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Foreign Direct Investment in Latvia and Serbia: A Comparative Analysis

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Abstract

The main purpose of this study is to compare foreign direct investment (FDI) patterns in Latvia and Serbia, examining underlying trends, institutional frameworks, and historical contexts that shape investment dynamics. By analyzing regulatory structures, incentive schemes, and investment structure and dynamics, we synthesize best practices and policy recommendations for fostering sustainable investment inflows in both countries.

The study employs a comparative case study approach to analyze institutional frameworks related to FDI, as well as the performance of foreign affiliates and the dynamics of FDI inflows in Latvia and Serbia, focusing on the period from 2010 to 2023. Utilizing descriptive statistical methods and data from central banks, national statistical offices, and international organizations, the research examines trends, structures, and origins of FDI, connecting them to historical contexts and institutional and economic factors.

Despite their disparate historical contexts, both countries share a common thread in their transition toward market-oriented economies, marked by proactive policies aimed at attracting foreign investment. Our study shows how divergent approaches in integration and regulatory harmonization impact patterns, structures, and dynamics of foreign direct investment.

Our research proposes tailoring FDI frameworks and incentive policies to leverage the strengths and address weaknesses in Latvia and Serbia. For Latvia, expanding economic diplomacy and supporting existing foreign affiliates could enhance investment retention and attraction, particularly from non-European Union (EU) countries. For Serbia, policies should prioritize FDI in technology-intensive and high-value-added sectors, supported by digitalization, workforce development, and regulatory alignment with the EU.

The study provides a unique quantitative and qualitative comparison of factors that affect the FDI inflows, dynamics, and structure of those inflows in Latvia and Serbia, contributing to understanding the options of policymakers in transition economies for attracting investments and ensuring that they have positive effects on economic development.

Keywords: foreign direct investment, investment promotion, institutional quality, Serbia, Latvia

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Introduction

Foreign direct investment (FDI), particularly when associated with technological progress, plays an important role in capital accumulation, serving as a catalyst for economic integration, development, and growth. This fundamental principle underscores why attracting foreign investment remains a prominent policy goal for most transition economies. This emphasis stems from recognizing the potential of FDI to introduce advanced technologies, managerial expertise, and access to global markets, thereby enhancing productivity and stimulating economic transformation. Consequently, policymakers in these transition economies, including Serbia and Latvia, prioritize the creation of a conducive investment climate and the implementation of targeted policies to attract foreign investors and stimulate FDI inflows.

FDI decisions are affected by many factors, such as tax incentives, access to consumers, labor costs, social climate, infrastructure, availability of a suitable labor force, the possibility of developing new consumer habits in the host country, simple and understandable regulations and other factors corruption (Krivins, Vilks, and Kipane 2024).

Undoubtedly, FDI can have positive effects on the host country, including improving the country's balance of payments, increasing productivity, transferring technology, addressing the problem of unemployment, improving the quality of the country's labor force, and developing new industries. However, the effect can be neutral or even negative in certain situations. Thus, attention should be paid to the different approaches of political parties to the issue of protecting foreign capital and investment. Ineffective government administration, a lack of development programs (Remeikiene et al. 2022), a lack of basic infrastructure in the host country, rapid change in political preferences, inconsistency of the state apparatus, deliberately or unwittingly cultivated antipathy towards foreign capital, potential risks of nationalization, and strong government economic intervention, can scare off foreign investment. Reducing bureaucratic procedures is also extremely important in the field of public procurement, which is also associated with foreign investments. On the other hand, foreign investment has great potential for aiding the integration processes of the host countries (Kastratović 2024).

The business environment of local government, local government's fiscal stress, land resources, and wealth are important determinants in attracting commercial investment (Wang, Sun, and Shi 2024). In addition, factors such as economic growth, pollution, trade, domestic capital investment, gross value-added, and the financial stability of the country can influence FDI decisions (Brkić, Kastratović, and Salkica 2021; Singh 2024).

The overarching objective of this study is to undertake a comprehensive examination of FDI patterns in Serbia and Latvia, with a particular emphasis on a comparative analysis. We frame our analysis around the main exploratory research question: How do Latvia and Serbia differ and align in the key factors that attract FDI, and how do these differences and similarities influence FDI patterns? To answer this question, we conducted a descriptive analysis of FDI patterns in the two countries, focusing on the period between 2010 and 2023.

By scrutinizing the investment landscapes of these two countries, the research sheds light on the underlying trends and major factors that have shaped foreign investment inflows over time. Furthermore, the study seeks to delve into the institutional frameworks that govern foreign investment in each nation, thereby discerning the regulatory structures and policy frameworks that have influenced investment dynamics. The research also aims to elucidate how different historical contexts have shaped distinct investment frameworks and investment performances in Serbia and Latvia. Moreover, by comparing incentive schemes that are prevalent in both countries, the study identifies the best practices and policy recommendations that are conducive to fostering sustainable FDI inflows. Through this multifaceted analytical approach, the research seeks to contribute empirically grounded insights that could be of use for policy formulation aimed at optimizing FDI outcomes in Serbia and Latvia.

Literature review

In recent years, scholarly discourse on international investment has investigated the economic landscapes of both Latvia and Serbia. For instance, research into the impact of FDI in Latvia has highlighted its role in shaping the country's economic trajectory (Saksonova, Konovalova, and Savchina 2023). Meanwhile, analyses of entrepreneurship development in Serbia have investigated the key external factors that influence the country's business ecosystem (Jaško et al. 2023). Moreover, examinations of FDI in the Serbian energy sector have provided insights into the interplay between investment inflows and its economic growth (Pavlović et al. 2022). Similar insights are provided for foreign investment in other sectors, such as agriculture, where they were found to integrate it into the world economy (Kastratović 2023).

However, while existing research offers valuable insights into these countries' economic landscapes, it predominantly examines them within broader regional or thematic contexts. Studies often encompass multiple countries or regions, such as Europe as a whole, the European Union (EU), Central and Eastern European countries, the Baltic countries, or the Western Balkans (Margaryan, Terzyan, and Grigoryan 2020; Bilas and Franc 2022; Burlea-Schiopoiu, Brostescu, and Popescu 2023; Lubeniqi 2023). Despite the wealth of literature on foreign investment, there remains a notable gap in comparative studies specifically focused on transition economies adopting different strategies of economic transformation and integration. Latvia and Serbia pose a suitable case study for this endeavor. This underscores the contribution of our research, which seeks to fill this void by providing a comparative analysis of these two countries. By focusing on the distinct economic dynamics of Latvia and Serbia, our study offers nuanced insights into their investment landscapes and contributes to a deeper understanding of the factors that shape their economic trajectories.

We also compare the situation in Serbia and Latvia with pan-European and global practice. Therefore, we draw attention to several scientific articles that are related to modern trends, namely (1) the Green Deal and low-carbon innovations, (2) technology and infrastructure, (3) force majeure and other risks.

FDI has the potential to positively affect energy consumption (Shinwari et al. 2024). In this regard, it is also important that multilateral support from development banks in green public-private partnerships (PPPs) may help alleviate the cultural tightness impediment (Uzuegbunam 2024).

Regarding technology and infrastructure, modern research emphasizes that technological skills, similarities in technological skills, high-tech and innovative industrial activities, and access to finance between the recipient and investing countries positively influence FDI flows (Uttama 2024).

Recent research suggests that the investment risk system comprises three risk subsystems: operating cost, operating revenue, and government subsidy. Among these, the subsidy risk subsystem most significantly influences the IRSC (investment risk of social capital). Within the boundary risks, design risk and contractual risk are the most vital factors in preventing and controlling the IRSC (Sun et al. 2023). PPP projects that adopt contractual forms in which the private party takes more risks, awarded through competitive methods and benefitting from indirect government support programs, are characterized by a larger investment volume (Fleta-Asín and Muñoz 2023).

Considering the previously reviewed literature and the variety of topics on FDI, it is clear there are numerous channels through which the attraction and the effects of FDI can be considered in the comparative context. We base our analysis on comparing the institutional frameworks and historical contexts of using FDI as a vehicle of economic development in Latvia and Serbia, as well as some of the most widely anticipated economic effects of their inflows.

Methodology

We also compare the performance of foreign affiliates in Latvia and Serbia and how they affect their respective economies. This segment of the comparison is based on Inward Foreign Affiliates Trade Statistics. This novel statistical concept is based on structural business statistics and aggregates the performance of firm-level data for companies that have a significant and controlling interest in foreign capital.

We apply descriptive statistical methods to analyze trends, dynamics, structure, origins, and the relative significance of FDI in two countries. The data are graphically presented to facilitate comparisons between the two countries and to highlight major trends. The trends are connected to major historical and economic factors that influenced them, using historical methods to provide context. We also provide summary statistics to highlight the most important quantitative similarities and differences between Latvia and Serbia in terms of their FDI performances and general business environment.

The descriptive analysis focuses on inward flows of investment due to their greater development implications for host economies. We particularly emphasize the period between 2010 and 2023, during which both countries achieved similar levels of investment climate, making their performances in attracting FDIs comparable. The analysis is based on a case study approach that focuses exclusively on Latvia and Serbia. These two countries are compelling subjects for comparative analysis due to their similar historical contexts and transition processes despite the differing paces of transition and economic integration. These similarities and differences allowed us to isolate the effects of economic integration on FDI patterns.

We guide our exploration with general research questions related to the nature of the main patterns and dynamics of FDI inflows and the factors that contributed to their differences. Based on our findings, we identify the best practices and synthesize policy implications that the two countries could apply to improve FDI inflows.

In our analysis, we use data from various sources. Details on FDI inflows and their structure come from the databases of the Central Bank of Latvia (*Latvijas Banka*) and the Central Bank of Serbia (*Narodna Banka Srbije*). The data were supplemented with additional times series adapted from the UNCTADStat database of the United Nations Conference on Trade and Development. Finally, we consider additional sources for collecting data to compare the business environment of the two countries, including the Central Statistical Bureau of Latvia (*Centrālā statistikas pārvalde*), the Statistical Office of the Republic of Serbia (*Republički zavod za statistiku*), World Bank Doing Business Archives, Transparency International data, and World Intellectual Property Organization data.

Results and discussion

Both the Latvian and Serbian economies are open, service-based, and export-oriented. The tertiary sector is hugely important for both countries and among the key drivers of economic activity. Furthermore, both countries have been strongly affected by historical factors, as neither had developed market-oriented economies in the early 1990s. Thus, both underwent a thorough transition process. The transformation of their economic systems relied on foreign capital and the privatization of state-owned enterprises. In more recent history, both countries were similarly affected by the negative effects of the global economic environment during the period of the Global Financial Crisis and the COVID-19 pandemic, decreasing their gross domestic product. Lately, both countries have faced similar challenges related to an increasingly unstable global economic and political environment.

Both countries recognize the importance of FDI and have experienced substantial initial inflows of foreign capital through privatization. In these early stages, FDI inflows in both countries were considered an instrument for promoting the process of transition. FDI was an important source of capital for investment. However, in the past decade, Serbia has increasingly relied on foreign capital to finance investment, adopting this approach as a primary strategy to address the chronic scarcity of capital that this economy faces.

There are also notable differences between the two economies. Despite both countries sharing a similar economic background prior to the 1990s, Latvia went through the transition process more efficiently. The transition was considered completed in 2019, whereas, in Serbia, it is still ongoing. Serbia maintains more state-owned enterprises than Latvia, increasing the political influence over the local economy. In addition to initiating the transformation of the economic system, during the 1990s, Serbia underwent civil unrest, political instability, and economic isolation, culminating in war in 1999, which devastated the economy and halted the transition and integration of its economy into the global economy. The effects are evident in our comparative analysis, particularly regarding outcomes related to accession to key regional trade integrations and global institutions for the two countries.

There are significant differences between the two countries in their current geopolitical positions and the results of their integration. Latvia successfully acceded to the EU and is a member of both the Organization for Economic Cooperation and Development and the World Trade Organization. Serbia's integration has been more sluggish, as it is still in the process of acceding to the European, while accession to the World Trade Organization has proven to be similarly challenging.

Differences in integration also reflect Serbia's comparatively lower levels of regulatory harmonization and lower levels of economic and political cooperation with EU member states. Another result of this is the more diversified approach Serbia takes in sourcing foreign capital and conducting trade, relying heavily on bilateral trade and investment agreements. This reflects differences in trade flow patterns between Latvia and Serbia. Latvia mostly engages in trade with the Baltic states and most of the developed European economies, such as Germany and Italy, all of which are EU member states. In contrast, besides significant trade flows with the EU member states, Serbia maintains trade relationships with signatories of the CEFTA 2006 agreements – China, Russia, and Turkey.

Differences in the speed of conducting and completing the transition also resulted in differences in public influence on the local economy between the countries. For instance, in Latvia, the privatization process is largely completed, with the remaining few state-owned enterprises playing a reduced role in the economy. While privatization in Serbia has been completed in many sectors, many state-owned or state-influenced enterprises still exist, particularly in the telecommunications, energy, and transportation sectors, maintaining considerable influence over the enterprises in the private sector.

Finally, differences in previously outlined contexts and factors led to significant differences in the development level of the two compared economies. Today, Latvia is considered a developed economy, with GDP per capita more than double that of Serbia. Meanwhile, Serbia is still considered a transition economy or a developing economy, depending on the classification used.

The two countries share relative attractiveness for FDI. Both have a well-established and conductive business, institutional, and regulatory environment, with each offering specific advantages to foreign investors. The attractiveness of each economy is, thus, dependent on the context of the specific investment project and the relative importance of various factors to foreign investors.

Despite their respective differences, both countries have well-integrated economies, maintaining strong cooperation with large economies. Using different channels, both countries offer market access to foreign investors, which goes significantly beyond their limited domestic markets. They offer good strategic positions to foreign investors, serving as a gateway between large economic regions. For instance, Latvia provides access to the EU and the member countries of the Commonwealth of Independent States. Serbia is well-positioned in bridging developed member states of the EU with the economies in the Eastern Europe.

In both countries, there is a favorable investment climate that fosters foreign investment. Both countries have good labor market conditions that offer a relatively inexpensive, educated, and multilingual workforce, for example. They also offer a competitive tax system, although Latvia leads in this regard with one of the most competitive tax systems in Europe. For example, it is one of the rare systems that completely abolished taxing reinvested earnings. Both countries also have relatively well-developed infrastructure, which is important for supporting investment.

Active support of investments is present in both countries. Financing sources differ, however. Latvia relies heavily on funding from the EU, whereas Serbia redistributes its fiscal earnings to investors. For this reason, Serbia requires strong fiscal performance to maintain its current level of support. In both countries, policymakers make use of Special (Free) Economic Zones. In both cases, these zones cater to the specific needs of foreign affiliates and significantly facilitate their business. It is, therefore, unsurprising that in both countries, multinational enterprises concentrate their activities in these zones. Serbia currently has three times more active Special Economic Zones than Latvia, although this largely reflects the difference in size of the country.

There is a significant difference between Latvia and Serbia in terms of the extent to which their respective legislation is harmonized with international and, particularly, EU standards. Latvia, as an EU member state, has more harmonized legislation, imposing significantly fewer hurdles on multinational enterprises in adapting their activities to the local business environment. Although Serbia is in the process of regulative harmonization and actively conducts reforms, it still lacks the level of harmonization present in Latvia, imposing substantially higher adjustment costs on foreign investors.

Both countries face similar challenges in attracting FDI. These challenges are mostly related to the limited size of their domestic markets, underdeveloped capital markets, low levels of investment in research and development (R&D), an extensive shadow economy, regulatory constraints, and political factors. However, each country is affected by these challenges differently, and some factors contribute to lower FDI inflows more than others in the two contexts.

Notably, Latvia and Serbia both lag behind the most developed economies of Europe in terms of R&D investment, which stands at under 1% of GDP. In both cases, this restricts the development of innovation capacities in local enterprises, making them less attractive to foreign investors. In addition, limited investment in R&D contributes to technological lagging. While there is a noticeable trend of increasing investment in R&D in Serbia, it has still not reached the average level of developed economies.

Although both countries are challenged by political factors limiting higher FDI inflows, the nature of these factors differs. On one hand, in Latvia, the political factors are predominantly external. On the other hand, FDI inflows in Serbia are affected by both internal and external factors. Specifically, both countries are negatively affected by the increasingly unstable global economic environment and, in particular, the negative economic spillover effects of the war in Ukraine, which increases the perception of regional instability for Eastern and South-Eastern economies in general. In addition to these external pressures, in Serbia, there is also considerable political influence on the local economy, as business decisions might be affected by political pressures.

The countries differ in terms of export diversification and dependence on specific markets of partner economies. Although both countries are reliant on the EU market, Latvia is more dependent. Serbia currently has a more diversified export market, but the ongoing integration processes could limit export possibilities to countries such as Russia and China in the future as the country adjusts its trade policy with that of the EU.

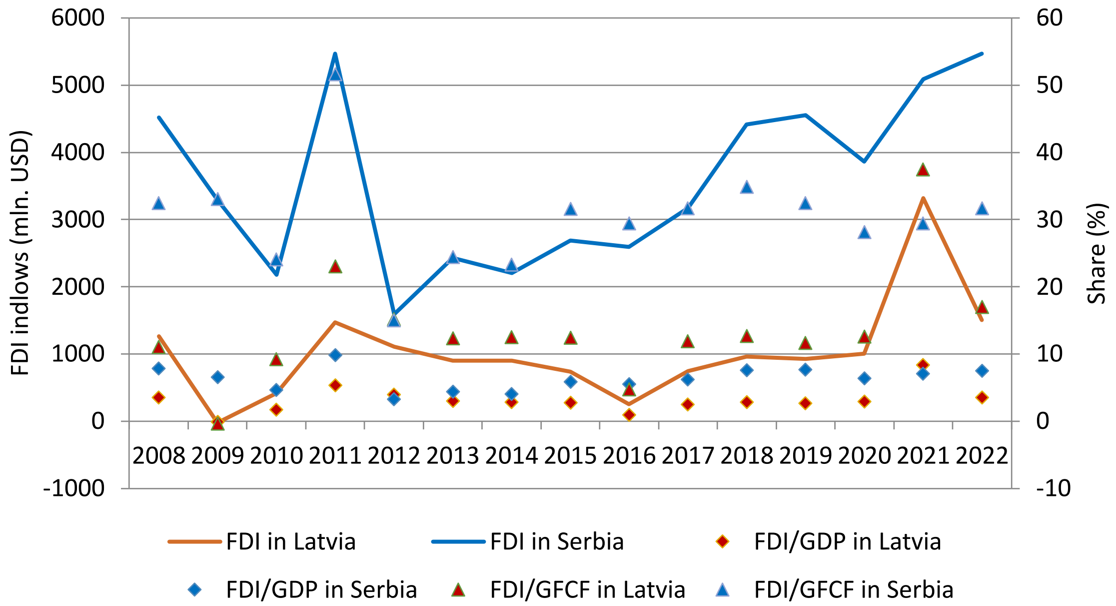

Chart 1. Comparison of Foreign Direct Investment dynamics

Source: authors' elaboration based on data from the United Nations Conference on Trade and Development 2024.

We provide a visualization of the comparison of FDI dynamics between Latvia and Serbia in Chart 1. These results indicate that Serbia consistently reports higher absolute inflows of FDI compared to Latvia. The average inflows in the observed period for Serbia are 3.56 billion USD annually, whereas the average inflows for Latvia stand at 1.03 billion. As differences in economy size could contribute to these different dynamics, we additionally consider relative indicators of FDI inflows, which control for gross domestic product in each country. The results of this additional analysis confirm the previously established pattern. In the observed period, there is a higher significance of FDI in the Serbian economy. Furthermore, the Serbian economy is more reliant on foreign capital in financing investment in general, which could either indicate its higher relative attractiveness to foreign investors or scarcity of alternative capital sources. However, if a longer time frame is considered, the results show greater foreign capital accumulation in Latvia. This is evidenced by the inward FDI stock per capita comparison, which indicates that this variable has a nearly double value in Latvia as in Serbia.

These results show that both countries navigated considerable challenges and demonstrated resilience in attracting FDI. However, differences in historical contexts, integration approach, and economic policies contributed to differences in the dynamics of their FDI inflows. Although the dynamics of significant FDI inflows started with a delay in Serbia, both countries share a similar initial motivation for attracting FDI. Both countries sought to transition to a market-oriented economy, undergoing the processes of transition and privatization. Therefore, both countries laid out a favorable regulatory framework to attract foreign investment, and for Serbia, this even involved the positive discrimination of foreign investment between 2002 and 2015. In both countries, attempts to promote foreign investment yielded significant results, as evidenced by substantial and persistent inflows of FDI in the years following the establishment of favorable regulation.

Another common characteristic of FDI dynamics in Latvia and Serbia is that following the initial inflows related to privatization, the investment channels shifted towards greenfield investment projects, the reinvestment of earnings in the host country, and cross-border mergers and acquisitions of privately owned enterprises. However, for Serbia, this shift was delayed due to its unique situation in the 1990s. Another similarity in dynamics is related to the response to the Global Financial Crisis. Both economies were negatively affected by this event, and there were differences in the initial response of policymakers. For example, Latvia responded to the new challenge with prompt austerity measures, quickly regaining foreign investors' confidence, which supported the quick recovery of foreign investment dynamics. By contrast, Serbia delayed its response, resulting in a more unsteady recovery trajectory between 2008 and 2012. However, over the 2010s, both countries experienced gradual and steady growth in foreign investment. Another similarity in dynamics could be identified during the COVID-19 pandemic. The pandemic had a temporary negative impact on foreign investment inflows in both countries; uncertainties increased with lockdowns, while the growing logistical problems affected investment activity in general. Both economies also experienced a rebound in FDI inflows in 2021, and the robust growth in investment continued throughout the following years.

Some structural differences in FDI inflows in Latvia and Serbia are also worth considering. Both economies receive a significant portion of FDI from EU member states, as well as from the other countries of their respective geographic regions. The main difference is the comparatively higher level of diversification of foreign investment sources in Serbia. Specifically, there is an increasing presence of foreign capital originating from Asian economies, particularly China. By contrast, Latvia maintains a strong reliance on foreign capital originating from the EU, with Sweden playing a particularly pivotal role.

Latvia and Serbia employ distinct strategies in attracting FDI, with Latvia diversifying inflows across higher-value sectors and Serbia concentrating the inflows and leveraging its existing industrial strengths. Latvia exhibits a much higher concentration of foreign investment in professional scientific and technical services and the information and communication technology (ICT) sector compared to Serbia. Another difference is the much higher importance that the construction sector has for FDI in Latvia. The difference has been reduced over the past several years due to the ongoing real estate boom in Serbia, where there is a noticeable increasing trend of foreign investment inflows in the sector.

The manufacturing industry has significant inflows for FDI in both countries. In both cases, foreign affiliates in the sector are export-oriented, reflecting the countries' limited domestic market size.

In Serbia, the investment is directed more toward the automotive industry and in the consumption goods industry, where Serbia has a particularly strong comparative advantage. In Latvia, foreign investors focus on industries with somewhat higher value added. In both countries, foreign investment in the manufacturing sector has supported the formation of clusters. This has improved the potential for positive spillover effects of FDI and the establishment of linkages between foreign affiliates and indigenous firms, helping improve the overall competitiveness of the manufacturing industry.

Nonetheless, there are some differences in the nature of these agglomerations in Latvia and Serbia. For instance, in Serbia, the agglomerations are of an intra-industry nature, mainly present in the automotive industry and the related industries providing the inputs required for motor vehicle manufacturing. In Latvia, they are more geographic, with a wider range of industrial activity concentrated in the Riga and Pieriga regions.

Latvia and Serbia both experienced large inflows of FDI in financial sectors. Historically, this sector was attractive for investment due to lower levels of competition posed by the domestic financial institutions and consequential profitable opportunities. Serbia has specifically higher foreign investment in the retail, wholesale, and transport sectors, reflecting the country's comparative advantage for logistics, created through its strategic position and significant investment in infrastructure.

Foreign affiliates exhibit similar characteristics in both countries. In both cases, they disproportionately contribute to output, employment, and value-added. For instance, both countries report that approximately 20% of the workforce is employed by foreign affiliates. In both cases, the affiliates are important contributors to tax revenues, although it is more pronounced in Latvia. An interesting difference between the countries exists in terms of inactive foreign affiliates. In Latvia, 59% of registered foreign affiliates are not engaged in any economic activity, while the data suggest that the majority of foreign affiliates in Serbia are operational.

Table 1. Comparison of business environment

	Latvia	Serbia	Germany
FDI stock per capita (USD)	13,019	6,676	12,085
GDP per capita (USD)	17,340	6,534	43,566
Protection of minority investors	68	70	62
Corruption Perception Index	60	36	78
Global Innovation Index (rank)	37	55	8

Source: authors' elaboration based on data from the United Nations Conference on Trade and Development 2024, Transparency International 2024, and World Intellectual Property Organization 2024.

A more general comparison of the business environment in Latvia and Serbia can be made using the descriptive statistics in Table 1. Both countries are compared with Germany, which is widely considered a leading economy in the EU. The results of this part of our comparative analysis suggest that Latvia offers a more stable and business-friendly environment. For example, its economy is substantially more developed than Serbia's, evidenced by a GDP per capita that is more than twice as large. However, both countries lag behind the most developed economies of the EU, although Latvia is fast converging in its income level, unlike Serbia.

Finally, our comparison reveals strong performances in innovation in Latvia. Although it lags behind the EU leaders, its performance is still relatively strong. Serbia, on the other hand, has a lower innovativeness score than Latvia, which is reflected by the previously described structure of FDI inflows.

The final part of our comparative analysis concerns the institutional framework for foreign investment. Both Latvia and Serbia have established frameworks that are conducive to FDI. Similarly, both are committed to providing a favorable business and investment environment, with dedicated institutions responsible for promoting investment, implementing incentive programs, facilitating administrative burdens on investors, and serving as one-stop shops. The regulatory framework in both countries is based on the national treatment of foreign affiliates. Companies are not discriminated against based on the origin of their capital, and the same regulatory conditions apply to domestic firms and foreign affiliates alike. Issues of expropriation are addressed transparently, and the regulatory framework guarantees fair treatment to investors. Both countries offer substantial fiscal and financial incentives for investment, particularly within Special Economic Zones.

There are also several differences between the regulatory frameworks of the two countries that should be mentioned. For example, in Latvia, foreign investors must meet specific sector-level prerequisites. In contrast, Serbia does not have such sectoral limitations, except for a legal provision that prohibits non-residents from owning agricultural land. Although both countries use financial measures to incentivize investment, the sources of financing differ. Latvia utilizes EU structural funds and the InvestEU program, whereas Serbia relies on its state budget, significantly limiting its capacity for financial incentivization investments. Finally, there is a noticeable difference in how each country guarantees protection for investors' interests in the future. Latvia is moving towards unified treatment of investors within the EU and abolishing bilateral investment treaties. Conversely, Serbia continues to rely heavily on bilateral investment treaties as a means of regulating investor rights and interests.

Conclusions

In this paper, we presented the results of a comparative analysis of the regulatory frameworks and patterns of FDI in Latvia and Serbia. We focused on the period between 2010 and 2023 and based our analysis on a descriptive approach, and our results provide a thorough comparison of the FDI patterns in these countries. We examined the underlying trends, institutional frameworks, and historical contexts that have shaped the investment dynamics in both countries. The results, thus, provide a detailed answer to our initial research question. Namely, they elucidate the differences and similarities between Latvia and Serbia in key factors that affect FDI patterns. The analysis also yielded interesting insights into the differences in approaches the two countries took in creating a conducive environment for FDI.

Our comparative study identified various similarities between Latvia and Serbia, both in terms of FDI patterns and the dynamics and their institutional and regulatory frameworks. The similarities and differences between the countries could have important implications for policymakers in those two countries specifically, but in some regards, more generally, in transition economies. Foreign investment frameworks and, particularly, incentive policies should be tailored to take advantage of the identified strengths and offset the identified weaknesses.

For Latvia, this means a wider reach of economic diplomacy in promoting the country as an attractive investment location, particularly to investing countries from outside the EU. Moreover, considering the specific problem of inactive foreign affiliates, Latvia's policymakers could evaluate the possibilities of providing full support to existing affiliates to maintain their operations following the initial investment.

For Serbia, policymakers could direct their activities towards increasing FDI inflows to more value-added activities. For instance, incentives policies could be adjusted to specifically target investment in more technology-intensive sectors or tie the incentives to investment in R&D and the transfer of technology rather than the absolute number of jobs created. Digitalizing the government and, generally, improving workforce competencies in using ICT, as well as innovation and entrepreneurship, could create the basis for the development of innovative sectors and make them attractive for FDI. The existing empirical evidence suggests that higher adoption of ICT in European countries improves the internationalization of enterprises (Kastratović and Bjelić 2022). Strengthening economic integration, harmonizing regulations with the EU, and adopting integration standards could greatly reduce the costs of compliance for foreign investors and provide them with better access to other markets, which could further improve inflows of FDI.

Foreign investment inflows were demonstrated to impact the creation of industrial clusters in Serbia, increasing the positive effects of agglomeration. This implies the importance of actively promoting strategically important investments. However, potential negative effects on market structure and competition must also be considered when designing such policies (Kastratović 2018).

Our study contributes to the literature by synthesizing existing research on the role of FDI in economic integration and the development of transition economies while offering a novel comparative perspective on Latvia and Serbia. By analyzing the institutional and economic factors that influence FDI inflows, the study identified critical strengths and weaknesses in each country's approach. The examination of FDI patterns and dynamics improves our understanding of how historical and structural differences between these countries have shaped their ability to attract and sustain foreign investments.

The value-added of this study is its innovative use of foreign affiliates' trade statistics, enabling a more granular analysis that extends beyond macro-level FDI inflows to include the operational performance of foreign affiliates. This fine-grained approach allows for a detailed examination of how investment trends and foreign-owned companies react to institutional frameworks, incentive policies, and broader economic conditions. Moreover, by explaining the main causes behind specific changes in FDI flows and benchmarking their respective performances, the paper provides insights for policymakers who can tailor incentive policies to specific contexts to inform policymakers and achieve their aims of sustainable investment and greater economic integration.

There are some limitations to our comparative study that must be acknowledged. Our comparative analysis was based on a limited sample. It is a case study of two countries, which allowed us to conduct a detailed exploration of patterns and dynamics related to foreign investment. However, some conclusions and implications might not be applicable to other countries, even if they share similar characteristics to Latvia and Serbia. Although our study provides insights into the best practices and causes of differences in FDI performances, these effects are difficult to quantify in our limited sample. Therefore, an interesting avenue for future research would be to consider the effects of various determinants that were found to be relevant in our comparative analysis of the dynamics and structure of FDI in countries of the Western Balkans and Baltic region.

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Bezpośrednie inwestycje zagraniczne na Łotwie i w Serbii: analiza porównawcza

Głównym celem badania jest porównanie bezpośrednich inwestycji zagranicznych (BIZ) na Łotwie i w Serbii, zbadanie leżących u ich podstaw trendów, ram instytucjonalnych i kontekstów historycznych wpływających na dynamikę tych inwestycji. Na podstawie analizy regulacji, programów motywacji oraz struktury i dynamiki inwestycji przedstawiono najlepsze praktyki i zalecenia w obszarze polityk, dotyczące wspierania zrównoważonego napływu inwestycji do obu krajów.

W badaniu zastosowano porównawcze podejście case study do analizy ram instytucjonalnych BIZ, wyników finansowych powiązanych podmiotów zagranicznych oraz dynamiki napływu BIZ do Łotwy i Serbii, koncentrując się na latach 2010–2023. Wykorzystując opisowe metody statystyczne i dane z banków centralnych, krajowych urzędów statystycznych i organizacji międzynarodowych, a także uwzględniając kontekst historyczny oraz czynniki instytucjonalne i ekonomiczne, zbadano trendy, strukturę i pochodzenie BIZ.

Pomimo odmiennych kontekstów historycznych oba kraje łączy sposób przejścia do gospodarki rynkowej, cechujący się proaktywną polityką mającą na celu przyciągnięcie inwestycji zagranicznych. Niniejsze badanie pokazuje, jak rozbieżne podejścia do integracji i harmonizacji w zakresie regulacji wpływają na wzorce, struktury i dynamikę bezpośrednich inwestycji zagranicznych.

Opracowanie zaleca dostosowanie ram BIZ i polityki motywacyjnej w celu wykorzystania mocnych stron i rozwiązania problemów w obszarze BIZ na Łotwie i w Serbii. Dla Łotwy zaleca się rozszerzenie dyplomacji gospodarczej i wspieranie istniejących oddziałów zagranicznych, co może zwiększyć retencję i atrakcyjność inwestycji, zwłaszcza z krajów spoza Unii Europejskiej. W przypadku Serbii polityka powinna priorytetowo traktować bezpośrednie inwestycje zagraniczne w sektorach zaawansowanej technologii i o wysokiej wartości dodanej, wspierane przez cyfryzację, rozwój siły roboczej i dostosowanie do regulacji UE.

Badanie przedstawia unikalne ilościowe i jakościowe porównanie czynników wpływających na napływ BIZ, dynamikę i strukturę tych napływów na Łotwie i w Serbii, przyczyniając się w ten sposób do zrozumienia możliwości decydentów w gospodarkach będących w okresie transformacji w zakresie przyciągania inwestycji i zapewnienia ich pozytywnego wpływu na rozwój gospodarczy.

Słowa kluczowe: bezpośrednie inwestycje zagraniczne, wspieranie inwestycji, jakość instytucjonalna, Serbia, Łotwa