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THE IMPACT OF FOREIGN DIRECT INVESTMENT ON THE ECONOMIC GROWTH OF THE REPUBLIC OF SRPSKA

Summary: *This research aims to explore the impact of foreign direct investment (FDI) on gross domestic product (GDP) per capita in The Republic of Srpska. Through data analysis from the period 2020-2023, using correlation, regression, and ANOVA analysis, we investigate the complex relations among these key variables of economic development. Our goal is to understand whether and to what extent foreign investments contribute to the economic growth of this region and what the impact of the COVID-19 pandemic and high inflation has been on this relation. Responding to this research question, our analysis indicates a strong positive correlation between FDI and GDP per capita, implying a significant positive impact of foreign investments on economic growth in The Republic of Srpska. Regression analysis further confirms this conclusion, showing that any increase in foreign direct investment results in an increase in GDP per capita. We have also identified the negative impact of the COVID-19 pandemic and high inflation on investments and GDP, highlighting the need for adequate policies and strategies to support economic recovery and sustainable growth.*

Key words: *foreign direct investment, GDP per capita, The Republic of Srpska, economic growth, COVID-19 pandemic, inflation*

JEL classification: *E22, F21*

INTRODUCTION

In today's globalized economic environment, foreign direct investments (FDI) play a crucial role in the economic development of many countries, including The Republic of Srpska. This segment of investment has become a significant driver of growth, job creation, and overall economic stability. FDIs bring foreign capital, technology, expertise, and access to international markets, which can significantly contribute to the economic prosperity of a country. The Republic of Srpska, an entity of Bosnia and Herzegovina, faces challenges and opportunities in its economic development process. After periods of transition and conflicts, this region aims for stabilization and improvement of its economic foundation. In this context, the role of foreign direct investments becomes increasingly significant. Analyzing the impact of FDI on the economic growth of The Republic of Srpska is crucial to understand the dynamics of the economy of this region and identify potential paths for sustainable growth and development. In this research, we will explore how foreign direct investments influence the economic growth of The Republic of Srpska. The central aim of the research is to analyze the relation between FDI and gross domestic product (GDP) and identify factors that can modulate this relation.

Additionally, we will consider the implications of the COVID-19 pandemic and high inflation on investments and economic growth in The Republic of Srpska. Our approach is multidisciplinary and will encompass empirical data, theoretical concepts, and policy implications to provide a comprehensive insight into this topic. The key focus of our research is to understand the complex mechanisms underlying the relation between foreign direct investments and economic growth in The Republic of Srpska. Empirical data will provide the foundation for our analysis, allowing us to examine the actual state and trends regarding FDI and GDP in The Republic of Srpska. Theoretical concepts will help us interpret these data and create a framework for understanding the mechanisms underlying this relation. Policy implications will enable us to consider the broader context and understand how political and regulatory frameworks can affect the attractiveness of foreign investments and their contribution to economic growth. Our goal is to identify key guidelines for the economic growth and prosperity of The Republic of Srpska. This involves not only identifying challenges and obstacles but also recognizing opportunities and potential for further development. Through our multidisciplinary approach, we aim to provide a comprehensive insight that will benefit policymakers, the academic community, and the general public in understanding the complexity and potential of foreign investments for the economic development of The Republic of Srpska.

1. LITERATURE REVIEW

The influence of foreign direct investments (FDI) on economic growth is a topic that has attracted significant attention from researchers worldwide. FDIs are often considered a key driver of economic development, especially in developing countries. Various studies have explored this relation through different methodologies and analytical approaches, providing rich insights into the factors affecting the effectiveness of FDIs (Aizenman and Noy 2006; Alfaro and Charlton 2009; Alfaro, Kalemli-Ozcan and Volosovych 2007; Asiedu 2002; Azman-Saini et al. 2010; Balasubramanyam, Salisu and Sapsford 1996; Bengoa and Sánchez-Robles 2003; Bevan, Alan and Estrin 2004; Blonigen and Wang. 2005; Busse and Hefeker 2007; Carkovic and Levine 2002; Cheng 2017; Choe 2023; Choong and Lam 2010; Cleeve, Debrah and Yeboah. 2015; Djankov, McLiesh and Shleifer 2007; Dunning and Lundan 2008; Duvnjak 2020, 52; Gliberman and Shapiro 2002; Goergen, Renneboog and Roosenboom 2008; Herzer, Klasen, and Nowak-Lehmann 2008; Jensen 2003; Li and Resnick 2003; Lipsey and Sjöholm 2011; Lipsey 2002; Makki and Somwaru 2004; Mencinger 2003; Mody and Murshid 2012; Nunnenkamp and Spatz 2003; Olson 2014; Pelinescu and Radulescu 2009; Ram and Zhang 2002; Resmini 2000; Sridharan, Vijayakumar, and Rao 2009; Sylwester 2005; Tang 2008; Vu, Tu-Anh, Bernard and Nguyen 2008; Wang 2009; Zhang 2001). One of the key studies investigating the impact of FDIs on economic growth is the research by Borensztein and King, which demonstrated that FDIs significantly contribute to GDP growth in countries with stable political environments and developed institutional frameworks (Borensztein and King 2020). Similarly, Alfaro et al. highlighted that the positive impact of FDIs on growth is most pronounced in countries with well-developed financial markets (Alfaro et al. 2004). The mechanisms through which FDIs influence economic growth have also been extensively researched. One key mechanism is technology transfer. Blomstrom, Lipsey, and Zejan showed in their study that the presence of multinational companies in host countries leads to significant technology and knowledge transfer, contributing to increased productivity of local firms (Blomstrom, Lipsey and Zejan 1996). This research emphasizes the importance of technological progress as a mediator in the relation between FDIs and economic growth. Factors influencing the attractiveness of FDIs are also crucial to understanding their impact. Political stability and institutional quality are among the most important factors. Kaufmann and Kraay showed that countries with better institutional environments attract more FDIs, resulting in higher rates of economic growth (Kaufmann and Kraay 2002). Additionally, Asiedu highlighted that African countries with stable political systems and transparent regulatory frameworks

succeed in attracting more FDIs (Asiedu 2006). Regional studies provide specific insights into the dynamics of the impact of FDIs. Campos and Kinoshita analyzed the impact of FDIs on countries in Eastern Europe and concluded that FDIs have a positive impact on economic growth, especially in sectors where domestic firms have a low technological base (Campos and Kinoshita 2002). This study demonstrates how FDIs can help countries with low levels of technology to improve their industrial capacities and stimulate economic growth. Although many studies point to the positive effects of FDIs, there are also critical reviews. Rodrik emphasized that the impact of FDIs may be overestimated if negative effects such as market monopolies and profit repatriation are not taken into account (Rodrik 2008). This critical view underscores the need for a more detailed consideration of the potential negative aspects of FDIs to obtain a more comprehensive picture of their impact. Considering the impact of FDIs on economic growth, it is important to take into account specific mechanisms through which these investments operate. For example, the presence of foreign firms can contribute to the improvement of local infrastructure. Investments in infrastructure not only directly improve the business climate but also indirectly stimulate economic growth by increasing efficiency and reducing business costs. Increasing productivity is another key mechanism. FDIs often lead to the introduction of advanced technological solutions and better managerial practices, which can significantly enhance the productivity of local firms. Job creation is another important aspect of the impact of FDIs. Foreign investments often lead to the creation of new jobs, not only directly in foreign companies but also indirectly through the development of related sectors and services. This can have a positive impact on the local population, increasing their income and standard of living. The role of the state in promoting FDIs is also crucial. Political stability, efficient regulatory framework, and positive business culture are key elements that attract foreign investors. Countries that successfully combine these factors often experience a higher influx of FDI. For example, research shows that countries with stable political systems and transparent legislative frameworks tend to attract more foreign investments. In addition to political and institutional factors, economic factors play a significant role. A large market and high growth potential are attractive to foreign investors. Also, countries with developed financial markets have a greater ability to leverage the benefits of FDIs because they can better support the activities of multinational companies. In the context of The Republic of Srpska, these findings suggest the need to focus on strengthening institutional capacities and creating a favorable business environment to maximize the benefits of FDIs. Methodological approaches used in studies on the impact of FDIs on economic growth vary from econometric models to case studies. Econometric models often use panel data to analyze the long-term effects of FDIs on economic growth. For example, Borens and King's research uses panel data to analyze the impact of FDIs on economic growth in developing countries. On the other hand, case studies provide detailed insights into specific contexts and factors influencing the effectiveness of FDIs in certain countries or regions. In this paper, we will present the research methodology, as well as the limitations arising from it, with the aim of a detailed analysis of the position and impact of FDIs on the economic growth of The Republic of Srpska. Research limitations include data availability, variations in economic policy and institutional frameworks, as well as specific characteristics of the economy of The Republic of Srpska. However, despite these limitations, the goal is to provide a comprehensive analysis that will illuminate the key aspects of the impact of FDIs on economic growth and help formulate effective policies for attracting and optimizing the use of FDIs. Through the synthesis of empirical data and theoretical concepts, this research contributes to understanding the complex dynamics between foreign investments and economic growth in the context of the specificity of The Republic of Srpska. This research will be useful not only for the academic community but also for policymakers and investors seeking a deeper understanding of the impact of FDIs and how best to exploit their potential for economic development. The research also provides a significant contribution to understanding the dynamics between foreign investments and economic growth in The Republic of Srpska. Understanding these mechanisms and factors is crucial for formulating effective policies and

strategies that could enhance economic growth by promoting foreign investments. Through the synthesis of empirical data and theoretical concepts, the paper contributes to a better understanding of the complex interaction between FDIs and economic development. Ultimately, the goal of this research is to provide concrete recommendations for policymakers in The Republic of Srpska to attract and utilize foreign investments in a way that maximizes economic benefits and ensures necessary sustainable economic growth. Understanding the specific needs and potentials of The Republic of Srpska is crucial for creating tailored strategies that will enhance the business environment and attract high-quality FDIs.

2. RESEARCH METHODOLOGY

Considering the comparative and descriptive analysis, we rely on detailed correlation and regression analysis. In the linear regression model, the regression equation is expressed as:

$$Y_i = \beta_0 + \beta_1 * x_i + \epsilon_i \quad (i = 1, \dots, n)$$

where the index (i) denotes the i-th observation, (X) represents the independent explanatory variable, and (Y) represents the dependent variable. We aim to explain variations in the dependent variable (Y) based on the independent variable (X). The assessment of the simple linear regression function based on the sample is typically expressed as: $\hat{Y}_i = b_0 + b_1 x_i$, where \hat{Y}_i is the value of the dependent variable located on the best-fitting regression line, while b_0 and b_1 are estimates of the unknown regression parameters of the underlying population. Regression and correlation analysis of investments, along with other analyses of GDP and its components, aim to answer the hypothesis that foreign direct investments accelerate the GDP growth of The Republic of Srpska. This analysis includes the following indicators: mean, median, maximum value, minimum value, standard deviation, probability, skewness, kurtosis, standard error, correlation coefficient, t-statistic, and F-statistic. Additionally, the Durbin-Watson (D.W.) statistic is used to measure serial correlation between residuals. The value of the D.W. statistic ranges from 0 to 4. The F-statistic is used to test the significance of all variables in the model simultaneously. The model is considered statistically significant if the value of the F-statistic is greater than the critical value from the appropriate table. Also, the p-value should be less than 0.05 for the model to be statistically significant. The null hypothesis is rejected if no variable in the model is statistically significant. In addition to statistical analyses, we will also use comparative and descriptive methods to thoroughly analyze the investment structure and ensure the relevance of the research, as well as to validate the hypothesis.

3. RESULTS AND DISCUSSION

In the context of the analysis presented in the table, the dependent variable is Gross Domestic Product (GDP) per capita, while the independent variables are foreign direct investments (FDI) expressed in KM. Here, it is assumed that foreign investments influence the Gross Domestic Product, meaning that an increase in FDI can be reflected through the growth of GDP per capita.

Table 1. Macroeconomic Parameters of The Republic of Srpska for the Period 2021-2023 in 000 KM (The Republic of Srpska Institute of Statistics)

Year	Foreign Direct Investments (FDI)	GDP per capita
2023	440.000	14.077
2022	394.100	12.975
2021	211.000	11.078
2020	285.100	9.797
2019	209.100	9.848

Table 1 provides insight into key macroeconomic parameters of The Republic of Srpska for the period from 2019 to 2023, with a special focus on foreign direct investments (FDI) and gross domestic product (GDP) per capita. A significant increase in FDI is observed during most of the observed period, except for 2021, when there is a noticeable decrease in investments. A possible cause of this decline could be the COVID-19 pandemic, which has caused economic uncertainty and business restrictions. Additionally, the high inflation during this period should be considered, as it may affect the real value of GDP per capita. Further research focused on regression and correlation analysis would allow for a better understanding of the relation between foreign investments and GDP. These analytical tools enable the identification and quantification of the impact of FDI on the economic growth of The Republic of Srpska, taking into account other factors that may affect GDP, such as inflation, unemployment, and economic policies. Through such analysis, key factors contributing to or limiting economic growth can be identified, which can be essential for formulating economic development policies and strategies. This focused analysis provides deeper insight into the dynamics of the economy of The Republic of Srpska and allows for more precise prediction of future economic trends.

Table 2. Descriptive Statistics (calculated using IBM SPSS26 by the authors)

	Mean	Std. Deviation	N
BDPperCapita	11555,0000	1911,07470	5
FDI	307860,0000	105536,40604	5

Table 2 provides statistical data on Gross Domestic Product (GDP) per capita and Foreign Direct Investment (FDI) in The Republic of Srpska for the observed period. The average value of GDP per capita is 11,555 KM, with a standard deviation of approximately 1,911 KM. The standard deviation reflects the variability of GDP per capita values in the sample. A high standard deviation may indicate variability in economic performance during the observed period. The average value of Foreign Direct Investment is 307,860 KM, with a standard deviation of approximately 105,536 KM. A high standard deviation suggests significant variability in the amounts of foreign investment during the observed period. The sample covers five observed years or periods. This sample enables statistical analysis of trends in GDP per capita and foreign direct investment during the observed time frame. Overall, these statistical data provide insight into the mean values and variability of GDP per capita and foreign direct investment in The Republic of Srpska. This analysis can be useful for monitoring economic development and identifying potential factors influencing these economic indicators.

Table 3. Correlation Statistics (calculated using IBM SPSS26)

	BDPperCapita	FDI
Pearson Correlation	BDPperCapita	1,000
	FDI	,881
Sig. (1-tailed)	BDPperCapita	,024
	FDI	,024
N	BDPperCapita	5
	FDI	5

From Table 3, the correlation coefficients between Gross Domestic Product (GDP) per capita and Foreign Direct Investment (FDI) in The Republic of Srpska are visible. Here are a few key points:

- The Pearson correlation coefficient between GDP per capita and FDI is 0.881. This indicates a strong positive correlation between these two variables.
- The p-value for the correlation between GDP per capita and FDI is 0.024, which is less than the conventional significance threshold of 0.05. This means there is a statistically significant correlation between these variables.
- These results suggest that there is a strong linear relation between GDP per capita and foreign direct investment in The Republic of Srpska. When foreign direct investment increases, GDP per capita is expected to increase as well, and vice versa.
- Considering this correlation, it is important to further explore the cause-and-effect relation between these variables and identify additional factors that may influence their relation.

Overall, this correlation analysis provides insight into the nature of the relation between GDP per capita and foreign direct investment in The Republic of Srpska, which can be crucial for understanding the economic dynamics of this region.

Table 4. Model Summary (calculated using IBM SPSS26)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				Sig. F Change	Durbin-Watson
					R Square Change	F Change	df1	df2		
1	,881 ^a	,776	,701	1045,21982	,776	10,372	1	3	,049	2,698

Table 4 presents the results of the regression model investigating the relation between Foreign Direct Investment (FDI) as a predictor and Gross Domestic Product (GDP) per capita as the dependent variable. Here are the key points:

- The coefficient of determination (R-squared) is 0.776, indicating that approximately 77.6% of the variation in GDP per capita can be explained by the variation in foreign direct investment. This suggests that the model relatively well explains changes in GDP per capita.
- The adjusted coefficient of determination (adjusted R-squared) is 0.701. This is a corrected version of R-squared that takes into account the number of predictors and the number of observations in the model. The closer the adjusted R-squared is to 1, the better the model fits the data.
- The standard error of the estimate is 1045.21982. This is a measure of the average prediction error of the model. Smaller values indicate more accurate predictions.
- The model's F-statistic is 10.372, with a p-value of 0.049. This measure indicates the overall significance of the model. A p-value less than 0.05 suggests that the model has a statistically significant impact on the dependent variable.
- The Durbin-Watson statistic is 2.698. This statistic is used to check for the presence of serial correlation in the model's residuals. Values close to 2 indicate the absence or minimal presence of serial correlation.

Overall, the results of the model suggest that foreign direct investment has a significant impact on Gross Domestic Product per capita in The Republic of Srpska, with the model relatively well explaining changes in this economic variable.

Table 5. Correlation Statistics (calculated using IBM SPSS26)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11331372,611	1	11331372,611	10,372	,049 ^b
	Residual	3277453,389	3	1092484,463		
	Total	14608826,000	4			

In Table 5, the analysis of variance (ANOVA) for the regression model examining the influence of Foreign Direct Investment (FDI) on Gross Domestic Product (GDP) per capita is presented. Here are the key points:

- The sum of squares for regression is 11,331,372.611, while the sum of squares for residuals is 3,277,453.389. These values indicate the variability in the data explained by the model (regression) and the variability that remains unexplained by the model (residuals).
- The total sum of squares is 14,608,826.000, representing the total variability in the dependent variable.
- The F-value for regression is 10.372, with a p-value of 0.049. This indicates the statistical significance of the regression model. A p-value less than 0.05 suggests a statistically significant difference between the explained and unexplained variability, meaning that the model has a significant impact on the dependent variable.
- These results suggest that there is a statistically significant impact of Foreign Direct Investment on Gross Domestic Product per capita in The Republic of Srpska, confirming the significance of the regression model.

Overall, these results support the conclusions of the previously presented regression model, highlighting the statistical significance of the influence of Foreign Direct Investment on GDP per capita in The Republic of Srpska.

Table 6. Coefficients (calculated using IBM SPSS26)

Model	Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error				Zero-order	Partial	Part	Tolerance	VIF
1 (Constant)	6645,218	1594,556		4,167	,025					
FDI	,016	,005	,881	3,221	,049	,881	,881	,881	1,000	1,000

This table displays the regression coefficients for the model examining the impact of Foreign Direct Investment (FDI) on Gross Domestic Product (GDP) per capita in The Republic of Srpska. Here are the key points:

- The model's constant (Constant) is 6645.218 with a standard error of 1594.556. This is the intercept of the model, representing the value of GDP per capita when all predictor values are zero.
- The coefficient for FDI is 0.016 with a standard error of 0.005. The standardized coefficient (Beta) for FDI is 0.881. This suggests that for every one-unit increase in Foreign Direct Investment, GDP per capita increases by approximately 0.016 units. The

standardized coefficient allows for comparing the relative impact of different predictors on the dependent variable.

- The T-statistic for FDI is 3.221, with a p-value of 0.049. This indicates the statistical significance of the FDI coefficient at the 0.05 significance level, meaning that the FDI coefficient is statistically significant.
- Regarding correlations, there is a high correlation (0.881) between FDI and GDP per capita. This further confirms the results of the previous correlation analysis.
- Collinearity Statistics provide information on multicollinearity among predictors. The tolerance is 1.000, indicating the absence of multicollinearity. The variance inflation factor (VIF) is also 1.000, confirming the absence of multicollinearity issues.

We can evaluate the linear relation based on the model:

$$\hat{Y}_i = b_0 + b_1 X_{1i}, \quad i=1, \dots, 5$$

From the analysis using statistical software, we obtained that $b_0=6645.218$; $b_1=0.016$, thus the regression equation is:

$$Y = 6645,218 + 0,016X_1$$

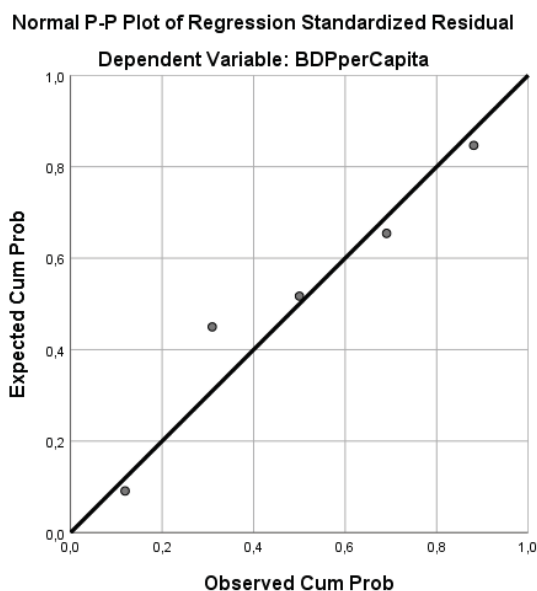


Image 1. Scatter plot (authors)

From the regression equation, it's evident that if investments increase by 1%, the GDP of The Republic of Srpska will increase by 0.016%. This confirms the hypothesis that foreign investments have a positive impact on the GDP of RS. Overall, these results demonstrate a statistically significant influence of Foreign Direct Investment on Gross Domestic Product per capita in The Republic of Srpska, which is consistent with previous analyses. The scatter plot, illustrating the distribution of points relative to the regression line, provides a visual depiction of the relation between foreign direct investment (FDI) and gross domestic product (GDP) per capita in The Republic of Srpska. If the points are clustered closely around the regression line, it indicates a strong positive or negative correlation between the two

variables. In this case, it implies a strong positive correlation between FDI and GDP per capita. The concentration of points around the regression line suggests that changes in foreign direct investments directly influence changes in GDP per capita, and the regression line represents the best-fitting line that describes this relation. Such a distribution of points confirms the results of previous analyses, further emphasizing the importance of foreign investments for the economic growth of The Republic of Srpska. This finding also provides a basis for confidence in the validity of the regression model considered, confirming its ability to predict changes in GDP per capita based on changes in foreign direct investments. Overall, the scatter plot provides a clear visual confirmation of the statistical analyses and regression model results, strengthening our confidence in the conclusions regarding the positive impact of foreign investments on the economic growth of The Republic of Srpska.

CONCLUSION

This research analysis extensively explored the impact of foreign direct investments (FDI) on gross domestic product (GDP) per capita in The Republic of Srpska. Through correlation, regression, and ANOVA analysis, we investigated the complex relations between these key variables of economic development. Our analysis revealed a strong positive correlation between FDI and GDP per capita, indicating a significant influence of foreign investments on economic growth in The Republic of Srpska. Regression analysis further confirmed this influence, showing that any increase in foreign direct investments results in an increase in GDP per capita. These results support the conclusion that foreign investments play a crucial role in the economic development of The Republic of Srpska. We also observed that during the COVID-19 pandemic and periods of high inflation, investments and GDP in The Republic of Srpska were significantly affected. The pandemic led to a decrease in foreign direct investments, which could have contributed to slowing economic growth. High inflation also had a negative impact on the economy, hindering the growth of GDP per capita. These factors are important for understanding the dynamics of economic development in The Republic of Srpska and for formulating adequate policies and strategies to mitigate their negative effects. Considering the obtained results, we can conclude that foreign direct investments play a key role in the economic development of The Republic of Srpska, especially in the context of global changes and challenges such as the pandemic and inflation. Policies that encourage foreign investments and create a favorable business environment can be essential for maintaining sustainable economic growth in this region. It is also important to continue researching and monitoring the effects of investments on other economic indicators, such as unemployment rates and economic inequality, to ensure a comprehensive approach to economic development in The Republic of Srpska. Through this analysis, we have raised numerous questions for further research. For example, further research could focus on identifying specific sectors that contribute most to economic growth through foreign investments, as well as analyzing the long-term effects of these investments on the structure and competitiveness of the economy. Additionally, research could explore the role of domestic investments and policies supporting domestic entrepreneurship in achieving sustainable economic development. Taking all this into account, we conclude that further research is crucial for understanding the complex mechanisms of economic development in The Republic of Srpska and for formulating policies that will support the long-term economic prosperity of this region. Given the results and implications mentioned, we recommend further research in this field to better understand the dynamics and factors influencing economic growth in The Republic of Srpska. This analysis provides a basis for further discussions and actions aimed at improving the economic situation in this region.

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