measures are needed. Moran (2014) highlighted that it isn’t enough for the host economy just to be open to FDI, it’s necessary to have targeting measures that will bring FDI inflows to the chosen sectors and produce higher unit-value exports. Government authorities in the Western Balkan economies should elaborate more efficient country-specific measures with a special focus on the sectoral distribution of FDI to diversify and elevate the production and export base. Estrin & Uvalić (2016) stressed that positive FDI effects on the Western Balkans as host economies depend on infrastructure development, institution quality, political stability, control of corruption, market size and labor education.

3. METHODOLOGY AND DATA

Panel data models are a relevant methodology that is broadly used in empirical studies because of the possibility of simultaneously combining cross-section data with time series. Baltagi (2005) stated that panel data models allow identifying and measuring the effects of investigated problem. There are two groups of panel data models divided by the time dimension and model specification assumptions: micro and macro panel data models (Eberhardt, 2011). This empirical study implements micro panel models that assume a shorter time dimension (often T<10 or fewer years), larger N dimension with more restrictive model specification assumptions compared to macro models i.e. homogeneity of regression parameters, independent errors and stationarity of variables.

3.1 Empirical Model

This study has the objective to provide an adequate contribution to the literature concerning the economic growth models and the role of FDI inflows together with selected macroeconomic indicators in achieving economic progress. The research subject and defined hypotheses are tested with a panel data approach as support for relevant government recommendations towards attracting favorable foreign investors and fastening the catching-up process in emerging economies.

In this paper, authors implement widely used micro panel models: Fixed individual effects (FE), Random individual effects (RE), FE with cluster corrected standard errors, Beck & Kats (1995) Panel Corrected Standard Errors and Driscoll & Kraay (1998) robust standard errors in FE estimation. Beck & Katz (1995) showed a Panel Corrected Standard Errors (PCSE) method that is based on POLS coefficient estimates and provides precise estimation because this method includes large T asymptotic based standard errors, which correct the contemporaneous correlation between the subjects, with good performance in small panels. If residuals are heteroscedastic and potentially autocorrelated, estimators (FE/RE) with cluster standard errors are widely applied. On the total sample (1997-2017) authors use the Driscoll & Kraay robust standard errors estimated by the FE method that is appropriate in larger time dimension panels with potential autocorrelation and heteroscedasticity of standard errors (Hoechle, 2007). This study also implements robust FE/RE estimation with cluster corrected standard errors and PCSE method.
on the two subsamples: pre-crisis (1997-2007) and post-crisis (2008-2017) to shorten the time dimension to be adequate for model application and to estimate differences in regression coefficients regarding the GFC and for the Visegrad group of countries. With panel data models with corrected standard errors authors test the following hypotheses:

**Hypothesis One:** The FDI net inflows are relevant source of financing the economic growth in selected Emerging European Economies.

**Hypothesis Two:** The selected macroeconomic indicators - inflation rate, government debt, external balance, REER, total factor productivity, labor productivity and tertiary education affect the economic growth in selected Emerging European Economies.

Regression equation for the Fixed individual effects model (FE) is as follows:

\[ y_{it} = \beta_{i} + \sum_{k=2}^{K} \beta_{k} x_{kit} + u_{it} \] (1)

where \( y_{it} \) is the dependent variable for individual \( i \) at time point \( t \), \( \beta_{i} \) is the heterogeneous free member that variates across individual units, \( \beta_{k} \) represents constant regression coefficients of independent variables \( x_{kit} \), and \( u_{it} \) is the standard error. The model includes the individual effects \( u_{it} \), i.e. heterogeneity of free members across individual units. The authors implement FE model with the dummy variable for the Visegrad States to estimate individual effects on a dependent variable across cross-section data. Heterogeneity of the analyzed sample of countries implies the estimation of the specified economic growth model with Fixed individual effects. The consistent estimation of \( \beta \) in FE is connected with the assumption of a non-correlation between the components of standard error \( u_{it} \) and the regressor \( x_{it} \) observed at any point in time. Barros et al. (2020) pointed out that the potential problem of endogeneity is often caused by the omission of important variables, measurement errors and simultaneity. The possible endogeneity problem between variables can be overcome with estimation by the Generalized Method of Moments (GMM).

The dependent variable is economic growth via the annual GDP growth rate (GDPgr). Research variables are chosen to test the hypotheses if FDI, inflation, public debt, trading balance, real exchange rate, productivity indicators and tertiary education, affect economic growth in selected EEEs. The estimated regression equation for FE can be presented as follows:

\[ GDP_{grit} = \beta_{1i} FDI_{it} + \beta_{2INF_{it}} + \beta_{3GD_{it}} + \beta_{4EB_{it}} + \beta_{5REER_{it}} + \beta_{6TFP_{it}} + \beta_{7LP_{it}} + \beta_{8SET_{it}} + u_{it} \] (2)

Given that this study investigates EEEs that went through the macroeconomic stabilization and transition process in the following period (1997-2017), the manuscript includes an estimation of the relationship with macroeconomic indicators like inflation, government debt, trading balance and real effective exchange rate. Also, productivity indicators and tertiary education as a proxy for labor quality are included in the model to test their significance and form a model with a wide range of variables.

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4 The independent variables in the analyzed economic growth model are: FDI - FDI net inflows in GDP, INF - annual inflation rate, GD - general government debt in GDP, EB - trading balance in GDP, REER - real effective exchange rate, TFP - total factor productivity growth rate, LP - labor productivity growth rate and SET - tertiary school enrolment.
3.2 Data

The research sample includes Western Balkan countries that are converging towards the Europe Union (EU) together with emerging economies that became the EU members in 2004, 2007 and 2013 (Hungary, Poland, Czech Republic, Slovakia, Slovenia, Estonia, Lithuania, Latvia, Bulgaria, Romania and Croatia). The panel data model is estimated in the total sample level and the two sub-periods regarding GFC to shorten the time dimension to be more appropriate for micro panel models and estimate the effects of the structural break. Countries in the selected sample of EEEs (N=16) in the period 1997-2017 (T=21) differ by development level and convergence pace. Visegrad States (V4) after the entry into the EU (2004) received the significant volumes of FDI and Greenfield FDI inflows following real convergence progress, so the authors intend to test the significance of the FDI in the economic growth model with the use of dummy variable for the V4 subsample in the two mentioned sub-periods.

The data for the dependent variable – annual GDP growth rate was obtained from The World Bank – The World Development Indicators database. The data for the independent variables in the economic growth model was collected from the following Internet databases:

1) The World Development Indicators Database:
   - FDI - percent share of FDI net inflows (inflows-outflows) in GDP;
   - INF - annual inflation rate (consumer prices);
   - EB – percent share of external balance on goods and services in GDP;
   - SET – gross percent of school enrolment tertiary i.e. share of college enrolment in total population of age 18-26;

2) The International Monetary Fund Database:
   - GD – percent share of general government debt in GDP;

3) The Bruegel Datasets:
   - REER - real effective exchange rate (an increase in the index indicates appreciation of the home currency against the basket of currencies of trading partners; index drop represents real depreciation of the national currency concerning currency basket of trading partners; CPI based on 67 trading partners; 2007 is the base year).

4) The Conference Board Total Economy Database:
   - TFP - total factor productivity growth rate (GDP growth decreased for labor quantity contribution, labor quality contribution and total capital services contribution);
   - LP – labor productivity growth rate per employee (output growth by employed worker);

4. PANEL DATA RESULTS

Specification tests and model estimations are performed with Stata/SE 12.0 software program. The results of the panel model estimations and related specification tests are presented in Table 1. According to the specification tests (Table 1) in the model are present fixed individual effects and random individual effects, but the results of Hausman’s (1978) specification test with a p-value under 0.05 indicate that FE estimation is optimal with consistent estimation in both sub-periods. The results of the F test (Table 1) indicate that both sub-periods present significant individual effects in the fixed-effects model. Based on results of modified Wald statistics (Baum, 2001) for the group heteroscedasticity (Table 1) that has p values less than 0.05, it can be pointed out that in both sub-periods, is present heteroscedasticity of standard errors in the model. In Table 1 authors present following autocorrelation tests: Jochmans Portmanteau test and Born-Breitung Bias corrected HR test (Jochmans & Verardi, 2019; Born & Breitung, 2016). Jochmans
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Portmanteau test with p values above 0.05 suggests an absence of residual standard error autocorrelation in the pre and post-crisis period. On the other hand, results of the Born-Breitung Bias corrected HR test with a p-value less than 0.05 indicate a presence of standard error auto-correlation type AR1 in analyzed sub-periods. The results of the heteroscedasticity and autocorrelation tests imply heteroscedasticity and potential autocorrelation of standard errors with direction to apply the micro panel models with corrected standard errors like cluster(id)FE, PCSE and Driscoll & Kraay FE.

Table 1. The panel data model of Economic growth

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<tr>
<td></td>
<td>cluster(id) FE</td>
<td>PCSE method</td>
<td>cluster(id) FE</td>
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<tr>
<td>Variables</td>
<td>coeff.</td>
<td>p - value</td>
<td>coeff.</td>
</tr>
<tr>
<td>FDI</td>
<td>0.1080</td>
<td>0.228</td>
<td>0.0438</td>
</tr>
<tr>
<td>FDI VS0</td>
<td>0.2396***</td>
<td>0.002</td>
<td>0.1172</td>
</tr>
<tr>
<td>FDI VS1</td>
<td>-0.0399***</td>
<td>0.006</td>
<td>-0.0216</td>
</tr>
<tr>
<td>INF</td>
<td>0.0094**</td>
<td>0.005</td>
<td>0.0100**</td>
</tr>
<tr>
<td>GD</td>
<td>0.0137</td>
<td>0.032</td>
<td>0.0084</td>
</tr>
<tr>
<td>EB</td>
<td>-0.0094</td>
<td>0.839</td>
<td>-0.0435</td>
</tr>
<tr>
<td>REER</td>
<td>-0.0322</td>
<td>0.376</td>
<td>-0.0214</td>
</tr>
<tr>
<td>TFP</td>
<td>0.7576***</td>
<td>0.000</td>
<td>0.7480***</td>
</tr>
<tr>
<td>LP</td>
<td>0.2088</td>
<td>0.282</td>
<td>0.1152</td>
</tr>
<tr>
<td>SET</td>
<td>0.0855**</td>
<td>0.012</td>
<td>0.0570***</td>
</tr>
<tr>
<td>F test FE/ Wald chi² test RE</td>
<td>0.6584</td>
<td>0.6704</td>
<td>0.7016</td>
</tr>
<tr>
<td>p&lt;0.05 FE</td>
<td>130.990</td>
<td>0.000</td>
<td>198.660</td>
</tr>
<tr>
<td>Palais &amp; Breitung test</td>
<td>28.340</td>
<td>0.0004</td>
<td>0.05 Choice of FE</td>
</tr>
<tr>
<td>Modified Wald test</td>
<td>chi²=1699.25</td>
<td>Prob&gt; chi²=0.000</td>
<td></td>
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<tr>
<td>Jochmans Portmanteau test</td>
<td>chi²=16.000</td>
<td>Prob&gt; chi²=1.000</td>
<td></td>
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<tr>
<td>Born &amp; Kraay HR test</td>
<td>HR=2.560</td>
<td>p=0.010</td>
<td></td>
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<tr>
<td>p&lt;0.05 FE</td>
<td>-</td>
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<tr>
<td>p&lt;0.05 FE</td>
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<tr>
<td>Dependent variable: GDP gr - annual GDP growth rate; Independent variables: FDI - percent share of FDI net inflows (inflows-outflows) in GDP; INF - annual inflation rate; GD - general government debt in GDP; EB - external balance on goods and services in GDP; REER - real effective exchange rate; TFP - total factor productivity growth rate; LP - labor productivity growth rate per employee (output per employed person growth); SET - school enrolment tertiary.</td>
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<tr>
<td>Dummy variable for FDI: FDI VS1 - Visegrad Group; FDI VS0 - sample without Visegrad Group.</td>
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<td>P-values: * significant at 10%, ** significant at 5%, *** significant at 1%.</td>
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Source: Authors calculation with Stata/SE 12.00 program.

The comparative outlook of robust panel model estimations is presented in Table 1. Before the crisis, FE and RE methods indicate a positive significant link between greater FDI net inflows and GDP growth rate in the sample of EEEs, but the presence of heteroscedasticity and potential autocorrelation indicate considering only robust estimations. FE cluster standard errors and the PCSE method imply a positive FDI transmission effect but are insignificant in pre and post-crisis periods. FDI net inflows contribute to economic growth in EEEs but this impact wasn’t estimated as significant by the proposed model in the following sub-periods. According to results of micro panel methods with robust standard errors, before the GFC economic growth is in a positive and significant nexus with inflation, government debt, total factor productivity growth rate and tertiary-educated workforce. This suggests that in EEEs in the pre-crisis period economic
growth coincides with inflation overheating, greater government indebtedness, the accelerated rate of total factor productivity and the rise of higher educated labor. After the GFC, robust results indicate that economic growth rate is in a positive significant link with inflation and total factor productivity, while a negative significant link is evident with trading balance sum and labor productivity growth rate. Analyzing the results, it can be highlighted that in EEEs in the post-crisis period economic growth is significantly related to the rise of total productivity growth rate, moderate inflation overheating, external disbalance and lower labor productivity i.e. cheaper workforce.

The robust estimation with a dummy variable for the Visegrad States showed that in the pre-crisis period FDI net inflows are negatively connected with economic growth, while after the crisis FDI has a positive significant effect on the GDP growth rate in this subsample of countries, significant at 1%. Based on these findings, it can be concluded that after the crisis economies in the Visegrad group with larger volumes of FDI net inflows achieved greater economic progress i.e. Poland. This is in line with expectations and correlation analysis between FDI and GDP growth performed in Ercegovac & Beker Pucar (2021), where Poland had a moderately high positive correlation between FDI and economic growth in the analyzed period.

Estimation with Driscoll & Kraay (D&K) method on the total sample level (1997-2017) gives evidence of a positive and significant nexus between FDI net inflows and GDP growth rate, significant at 5%. The presented results of the D&K method and post-crisis results of the Visegrad group support the assumption that greater FDI net inflows are a relevant factor of economic growth in the EEEs and the Visegrad States after the GFC. According to the robust results of the D&K method, besides FDI relevant factors of economic growth in EEEs are inflation, government debt, external balance, total factor productivity growth rate and labor quality. Inflation, total factor productivity and highly educated labor are relevant variables in the model and positively related to economic growth, significant at 1%.

5. FUTURE RESEARCH DIRECTIONS

Directions for further research might be testing a Granger causality between FDI and GDP growth in EEEs, as well as estimating the proposed economic growth model with other relevant methodologies like Generalized Method of Moments (GMM) or heterogeneous panels models (Augmented Mean Group).

6. CONCLUSION

This research provides empirical evidence supporting the assumption that FDI inflows positively affect economic growth in selected Emerging European Economies (EEEs) and the Visegrad States after the GFC. Presented results contribute to the existing literature on the FDI transmission effects and as such are interesting to a broad range of researchers and government policymakers. The focus of this panel data research is the direct nexus between FDI and GDP growth as well as the impact of selected macroeconomic indicators like inflation, government debt, external balance, REER, total factor productivity and tertiary educated labor on the economic growth in EEEs. Research showed that besides FDI relevant factors of economic growth in EEEs are inflation, government debt, external balance, total factor productivity growth rate and labor quality. Inflation overheating, government indebtedness, external disbalance, total factor productivity growth and highly educated labor are relevant variables related to economic
growth. The empirical results are obtained via micro panel estimators with corrected standard errors: cluster(id) FE, PCSE and Driscoll & Kraay FE. The comparative study of different panel estimators for selected EEEs is performed in the longer period (1997-2017), together with two sub-periods in regard to GFC (1997-2003 and 2008-2017) and with the use of a dummy variable for Visegrad group of countries.

The empirical findings are in purpose of giving useful guidance to the policymakers in emerging economies and the Western Balkans. Economic policy recommendations are directed in adequate measures to promote significant FDI inflows, and improve the total factor productivity level and labor quality in order to boost further real convergence process. Western Balkans should enforce a sustainable growth policy with stronger improvements concerning infrastructure, regulation, institutions, business environment, labor education and incentive measures for investments. Moreover, intense regional cooperation in the area of R&D, energy, transport and agriculture has the potential to furtherly stimulate the economic development of the region and attract FDI in higher-value-added industries. A stable macroeconomic situation, favorable business conditions and promotion of human capital development are the necessary preconditions for attracting FDI and speeding up the catching-up process.

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