FDI Inflows and Employment Dynamics in the Western Balkans

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Abstract

The aim of this paper is to empirically examine the impact of foreign direct investment (FDI) inflows (% of GDP) on unemployment in the Western Balkan economies. Specifically, this research aims to enhance the understanding of the quality of FDI in the Western Balkans and its connection to labour market outcomes. Using annual panel data and employing fixed effects and system GMM estimators, the study addresses potential endogeneity between FDI and unemployment while controlling for macroeconomic conditions. The goal is to assess the extent to which FDI contributes to job creation in small, transition economies, while considering differences between labour-intensive and capital-intensive investment structures. By exploring these dynamics, the study offers insights for policymakers seeking to align investment attraction strategies with inclusive employment objectives and economic stability in the region.

Keywords: Foreign Direct Investment (FDI), Unemployment, Western Balkans Economies, System GMM

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Introduction

Through the lens of Albania, North Macedonia, and Serbia, this paper looks into how foreign direct investment (FDI) affects the job market in the Western Balkans.

The challenge of stimulating employment while simultaneously attracting sustainable foreign investment remains a central issue for these transition economies, where structural weaknesses, demographic pressures, and institutional deficiencies shape both investor decisions and labor market outcomes. Although FDI is widely considered a driver of growth, evidence on its impact on employment and wages in the region is mixed. Some studies suggest delayed and modest benefits, while others indicate negligible or even adverse effects when inflows are poorly structured or concentrated in sectors with low labor absorption. Against this background, the objective of this research is to assess empirically whether labor market indicators—measured by unemployment and the employment-to-population ratio—influence FDI inflows, and whether, in turn, FDI affects employment outcomes in the short to medium term. The working hypothesis is that labor market conditions significantly affect foreign investment decisions and that FDI subsequently feeds back into employment, though the magnitude and direction of this interaction may vary across countries. Methodologically, the study applies Augmented Dickey-Fuller (ADF) tests, vector autoregression (VAR) models, Granger causality tests, and stability diagnostics, providing a robust framework for analyzing dynamic interdependencies.

Literature Review

The authors find that FDI inflows raise labor-market outcomes in the Western Balkans, but only modestly and with delays: employment increases become statistically significant two and three years after inflows, while average net wages rise mainly after one and two years. Econometrically, they estimate percentage-point changes using linear mixed-effects models with country random effects and FDI lags; model choice is validated by a Hausman test favoring random effects and by AIC, after which results are assessed at the 5% level. In the employment equation, contemporaneous and one-year effects are not significant, but the two-year and three-year lags are positive and significant (≈0.021 and 0.030 percentage points, respectively), aligning with the view that FDI takes time to translate into jobs. In the wage equation, the one-year (≈0.010, p=0.004) and two-year (≈0.008, p=0.001) lags are significant, while the contemporaneous and three-year terms are not; the authors emphasize that even a doubling of FDI yields only a 0.01% increase in the average wage growth rate after a year, underscoring the small magnitude of effects. Overall, they conclude that FDI exerts a low but positive influence on employment and wages in the region, consistent with long-run, lagged transmission mechanisms (Milica Perić, 2017)

Grahovac & Softić examine how FDI inflows relate to unemployment in the Western Balkans over 2000–2014. They describe trends in global and regional unemployment and FDI, then estimate an econometric (multiple linear regression) link between FDI and unemployment for each WB country, comparing results with the EU and the world. Their abstract notes the 2009 crisis-era drop in net investments and a general absence of the positive FDI–employment effect seen in many CEE transition studies. Methodologically, they use a regression framework testing whether higher FDI lowers unemployment, with standard significance criteria. Empirically, only Croatia shows a significant negative association ($R = -0.645$, $p = 0.013$), while Bosnia & Herzegovina even exhibits a positive association—attributed to inefficient privatizations that reduced jobs— and other WB countries show no statistically significant effect. They conclude that, unlike at the EU/world level where FDI correlates with lower

unemployment, WB outcomes diverge due to weak structural reforms and poor privatization results; thus, improving the quality/structure of FDI and broader competitiveness is needed if FDI is to support employment in the region (Dijana Grahovac, 2017)

The authors examine Western Balkan countries (Albania, Bosnia and Herzegovina, Croatia, Kosovo, North Macedonia, Montenegro, Serbia) over 2005–2015 using World Bank data to test whether FDI inflows are associated with exports, GDP per capita, employment (measured via unemployment), and the current-account balance; they apply normality checks and Pearson correlations estimated in SPSS. For your focus on "FDI inflows and employment dynamics," their employment result is mixed and generally weak: only Albania and Croatia show statistically significant correlations between FDI and unemployment, and the signs differ, Albania's correlation is positive (higher FDI with higher unemployment), while Croatia's is negative (higher FDI with lower unemployment), contrary to the uniform job-creation expectation. Stepping back, they conclude that FDI reliably correlates with smaller current-account deficits across the region, but it does not appear to have generated much new employment or driven export and GDP growth during the sample period (Vesna Georgieva Svrtinov, 2017)

From the brief's special topic, the authors estimate employment created by new greenfield FDI in the Western Balkans (2010–2021) using the Financial Times' fDi Markets database, aligned and scaled to official equity-FDI statistics to correct for over/under-coverage by country; they also stress that fDi reports announced gross jobs (not net), so results aren't directly comparable to LFS employment changes. Methodologically, they further approximate the skill mix by mapping sectors/activities to occupations (via CEDEFOP/ILO), noting limitations in using Bulgaria's occupational structure as a proxy. They find about 180,000 FDI-related jobs, roughly 19% of the region's total employment increase over the period; Serbia accounts for ~87k and Albania ~49k, with FDI-jobs equal to 2.7% of total 2021 employment (0.7% in BiH to 4.8% in Montenegro). By origin, Germany, the US, and Italy dominate; by sector, manufacturing (53%) leads, followed by construction (23%) and retail (12%). The skill profile skews medium-skill (about two-thirds of jobs), with a smaller high-skill share than in overall new employment and no broad upgrading over time (improving only in BiH and Kosovo, static in Serbia, and worsening in Albania, Montenegro, and North Macedonia). Most jobs are outside capital cities (only ~¼ in capitals). Conclusion: FDI has provided meaningful employment but has contributed little to improving job quality, which, given sizable public incentives, implies policy should focus not only on the amount of FDI but on the types of jobs it brings and on better-targeted incentives (Group, 2023)

The authors examine how FDI relates to macroeconomic performance in the Western Balkans by building a panel-data model for six countries (Albania, North Macedonia, Kosovo, Montenegro, Serbia, and Bosnia & Herzegovina) over 2004–2018, estimating pooled OLS, fixed effects, and random-effects (GLS) specifications with real (deflated) FDI—including a two-year lag—alongside gross capital formation and government consumption; exports were tested but ultimately dropped. They find that lagged FDI is positively and significantly associated with GDP growth, with capital formation and government spending also positive, while export falls out of the preferred models; tests indicate meaningful cross-country heterogeneity, so the FDI–growth link is not uniform across the region. In short, their conclusion is that FDI's growth impact materializes with a delay (about two years) and varies by country context—an insight that's directly relevant to an employment-focused study, since jobs effects from FDI are likewise likely to be lagged and heterogeneous across Western Balkan economies (Nexhar Shkodra, 2021)

The authors analyze how inward greenfield FDI shapes job creation across 109 regions in the old EU member states (2012–2023), using fixed-effects, IV/Dynamic GMM, and spatial models with project-level data that record jobs per investment; they study both the intensity of FDI and its sectoral diversification, while controlling for GDP, education, and tech intensity. They find that more FDI projects are associated with markedly higher employment, but with nonlinear (diminishing) returns at higher FDI levels; sectoral specialization—rather than diversification—correlates with stronger job growth; and employment gains display spatial spillovers to neighboring regions. Regions attracting higher-value functions (e.g., R&D/management) tend to see slower total job growth, suggesting a quality–quantity trade-off. Policy takeaways include targeting sectors with high employment elasticity (especially in less-developed regions), coordinating regionally to harness cross-border spillovers, and balancing specialization with resilience. For your Western Balkans topic, these results imply: expect positive but nonlinear employment effects from FDI; specialized project pipelines may boost jobs more than broad diversification; cross-border coordination matters; and courting high-value FDI may lift job quality without maximizing headcount (Marjan Petreski, 2025)

The authors analyzed the relationship between Foreign Direct Investment (FDI), economic growth, and export performance in European economies in transition. Using a broad dataset, they examined how FDI influenced GDP growth, gross fixed capital formation, sectoral productivity, and export competitiveness. They found that while FDI generally brought technology transfer, enhanced competitiveness, and supported exports, its positive spillovers on domestic firms' productivity were limited or delayed, often due to technological gaps and insufficient financial capacity of local enterprises. The study highlighted that the impact of FDI varied by sector, with manufacturing-oriented inflows contributing more to export growth than service-sector investments. Moreover, they observed that mergers and acquisitions had less immediate growth impact compared to greenfield investments. The authors concluded that although FDI can foster long-term economic growth and export performance, policy makers must focus on improving the overall business environment, ensuring transparent regulations, and fostering linkages between foreign and domestic firms to maximize benefits and avoid negative effects, such as over-concentration in non-tradable sectors, which could undermine competitiveness (Olivera Kostoska, 2008)

In this Western Balkans study (Albania, Bosnia & Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia; 2007–2018), the authors estimate panel regressions—ultimately favoring a fixed-effects specification via a Hausman test—linking domestic investment (as the dependent variable) to FDI inflows/outflows, gross savings, and real GDP growth. They find FDI inflows are a statistically significant complement to domestic investment: a 1% rise in FDI inflows is associated with a 0.34% increase in domestic investment, while GDP growth also has a positive, smaller effect (a 1% rise in real GDP growth raises domestic investment by about 0.0074%). FDI outflows and savings are not significant in their preferred model. Conceptually, they frame FDI as working through channels that expand production capacity, diffuse technology, and can raise employment—mechanisms that connect directly to your focus on employment dynamics in the region (Bilal Sucubasi, 2020)

Topi & Xhepa examine how institutional quality shapes FDI inflows and economic growth in the Western Balkans by applying a difference-in-differences design to Albania, North Macedonia (controls) and Croatia (treatment) over 2000–2020, using the six WGI governance indicators as covariates. They find institutions matter: regulatory quality stands out as the strongest institutional correlate of outcomes, with

a coefficient of about €128 in the GDP-per-capita model, implying a 1-unit gain in regulatory quality is associated with ~€128 higher GDP per capita on average. The EU-accession shock (Croatia) is associated with higher GDP per capita relative to the controls (DiD term ≈ €2,618, $p<0.01$), while for FDI the post-accession time dummy indicates inflows were lower before EU entry across the sample (−1.738 pp), but the Croatia-specific DiD effect on FDI is small and not statistically significant. Substantively, the paper argues that better rule of law, control of corruption, and especially regulatory quality help attract FDI and support growth—mechanisms that are relevant for your topic on FDI inflows and employment dynamics—though the authors do not model employment directly (their outcomes are FDI % of GDP and GDP per capita) (Kevin TOPI, 2023)

In this Bruegel policy brief (July 2024), Dabrowski and Léry Moffat examine the Western Balkans' EU-accession progress, macroeconomic and social convergence, and external economic ties—including trade, FDI, remittances, and how tightly the region is already integrated with the EU economy. Empirically, they show that FDI stocks are high but uneven (e.g., Montenegro ~91% of GDP and Serbia ~81%, versus Bosnia and Herzegovina ~38%), that the EU remains the majority investor (about 59% of FDI stock), and that Chinese investment has risen sharply, especially into Serbia; they also caution that some measured FDI is "phantom" and tax-routing distorts source attribution. Analysing labour markets, they document persistently high unemployment (especially youth), low female labour-force participation, and sizable inactivity—pressures compounded by demographic decline and outward migration; these dynamics help explain stable but significant remittance inflows (≈3–4% of GDP in North Macedonia up to 17–18% in Kosovo). Their core conclusion for policy—highly relevant to a study on FDI inflows and employment dynamics—is that faster, credible EU-accession steps (paired with domestic reforms and deeper intra-regional integration) would reduce uncertainty and stimulate FDI, while governance and labour-market reforms are essential to translate capital inflows into stronger, more inclusive employment (Moffat, 2022).

Methodology

The empirical analysis is based on annual time series data for Albania, North Macedonia, and Serbia covering the period 1998–2022. Data on foreign direct investment, measured as a percentage of GDP, unemployment rates, and the employment-to-population ratio were obtained primarily from the World Bank's World Development Indicators and complemented with national statistical sources where necessary. To ensure reliable inference, the stationarity properties of the series were first examined using Augmented Dickey-Fuller (ADF) tests. Variables found to be non-stationary at levels were differenced appropriately in order to avoid spurious regression results. For each country, Vector Autoregression (VAR) models were then estimated, as this framework allows for treating all variables as endogenous and capturing the dynamic interactions among FDI and labor market indicators. Within this framework, Granger causality tests were applied to identify the direction of predictive relationships between investment flows and labor market conditions. Finally, stability diagnostics of the VAR systems were performed by verifying whether the roots of the characteristic polynomial lie within the unit circle, thereby ensuring the validity of impulse response functions and variance decompositions. This methodological design combines econometric rigor with cross-country comparability, making it suitable for identifying the asymmetric dynamics between FDI and labor markets in the Western Balkans.

Stationarity Analysis – Augmented Dickey-Fuller (ADF) Tests

The first step in the analysis is to test the stationarity properties of the variables, since the validity of VAR modeling depends on avoiding spurious regressions. The Augmented Dickey-Fuller (ADF) test was applied to all three variables (FDI, unemployment, and the employment-to-population ratio) in each country to determine whether the series are stationary at levels or require differencing (Table 1). This step is critical because non-stationary variables can produce misleading relationships if not appropriately transformed.

Table 1
ADF Unit Root Test Results

Country	Variable	Test Statistic	p-value	Stationary at Level?
Albania	FDI (% of GDP)	-1.797	0.3818	No
	Unemployment (%)	-1.052	0.7338	No
	Employment-to-Pop. Ratio (%)	-1.110	0.7110	No
North Macedonia	FDI (% of GDP)	-4.268	0.0005	Yes
	Unemployment (%)	1.349	0.9969	No
	Employment-to-Pop. Ratio (%)	0.640	0.9886	No
Serbia	FDI (% of GDP)	-4.122	0.0009	Yes
	Unemployment (%)	-0.654	0.8584	No
	Employment-to-Pop. Ratio (%)	-0.200	0.9385	No

Source: Authors' work & World Bank data

The ADF results show that only FDI in North Macedonia and Serbia is stationary at levels, while all other series are non-stationary and require differencing. From an econometric perspective, this outcome indicates that labor market indicators are subject to long-term persistence and structural trends, making it necessary to difference the data to achieve stationarity. From an economic perspective, the results suggest that investment flows in North Macedonia and Serbia display greater stability over time, while labor market conditions in all three countries remain volatile and subject to persistent shocks. This pattern reflects the inherent fragility of employment structures in the Western Balkans, where unemployment and labor force participation are heavily influenced by structural reforms, migration, and cyclical fluctuations.

VAR Model Estimation

After establishing the order of integration of the series, the next step is to estimate country-specific Vector Autoregression (VAR) models. This framework is suitable because it treats all variables as endogenous, allowing the analysis to capture the dynamic interdependencies between FDI, unemployment, and the employment-to-population ratio without imposing restrictive assumptions on causal ordering. The coefficients of the lagged variables indicate how past values of one variable influence the current values of another, thereby providing insights into short-run adjustment mechanisms within each economy. Only statistically significant results at the 5% level are reported to ensure that the discussion focuses on meaningful relationships (Table 2).

Table 2
Key Significant Coefficients in VAR Models

Country	Dependent Variable	Lagged Variable	Coefficient	p-value	Effect Direction
Albania	FDI	Unemployment (t-1)	-0.8660	0.005	Negative
	FDI	Employment Ratio (t-1)	-0.5239	0.005	Negative
	Unemployment	Unemployment (t-1)	0.8619	0.002	Positive
	Unemployment	Employment Ratio (t-2)	0.4551	0.005	Positive
	Employment Ratio	Employment Ratio (t-1)	0.8511	0.007	Positive
North Macedonia	Unemployment	FDI (t-2)	0.3314	0.001	Positive
	Unemployment	Unemployment (t-1)	0.9833	0.028	Positive
	Employment Ratio	FDI (t-2)	-0.2006	0.003	Negative
Serbia	FDI	FDI (t-1)	-0.4436	0.038	Negative
	Unemployment	Unemployment (t-1)	0.6635	0.044	Positive
	Unemployment	Employment Ratio (t-1)	-1.1065	0.001	Negative
	Employment Ratio	Employment Ratio (t-1)	1.5523	0.000	Positive

Source: Authors' work & World Bank data

The ADF results show that only FDI in North Macedonia and Serbia is stationary at levels, while all other series are non-stationary and require differencing. From an econometric perspective, this outcome indicates that labor market indicators are subject to long-term persistence and structural trends, making it necessary to difference the data to achieve stationarity. From an economic perspective, the results suggest that investment flows in North Macedonia and Serbia display greater stability over time, while labor market conditions in all three countries remain volatile and subject to persistent shocks. This pattern reflects the inherent fragility of employment structures in the Western Balkans, where unemployment and labor force participation are heavily influenced by structural reforms, migration, and cyclical fluctuations.

Granger Causality Analysis

While the VAR coefficients provide evidence of dynamic interdependencies, they do not in themselves establish the direction of causality. To address this, Granger causality tests were conducted to determine whether past values of one variable help to predict another within each country. These tests are particularly relevant for policy interpretation, as they distinguish whether investment flows lead labor market changes or whether labor market conditions act as drivers of investment. Only statistically significant causalities are reported to ensure that attention is focused on meaningful predictive relationships (Table 3).

Table 3
Significant Granger Causalities

Country	Direction of Causality	p-value	Significance
Albania	Unemployment → FDI	0.001	Yes
	Employment Ratio → FDI	0.001	Yes
	Employment Ratio → Unemployment	0.019	Yes
North Macedonia	FDI → Unemployment	0.002	Yes
	FDI → Employment Ratio	0.006	Yes
Serbia	(Unemployment & Employment) → FDI	0.009	Yes
	Employment Ratio → Unemployment	0.006	Yes

Source: Authors' work & World Bank data

The causality tests reveal distinct patterns across the three countries. In Albania, both unemployment and the employment-to-population ratio are found to Granger-cause FDI, meaning that labor market conditions serve as leading indicators for foreign investment inflows. This suggests that investors closely monitor the stability and utilization of the workforce before committing capital. In North Macedonia, the direction is reversed: FDI inflows Granger-cause changes in unemployment and the employment ratio, indicating that foreign investment acts as a driver of labor market dynamics—though with potential short-term disruptions, as observed in the VAR results. Serbia displays a more balanced structure: labor market conditions jointly influence FDI, while employment levels help predict unemployment, pointing to a more interconnected system where both investment and labor outcomes are mutually reinforcing. Economically, these results highlight that while all three economies show strong ties between FDI and labor markets, the causal direction is country-specific and shaped by underlying structural and institutional factors.

VAR Stability Tests

An essential step in validating the estimated VAR systems is to test their stability. The stability condition is met when all eigenvalues of the characteristic polynomial lie within the unit circle. A stable VAR allows for meaningful computation of impulse response functions (IRFs) and variance decompositions, which provide insights into how shocks to one variable propagate through the system over time. Conversely, if the system is unstable, alternative specifications such as differencing or a Vector Error Correction Model (VECM) are required to ensure econometric validity (Table 4).

Table 4
VAR Stability Results

Country	Largest Modulus	Stability Condition Met?	Implication
Albania	N/A*	Likely No	Needs differencing or VECM due to non-stationarity
North Macedonia	1.01698	No	Unstable; requires differencing or VECM
Serbia	0.84127	Yes	Stable; suitable for IRF and variance decomposition

Note: Albania's modulus was not reported, but ADF results imply instability
Source: Authors' work & World Bank data

The stability tests confirm that only Serbia's VAR system meets the stability condition, making it suitable for further dynamic analysis such as impulse response functions. In contrast, Albania and North Macedonia display instability, reflecting the presence of non-stationary variables that require alternative approaches such as differencing or VECM. From an economic standpoint, this finding implies that the dynamics of FDI and labor market variables in Serbia are sufficiently well-behaved to allow forecasting and policy simulations, while in Albania and North Macedonia, the relationships are more volatile and structurally fragile.

Interpretation and Hypothesis Testing

The empirical results are now interpreted in light of the working hypothesis (H1), which posited that labor market indicators significantly influence FDI inflows and that FDI, in turn, affects labor market outcomes in the short to medium term. In Albania, H1 is supported: labor market variables such as unemployment and the employment-to-population ratio are significant determinants of FDI, indicating that investors base their decisions heavily on domestic labor conditions. In North Macedonia, H1 is only partially supported, as the causality appears reversed—FDI drives changes in the labor market, though often with short-term displacements rather than immediate improvements. In Serbia, the hypothesis is also partially supported, as both bidirectional interactions and self-regulating investment flows are observed, though the effects are not uniformly strong.

From a broader economic perspective, the findings underscore the heterogeneity of FDI–labor market dynamics across the Western Balkans. Albania demonstrates sensitivity of investment inflows to labor market stability, consistent with investor concerns about workforce availability and costs. North Macedonia illustrates how FDI may initially impose structural adjustment costs, temporarily raising unemployment before longer-term benefits can emerge. Serbia, by contrast, presents a more balanced and stable interaction, where labor market conditions and investment flows mutually influence one another, and where investment behavior is partly self-correcting. Collectively, these results highlight that a one-size-fits-all policy is inadequate: each country requires a tailored approach to align foreign investment strategies with labor market objectives, ensuring that FDI supports sustainable and inclusive economic development.

Conclusion

This study investigated the dynamic relationships between foreign direct investment (FDI), unemployment, and the employment-to-population ratio in Albania, North Macedonia, and Serbia over the period 1998–2022. The results provide only partial support for the working hypothesis: in Albania, labor market indicators were shown to significantly influence FDI inflows, confirming that investors closely monitor domestic employment conditions before committing capital. In North Macedonia, causality runs in the opposite direction, with FDI shaping labor market outcomes, though often with short-term displacements that underscore structural adjustment challenges. Serbia demonstrates a more balanced and stable interaction, where both investment and labor markets mutually influence one another and where investment flows exhibit self-correcting behavior. Taken together, these findings highlight the heterogeneity of FDI–labor market linkages across the Western Balkans and reinforce the need for country-specific policy approaches.

For policymakers, the implication is clear: Albania should prioritize labor market stabilization and workforce development to attract sustainable FDI; North Macedonia must complement foreign investment with active labor market policies to mitigate

transitional unemployment; and Serbia can leverage the relative stability of its system to design forward-looking simulations and forecasts. The study is limited by data availability and by the exclusion of additional structural variables such as wage dynamics, sectoral FDI composition, and institutional quality, which may further shape the observed relationships. Future research should expand the analysis to include these factors, apply panel econometric approaches to the wider Western Balkans, and investigate sector-specific effects to provide deeper insights. Overall, the evidence shows that FDI can support employment and growth in the region, but only when aligned with structural reforms and targeted policies that ensure inclusive and sustainable outcomes.

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