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## Investment and Local Economic Development: A Study of Realized Investment in Serbian Municipalities

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INVESTMENT AND LOCAL ECONOMIC DEVELOPMENT: A STUDY OF REALIZED  
INVESTMENT IN SERBIAN MUNICIPALITIES

By

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I dedicate this to my father, mother, brother, and grandparents for their support and encouragement

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# TABLE OF CONTENTS

Abstract .....	vi
1. INTRODUCTION .....	1
2. REGIONS AND INVESTMENT: THE WESTERN BALKANS .....	4
2.1 Economy .....	7
2.2 Foreign Direct Investment .....	9
3. SERBIA: LEGACY AND DECENTRALIZATION .....	12
4. INVESTMENT IN SERBIA'S MUNICIPALITIES.....	16
4.1 Theoretical Framework.....	21
4.2 Descriptive Analysis .....	23
4.3 Data.....	23
5. CONCLUSION .....	29
5.1 Future Work .....	30

## **ABSTRACT**

Serbia occupies a central position in Southeast Europe in a geographical as well as political sense and events and developments within its borders throughout the last century have had a major effect on neighboring nations. Numerous proposed initiatives in the region seek to strengthen the institutional framework for local governance, and to build its capacities and abilities to foster a competitive and attractive business environment for investors. Municipal-focused studies are scarce at best and the present research seeks to place an emphasis on the ability of local governments to attract investment and capital from abroad: why are certain municipalities more success in amassing imported investment? This research provides an initial descriptive analysis of municipal success by proposing the disaggregation of the state into local governing units to be further analyzed using economic growth determinants.

# CHAPTER ONE

## INTRODUCTION

“Regional disproportions are interactively connected with the unbalanced structures of population, with material limitations, and with structural disharmonies lasting for many years.”<sup>1</sup> The research question raised in this thesis is why some municipalities in Serbia are unable to attract investors and capital that is much needed for sustained economic development. Serbia occupies a central position in Southeast Europe and regional developments rarely escape the involvement of this former Yugoslav stronghold. In order to secure peace and stability in the Balkans various international organizations and governments have proposed initiatives and programs aimed at improving the economic conditions and ease the transition process for the emerging economies. Most recent trends, evident in proposed guidance, indicate that all states in the region should focus on attracting Foreign Direct Investment (FDI) and reorganizing their economies towards adoption and implementation of export-lead growth policies. What has often been omitted from analyses though is the dispersion of investment within the countries themselves. Most studies on FDI are at the national level and seek to outline factors that contribute to the attractiveness of the unit of analysis; however Serbia’s legacy of strong central authority in policy development is faced with mounting pressures from decentralization advocates and autonomy seeking administrators within its borders. Like its neighbors the Orthodox republic is taking steps towards European Union (EU) accession and thus will have to implement the policies mandated by the Union that call for the strengthening of local self-governance as opposed to strong central authority. This could be problematic for many municipalities since the experiences in local administration vary as much as do the figures reflecting economic development. Additionally academic literature analysis of municipal development in the region is scant at best, and now scholars are presented with an opportunity to study how localities are measuring up in their ability to attract the necessary for their prosperity investment and capital.

The economic development within Serbia is a topic of great importance, since historically it has been a source of grievance that on a couple of occasions has resulted in unpleasant

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<sup>1</sup> Radmila Miletic and Marina Todorovic, “The Regional Structure of Serbia,” *Journal of Urban and Regional Analysis* 1, no.1 (2009): 60



developments. Pumping Serbia full of FDI may not prevent animosities or decline in living standards if the distribution of investment continuously benefits certain localities while depriving others. In the past this pattern of economic development has led to conflict and secessionist rhetoric. Today such oratory may not be prevalent, but it is not absent either. And a rise in popularity of decentralization initiatives is not to be ignored since its incidence could fuel destabilizing for the region “go-it-alone” pursuits of independence. A number of the international community-sponsored initiatives advocate municipal competition for investment that would stimulate domestic economic productivity and ultimately raise living standards indiscriminately. Even if this planned course of action materializes as expected, it is necessary to account for current disparities in municipal ability to attract capital from abroad. Theories of regionalism provide a framework for studies on units of analysis greater than the state (Unions, Free Trade Areas, etc.) as well as reasoning for “unpacking” the nation and exploring administrative practices and self-governance without the “protective umbrella” of a state. For this thesis we shall unpack the state into municipal units of analysis since in Serbia’s case municipalities and regions are of governmental importance. At the regional level within the Republic two units are depicted as greater autonomy-seeking: Vojvodina and Sandzak however municipal developments are almost entirely neglected. Therefore the aim of this thesis is to shed light on municipal administration’s ability to provide a better business environment for private investors. The literature on FDI suggests that its determinants are similar to those of economic growth and provides a reason to use similar theoretical frameworks to account for variation in municipal ability to attract realized investment whose technological structure consists of imported equipment. The historiography concerned with Serbian municipality development is not an extensive one and it seeks to outline certain regional disparities and lack of progress;<sup>2</sup> it also accounts for regional labor market differences,<sup>3</sup> and performance management process in the public sector.<sup>4</sup> Much of the literature on the topic is from European sources and it appears that Western scholars have attempted little, if any work, on an “unpacked” Serbian state. It is not surprising that up to now any such studies are largely absent since strong central authority made

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<sup>2</sup> Radmila Miletić and Marina Todovorić, “The Regional Structure of Serbia,” *Journal of Urban and Regional Analysis* 1, no.1 (2009): 60

<sup>3</sup> Mihail Arandarenko and Milena Jovičić, “Regional Labour Market Differences in Serbia: Assessment and Policy Recommendations,” *The European Journal of Comparative Economics* 4, no.2 (2007), <http://eaces.liuc.it/18242979200702/182429792007040207.pdf>

<sup>4</sup> Željko Šević, (2005) "Measuring performance on a local government level in a transitional country: the case of Serbia", *International Journal of Public Sector Management* 18, no.7 (2005), doi: 10.1108/09513550510624059

the unit of analysis out of necessity the nation-state. Furthermore with few exceptions the literature on FDI also is state-centric thus this thesis will seek to urge further research of those state-driven factors as they might apply to the municipal level in the Republic of Serbia. The main thesis of this work is that municipalities that seek to implement policies and initiatives focused on strengthening the business climate at the local level will be able to attract greater attention from investors and thus be better positioned to amass larger amounts of realized investment in technical structure consisting of imported equipment. In Chapter 2 I present the Western Balkans as a region and outline the importance of economic development and FDI, subsequently Chapter 3 provides an outline of Serbia's legacy of central authority and decentralization, and Chapter 4 provides a theoretical framework and descriptive analysis of realized investment in imported equipment in Serbia's Municipalities. The conclusion summarizes the arguments presented in the thesis and suggests hypothesized interactions to be empirically tested in future research endeavors.

## CHAPTER TWO

### REGIONS AND INVESTMENT: THE WESTERN BALKANS

The idea of “all-Balkan” cooperation has its origins in the late nineteen-eighties when the region’s foreign ministers gathered to initiate a mechanism “...established at their first meeting in Belgrade in 1988.”<sup>5</sup> The Western Balkans<sup>6</sup> (Kafkalas 2007) region has been transformed dramatically since that meeting nonetheless themes of cooperation persist and is often pointed out that “The best way to achieve the goal values is a paradigm driven by integration and cooperation rather than disintegration and separation.”<sup>7</sup> As an administrative unit (Kingdom, or a republic) the nation of Serbia has, arguably, occupied a central role in the region in one way or another for centuries. This was the case throughout the two World Wars, the Cold War, and the subsequent violent dissolution of the Union of the South Slavs (Yugoslavia.) Today the Republic of Serbia is an important cornerstone in the Western Balkans and can once again undertake a leadership position in a transitioning region aspiring for EU (European Union) integration. Much of the advocacy from their Western Europe counterparts calls for an increased cooperation among the countries of Southeast Europe as a means to address the prevalent economic instability, poverty, and unemployment in their societies.<sup>8</sup> It is often pointed out that the people of the region share a multitude of social, economic, and environmental concerns and therefore would be best if they “...were able and willing to jointly address these issues in the context of a geographical region.”<sup>9</sup>

The end of the Cold War and the breakdown of the communist regimes signaled the dawn of a new era in Southeastern Europe, an era that exposed common features of the Southeast European (SEE) nations. Low levels of development, “unfavorable natural” characteristics, lack of effective national institutions, and negative political developments significantly outweighed

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<sup>5</sup> Ranko Petkovic, “The Balkan political map after the Cold War and Yugoslav crisis,” *Review of International Affairs* 1044 (1996):2.

<sup>6</sup> The Western Balkans are popularly defined in the literature as the countries of: Albania, Bosnia and Herzegovina, Croatia, Serbia, Montenegro, the Former Yugoslav Republic of Macedonia, and the UN-governed Kosovo.

<sup>7</sup> Bruno S. Sergi and Querim R. Querimi, *The Political Economy of Southeast Europe from 1990 to the Present: Challenges and Opportunities* (New York: The Continuum International Publishing Group Inc., 2008), 2

<sup>8</sup> Bruno S. Sergi and Querim R. Querimi, *The Political Economy of Southeast Europe from 1990 to the Present: Challenges and Opportunities* (New York: The Continuum International Publishing Group Inc., 2008), 13-18

<sup>9</sup> Erhard Busek, ed., *10 Years Southeast European Cooperative Initiative: From Dayton to Brussels* (Wien: Springer-Verlag/Wien, 2006), 32.

any favorable circumstances.<sup>10</sup> Nonetheless from the dissolution of the Slavs emerged the realities of common interests preventing any notion of prolonged isolation in a region deserving of “...increased genuine attention.”<sup>11</sup> The regional dynamics are currently displaying a possibility for the EU accession of all administrative entities of this “...miniature of a divided world.”<sup>12</sup> As Kafkalas (2007) points out this is an extraordinary opportunity for the research and analysis of factors and interactions in a

“...historical laboratory where it becomes possible to study the various conflicts and contradictions in the restructuring and transition of national economies, which are shaped by the combination of their internal dynamism and the powerful forces of European integration and globalization.”

The recent developments in the Western Balkans also provide a fertile ground for an examination of the state as a unit of analysis that are beyond the scope of the present research, nonetheless their guiding principles cannot be overlooked here. Since the collapse of the communist regimes and the dissolution of Yugoslavia numerous nations have successfully vied for statehood (this process is ongoing and addressed further in paper) on cultural (among other) grounds at the local level. At the same time these same “newcomer” countries are subdued into cooperation and integration through various regional initiatives or associations by global market forces. Such developments aid arguments suggesting that states seem to be losing power to the global market place as well as new local, regional (within state), social and political movements simultaneously.<sup>13</sup> Wunderlich (2007) also accounts for the suggestions that the state is under pressure “‘from above’ and ‘from below’” in the complex interplay between the three levels and provides a brief overview of the dispersion of power depicted in multilevel governance research which studies the supranational institutions of the EU, the states and their national governments, as well as the micro (or regional) authorities within the states themselves.<sup>14</sup> In the case of the Balkans the attempts to maximize scarce resources entail coordination and “...concentration of efforts through the adoption of a comprehensive ‘regional approach’ parallel to the

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<sup>10</sup> Christos Papazoglou, *The Economies of South Eastern Europe: Performance and Challenges* (New York: Palgrave Macmillan, 2005), 21-22.

<sup>11</sup> Bruno S. Sergi and Querim R. Querimi, *The Political Economy of Southeast Europe from 1990 to the Present: Challenges and Opportunities* (New York: The Continuum International Publishing Group Inc., 2008), 17

<sup>12</sup> Grigoris Kafkalas, “Overcoming the Fragmentation of Southeast Europe: An Introductory Overview of Main Themes,” in *Overcoming Fragmentation in Southeast Europe: Spatial Development Trends and Integration Potential*, ed. Panayiotis Getimis and Grigoris Kafkalas (Hampshire: Ashgate Publishing Company, 2007), 4

<sup>13</sup> Michael Keating, John Loughlin, and Kris Deschouwer, *Culture, Institutions and Economic Development: A Study of Eight European Regions* (Massachusetts: Edward Elgar Publishing Limited, 2003), 2.

<sup>14</sup> Jens-Uwe Wunderlich, *Regionalism, Globalization and International Order: Europe and Southeast Asia* (Burlington: Ashgate Publishing Company, 2007), 32

processes...<sup>15</sup> implemented nationally in pursuit of European integration. And the other aspect of the dilemma, outlined above, representing the local forces affecting state actions are evident in the extreme fragmentation and diverging national interests when focusing efforts upon domestic goals.<sup>16</sup>

Can Southeast Europe be viewed as a “region?” Papazoglou (2005) indicates that this interesting question must be tackled through the examination of political, historical, and economic criteria. This appears to be a central theme in the literature and various authors suggest the “idea” of a region to be “...as much socially and politically constructed as it is economically determined.”<sup>17</sup> His analysis of these factors concludes that their aims of EU accession put them side by side in their political as well as economic developments,<sup>18</sup> and increases their disposition to cooperate towards a regional integration culminating in a free trade area. The fruits of such developments are already evident and it would be hard to argue against statements claiming that “Such integration is happening, to different degrees, at the levels of the region (SEE), the EU, and the world.”<sup>19</sup> As Kathuria (2008) also points out cultural and/or physical proximity at the regional level usually spur such amalgamation, and in SEE the Central European Free Trade Area (CEFTA 2006) is a manifestation of this process and according to the World Bank, a major step toward increased cooperation for the EU aspiring nations. Furthermore regional integration is viewed as a stepping stone towards the ultimate goal of EU membership. This is also echoed by Papazoglou (2005) who notes that cooperation has become an important objective in all countries of the region<sup>20</sup>; this must also be extended to include the administration of Kosovo as it too participates in regional cooperative initiatives. Additionally some scholars of nationalism and its relation to economic development further assert that the Western Balkans would be best served by larger heterogeneous units resulting from cooperation

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<sup>15</sup> Grigoris Kafkalas, “Overcoming the Fragmentation of Southeast Europe: An Introductory Overview of Main Themes,” in *Overcoming Fragmentation in Southeast Europe: Spatial Development Trends and Integration Potential*, ed. Panayiotis Getimis and Grigoris Kafkalas (Hampshire: Ashgate Publishing Company, 2007), 8.

<sup>16</sup> Grigoris Kafkalas, “Overcoming the Fragmentation of Southeast Europe: An Introductory Overview of Main Themes,” in *Overcoming Fragmentation in Southeast Europe: Spatial Development Trends and Integration Potential*, ed. Panayiotis Getimis and Grigoris Kafkalas (Hampshire: Ashgate Publishing Company, 2007), 8.

<sup>17</sup> Jens-Uwe Wunderlich, *Regionalism, Globalization and International Order: Europe and Southeast Asia* (Burlington: Ashgate Publishing Company, 2007), 36

<sup>18</sup> Christos Papazoglou, *The Economies of South Eastern Europe: Performance and Challenges* (New York: Palgrave Macmillan, 2005), 3-4.

<sup>19</sup> Sanjay Kathuria, ed., *Western Balkan Integration and the EU: An Agenda for Trade and Growth* (Washington, D.C.: The World Bank, 2008), 65.

<sup>20</sup> Christos Papazoglou, *The Economies of South Eastern Europe: Performance and Challenges* (New York: Palgrave Macmillan, 2005), 4.

and integration than proliferated smaller nation-states.<sup>21</sup> Thus far it appears that the literature is unanimously supportive of regional integration and cooperation rather than disintegration and separation. This is not surprising giving the historical developments, divisions, and secession-prone political units that paint the Balkans as the powder keg of Europe. Attempted unifications have been short lived, largely destabilizing, and foreign intervention has been required to appease quarrels. And even though regional cooperation in SEE was largely unimaginable as recently as a decade ago<sup>22</sup>, today it is not an option but a necessity for the inhabitants of the Balkans since “Each of these peoples, with their historic ties to land, have no choice but to coexist and to interact in social, economic, and political ways.”<sup>23</sup> Their peaceful concomitance is by no means insignificant and “The importance of creating stability in the Balkans is critical.”<sup>24</sup>

## 2.1 Economy

The literature reviewed above indicates that the international community is well aware of the importance of peace and stability in the Balkans. And regional cooperation - in addition to - integration through participation in various initiatives and associations is viewed as means capable of maintaining the desired tranquility. The economic integration is considered especially vital since it could provide the relatively small economies with open markets necessary for an export-driven growth and development and “The promotion of export growth strategies has advanced the reality of increased economic regionalization.”<sup>25</sup> Nonetheless despite the fact that much of the literature examined is focused on studying the Balkan nations as a region, it cannot be overlooked that regional development is also employed to refer to a sub-national unit.<sup>26</sup> Even though economics are rarely cited as the sole contributor to conflict escalation in the region, most scholarly literature lists growth and prosperity as subsidizing the grievances. In its Report of an

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<sup>21</sup> Milica Zarkovic Bookman, *Economic Decline and Nationalism in the Balkans* (New York: St. Martin's Press, 1994), 3.

<sup>22</sup> Peter Schön and Petra Pelster, “Southeast Europe within Changing European Geographies-Tracing Socio-economic Disparities and Potentials of Integration,” in *Overcoming Fragmentation in Southeast Europe: Spatial Development Trends and Integration Potential*, ed. Panayiotis Getimis and Grigoris Kafkalas (Hampshire: Ashgate Publishing Company, 2007), 181

<sup>23</sup> Milica Zarkovic Bookman, *Economic Decline and Nationalism in the Balkans* (New York: St. Martin's Press, 1994), 154.

<sup>24</sup> Steven Rattner and Michael B.G. Froman, *Promoting Sustainable Economies in the Balkans* (New York: Council on Foreign Relations, 2000), 7.

<sup>25</sup> Jens-Uwe Wunderlich, *Regionalism, Globalization and International Order: Europe and Southeast Asia* (Burlington: Ashgate Publishing Company, 2007), 35

<sup>26</sup> John B. Parr, “Regional Economic Development: An Export Stages Framework,” *Land Economics* 75, no.1 (1999), <http://www.jstor.org/stable/3146995>

Independent Task Force the Council on Foreign Relations finds that increasing prosperity could help reduce tensions and provide incentives to cooperate in raising the standards of living in the region in attempts to solidify long-term peace and stability.<sup>27</sup> Ivo Bicanic (1996) also refers to the region as an “interesting ‘laboratory’” where one can study the economics of transition. His analysis of the Yugoslav successor states yields the effects of different economic structures and he urges caution towards a single set of economic policies to be implemented in a heterogeneous environment.<sup>28</sup> Bookman (1994) on the other hand sees large heterogeneous units as advantageous and her “lose confederative union” would increase the scope of economic interaction among members, and such system is viewed as capable of yielding highest rate of economic growth.<sup>29</sup> Even though Ivo Bicanic’s analysis concludes that economic policies in heterogeneous economic environment produce asymmetric affects that could lead to undesirable “go-it-alone” policies it appears that the two authors are referring to different integrative models for the region. Whereas one explains the economic transition of the break-up of the latest Yugoslav experience, Bookman proposes an alternative voluntary association similar to the numerous initiatives and mechanisms at work in the region today. The caution raised by Bicanic should not be overlooked however, for even in today’s “calm” Balkans a heterogeneous unit is yet to prove effective in reducing the significant economic inequality among groups and between regions.

Up to this point much of the literature has sought to depict the Balkans, or Southeast Europe, as a region within Europe and this is not without due cause; however studies of “...the regional level, identifying the region as an intermediate level between the state and the locality, with a certain sense of common identity and institutions”<sup>30</sup> are scarce. The reason for this void is the ongoing development and nation-building in the newly independent entities. Nonetheless even though macroeconomic policies analyses are warranted in light of encouraged cooperation and integration of the West Balkan countries into a free-trade market, research on regional

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<sup>27</sup> Steven Rattner and Michael B.G. Froman, *Promoting Sustainable Economies in the Balkans* (New York: Council on Foreign Relations, 2000), 7-8.

<sup>28</sup> Ivo Bicanic, “The Economic Divergence of Yugoslavia’s Successor States,” in *Problems of Economic and Political Transformation in the Balkans*, ed. Ian Jeffries (New York: Pinter, 1996), 147.

<sup>29</sup> Milica Zarkovic Bookman, *Economic Decline and Nationalism in the Balkans* (New York: St. Martin’s Press, 1994), 164-7.

<sup>30</sup> Michael Keating, John Loughlin, and Kris Deschouwer, *Culture, Institutions and Economic Development: A Study of Eight European Regions* (Massachusetts: Edward Elgar Publishing Limited, 2003), 3.

development without the protective umbrella of the nation-state is needed.<sup>31</sup> As pointed out the peoples of the “powder keg” of Europe have, and will, interact and collaborate for a variety of reasons; and such integration and cooperation is applauded by the international community as it is viewed as a means to maintain peace and stability in the area. Much of the scholarly work on new regionalism concerns the emergence of the city-region as an important actor in the world economy as it becomes the source of the direct local response to stresses and strains, increasingly overshadowing central government initiatives aimed at various problems.<sup>32</sup> However in the Balkans in particular there is a void in the literature and studies of municipalities as adopters of initiatives, as well as solution providers for local maladies and stagnant development are much needed. Analyses of regions are often done, however the scale is sometimes questioned since regions change over time, and it is possible to witness new regions coming into existence within already settled and defined nations.<sup>33</sup>

## 2.2 Foreign Direct Investment

Foreign Direct Investment (FDI) is viewed as an essential factor for economic development in the Balkans, and its combination with export-led growth much needed for stability and increased living standards. The impacts of FDI are expected to affect the growth abilities of the host nation through enhanced capital accumulation and novelty inputs in the production capabilities of countries, in addition to diffusion of knowledge, training, organizational arrangement, managerial practices, and benefits of technological upgrading.<sup>34</sup> Therefore “foreign investors may increase productivity in the recipient economy and FDI can be deemed to be a catalyst for domestic investment and technological progress.”<sup>35</sup> And even though FDI is often an efficient option for “catching-up” it is pointed out that “pumping” a country full of FDI will not necessarily result in development.<sup>36</sup> The academic literature on FDI in the SEE is

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<sup>31</sup> Michael Keating, John Loughlin, and Kris Deschouwer, *Culture, Institutions and Economic Development: A Study of Eight European Regions* (Massachusetts: Edward Elgar Publishing Limited, 2003), 15

<sup>32</sup> Allen J. Scott et al., “Global City-Regions,” in *Global City-Regions: Trends, Theory, Policy*, ed. Allen J. Scott (New York: Oxford University Press, 2001), 21

<sup>33</sup> John B. Parr, “Regional Economic Development: An Export Stages Framework,” *Land Economics* 75, no.1 (1999), <http://www.jstor.org/stable/3146995>

<sup>34</sup> Luiz R. de Mello Jr., “Foreign Direct Investment-led Growth: Evidence from Time Series and Panel Data,” *Oxford Economic Papers* 51, (1999)

<sup>35</sup> Luiz R. de Mello Jr., “Foreign Direct Investment-led Growth: Evidence from Time Series and Panel Data,” *Oxford Economic Papers* 51, (1999)

<sup>36</sup> Rajneesh Narula and Christian Bellak, “EU Enlargement and Consequences for FDI Assisted Industrial Development,” *Transnational Corporations* 18, no.2, (2009)



mostly concerned with the cross-national analyses and studies of allocation within the nations themselves are scarce. Nonetheless there is an increase in investment incentive programs aimed at the promotion of regional development that seek to portray various localities as investment opportunities in order to stimulate the microeconomic environment. Factors such as “investment patterns, labor force requirements, productivity levels, intersectoral and interindustry linkages within the regional economy”<sup>37</sup> are expected to differ within various sectors of region export bases. Investments (FDI in particular) in the Balkan transition countries is often viewed as insufficient compared to their Central European counterparts and differences in attitudes towards FDI among the administrative entities of the region are often said to be determined by various cultural, ethnic, social, and other factors.<sup>38</sup> Since the literature on FDI in the Balkans is dominated by cross-national studies, the unit of interest is the nation state or a region comprised of nation states. Furthermore “Numerous surveys and publications, such as those from the UN, routinely publish aggregated data on FDI by country.”<sup>39</sup> If we are to examine the FDI inflows in the Balkans - as a conglomeration of countries - it would be difficult to obtain knowledge on the success of local initiatives within the administrative entities. And as the governance capabilities of localities and municipalities are increasing in light of decentralization forces, attention should focus on the administration of these sub-national units within a wider European, or world, framework as local governments increasingly are empowered to formulate and implement their own economic policies. Therefore examining the region as a “sub-national” unit capable of attracting investment would yield valuable knowledge as Southeast Europe strives to elevate and sustain economic development. In the case of the Former Yugoslav entities studies of the sub-national unit are of particular interest as the contours of the geographical space occupied by nation states are yet to be labeled “permanent.” We are witnessing increased decentralization as “...even in a unified state, subnational leaders can wrestle away policymaking autonomy, especially in regard to economic decisions, from the central government.”<sup>40</sup> In his study

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<sup>37</sup> John B. Parr, “Regional Economic Development: An Export Stages Framework,” *Land Economics* 75, no.1 (1999)

<sup>38</sup> Trajko Slaveski and Pece Nedanovski, “Foreign Direct Investment in the Balkans: The Case of Albania, FYROM, and Bulgaria,” *Eastern European Economics* 40, no.4 (2002)

<sup>39</sup> Deepak Sethi, S.E. Guisinger, S.E. Phelan, D.M. Berg, “Trends in Foreign Direct Investment Flows: A Theoretical and Empirical Analysis,” *Journal of International Business Studies* 34, no.4 (2003), <http://www.jstor.org/stable/3557177>

<sup>40</sup> Edmund J. Malesky, “Straight Ahead on Red: How Foreign Direct Investment Empowers Subnational Leaders,” *The Journal of Politics* 70, no.1 (2008)  
doi:10.1017/S0022381607080085

Malesky (2008) indicates that a source of such decentralization is integration into the world economy via access to FDI that could empower subnational leaders and provide them with sufficient resources which in some cases could lead them to seek, and ultimately gain, increased independence from central government authority. Such developments tend to amplify the importance of subnational economic development policy. In the Western Balkans attempts to ameliorate the problems of “...sustainable development and economic cohesion at the local, urban, and regional levels have been limited because there is an absence of a ...strong tradition for regional and local development policy.”<sup>41</sup> This void of a regional development policy stems from limited historical and institutional capacities of the relevant administrative entities at the local levels.<sup>42</sup> Thus the issues of economic underdevelopment at the local (regional) level are often poorly addressed and “...remain abstract and sometimes conflicting, showing little engagement with the processes that are essential for balanced economic development, such as diffusion effects, spatial linkages and spillovers.”<sup>43</sup> Hence the spillover effects from FDI may be restricted to certain sub-national units providing economic benefits, while other localities may not be equipped to absorb or attract any generated spillover; however these disparities are rarely if ever accounted for. Nonetheless the different types of FDI are often clustered in certain locations in order to take advantage of existing infrastructure – climate - and the presence of investors often creates a “following” as other industries follow suit in the host country region.<sup>44</sup> In Southeast Europe the limited resources and need for sustainable economic growth are combined with (usually) highly educated workforce, and relatively developed nations branding them “...well placed to benefit from the technology and knowledge transfer associated with FDI.”<sup>45</sup>

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<sup>41</sup> Vassilis Monastiriotis and George Petrakos, “Local Sustainable Development and Spatial Cohesion in the Post-transition Balkans: in search of a development model,” *The Hellenic Observatory: The European Institute*, GreeSE Paper No.29 (2009)

<sup>42</sup> Vassilis Monastiriotis and George Petrakos, “Local Sustainable Development and Spatial Cohesion in the Post-transition Balkans: in search of a development model,” *The Hellenic Observatory: The European Institute*, GreeSE Paper No.29 (2009)

<sup>43</sup> Vassilis Monastiriotis and George Petrakos, “Local Sustainable Development and Spatial Cohesion in the Post-transition Balkans: in search of a development model,” *The Hellenic Observatory: The European Institute*, GreeSE Paper No.29 (2009)

<sup>44</sup> Dimitri G. Demekas, Balázs Horváth, Elina Ribakova, and Yi Wu, “Foreign Direct Investment in Southeastern Europe: How (and How Much) Can Policies Help?,” *International Monetary Fund*, WP/05/110 (2005)

<sup>45</sup> Dimitri G. Demekas, Balázs Horváth, Elina Ribakova, and Yi Wu, “Foreign Direct Investment in Southeastern Europe: How (and How Much) Can Policies Help?,” *International Monetary Fund*, WP/05/110 (2005)

## CHAPTER THREE

### SERBIA: LEGACY AND DECENTRALIZATION

Serbia occupies a central position in Southeast Europe in a geographical as well as political sense. Throughout the last century political developments in Serbia have had a major effect on neighboring nations and have resulted in the augmentation of state borders as various administrative entities have unified under a single central authority; and at other times have been subjugated to secessionist movements driven by decentralization forces resulting from political developments. In the course of these changes the involvement of the Serbian nation has rarely, if ever, been omitted. The first Yugoslav experience is often associated with "...the domination of the entire state apparatus by the Belgrade centralists."<sup>46</sup> Often referred to as the "First Yugoslavia" this endeavor housed the populations of Serbia, Montenegro, Croatia, Bosnia-Herzegovina, Former Yugoslav Republic of Macedonia, Slovenia, and Kosovo under the same roof within the Union of the Southern Slavs. The subsequent developments are well depicted in the literature and will be briefly called upon here in order to provide a background to the resulting changes of administration and economic developments.

The birth of Yugoslavia at the end of the First World War was accompanied by attempts to integrate the fiscal, and transportation, systems of administrative units (and their economic institutions) that were in various stages of development.<sup>47</sup> The path implemented by the governing body of the Union sought economic development through centrally administered industry incentivizing, rather than agriculture, and by "World War II the government owned and operated all railroads, all telegraph and telephone lines and radio stations, most of the banks, most of river shipping and harbor storage facilities, some large lumber mills, numerous coal mines, iron mines, and steel plants, several sugar factories, and all processing facilities for tobacco and salt."<sup>48</sup> Furthermore it was determined that additional assistance to the industries would be assured by "high protective tariffs, resulting in a protectionist system whose rates were among the highest in Europe; and lastly, but not of least importance, industrial development was going to be spurred by foreign investors and... Most of the industrial expansion in the interwar

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<sup>46</sup> L.S. Stavrianos, *The Balkans since 1453* (New York: Holt, Rinehart and Winston, 1966), 624

<sup>47</sup> L.S. Stavrianos, *The Balkans since 1453* (New York: Holt, Rinehart and Winston, 1966), 633

<sup>48</sup> L.S. Stavrianos, *The Balkans since 1453* (New York: Holt, Rinehart and Winston, 1966), 637

years was financed by foreign capital.”<sup>49</sup> State ownership and operation of industry increased in subsequent years and by the end of 1946 additional forty-two branches of industry were under central authority.<sup>50</sup> Developments in the international arena (particularly relationships with Soviet leadership) however inspired policies aimed at the “withering of the state” and decentralization reforms in the late 1940s and early 1950s increased responsibilities at the local level.<sup>51</sup> The ensuing developments have also been well addressed in various studies and academic works emphasizing ethnic conflict and nationalist policies which contributed to the fragmentation of the Yugoslav state as a result of increased republican autonomy and eventually culminated in the independence and creation of a handful of nation states. For the purpose of this research a brief historical account of economic policy development is necessary in order to establish a parallel between the state of the Yugoslav economy (portrayed as a collection of economies at various levels of development) and current level of municipal development and proposed increased autonomy over innovation and implementation of economic policies at the local level in the Republic of Serbia.

In the mid and late 1960s an alternative to the “nonexistent Yugoslav economy” was “to allow the republics more power to mould the reforms to suit their particular economic needs.”<sup>52</sup> And today Serbian municipalities are making a similar case for increased autonomy over development and enactments of economic policies at the local level. The regional inequalities in Serbia have been the focus of central policies that have failed to address the cleavages and as a result the country’s number of underdeveloped municipalities is said to be as high as 37.<sup>53</sup> In the past strong central authority has often been blamed for ineffectiveness in addressing local economic development and misappropriation of funds to “hopelessly inefficient” endeavors such as the Smederevo steel works in Serbia<sup>54</sup>. And the political landscape had become a battleground for arguments in support of decentralization (above is an example of the funding of inefficient state enterprises depicted as economic disasters, that could complement the Agrokomerc

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<sup>49</sup> L.S. Stavrianos, *The Balkans since 1453* (New York: Holt, Rinehart and Winston, 1966), 637

<sup>50</sup> R.J. Crampton, *The Balkans Since the Second World War* (London: Pearson Education, 2002), 25

<sup>51</sup> R.J. Crampton, *The Balkans Since the Second World War* (London: Pearson Education, 2002), 114-115

<sup>52</sup> R.J. Crampton, *The Balkans Since the Second World War* (London: Pearson Education, 2002), 127

<sup>53</sup> Radmila Miletic and Marina Todorovic, “The Regional Structure of Serbia,” *Journal of Urban and Regional Analysis* 1 (2009): 61-62

<sup>54</sup> R.J. Crampton, *The Balkans Since the Second World War* (London: Pearson Education, 2002), 143

enterprise scandal<sup>55</sup>) whose enthusiasts claim that increased local empowerment would assure the avoidance of Smederevo occurrences since central authority will be prevented from interfering with local affairs; and counterarguments being that Agrokomerc is an example of too much decentralization and the need for improved central control.<sup>56</sup> As in the past economic developments in the region today play a vital role in the political arena and questions of decentralization and secessionist sentiments are easily ignited and utilized as radical rhetoric in underdeveloped areas in particular. “The roots of the increasingly obvious revival of the national question in the 1960s were primarily, but not exclusively, economic in nature”<sup>57</sup> and we would like to think that the Balkan societies have moved beyond conflict laden nationalist questions; however the detailed historiography of the Yugoslav conflicts warns the reader of the importance economic prosperity has on dampening similar to the 1960s revivals. The political decentralization of that time period “...endowed Yugoslavia’s local (communal) governments with both incentives and the capability to take investment initiatives, the essential ingredient of the later condemned vice of ‘economic localism.’”<sup>58</sup> Yugoslavia is no longer a member of the international system, its building blocks now represent independent nations in the global nation-state arena. Similarly to its predecessor in the 1960s, the Republic of Serbia is confronted with a parallel “economic localism” as regions - identified by national communities - vie for increased autonomy (Vojvodina, and a case can be made for Sandjak, and the Preševo Valley). Decentralization forces also give rise to separation movements in neighboring Bosnia as its Republika Srpska seeks to secede and unite with its Serbian brethren, and Albanians in Macedonia, as well as the Magyars of northern Vojvodina are also noted to “entertain somewhat more fanciful notions of secession.”<sup>59</sup> The purpose of this research is not to provide the allusive panacea for permanent tranquility in the Balkans, nor to provide a roadmap for

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<sup>55</sup> The Agrokomerc affair had a profound effect in Yugoslavia, and it showed how few officials associated with the enterprise had grown exceedingly wealthy, in stark contrast to the majority of the working population who had become significantly poorer.

<sup>56</sup> R.J. Crampton, *The Balkans Since the Second World War* (London: Pearson Education, 2002), 144

<sup>57</sup> Dennis Rusinow, “Reopening of the ‘National Question’ in the 1960s,” in *State Collapse in South-eastern Europe: New Perspectives on Yugoslavia’s Disintegration*, ed. Lenard J. Cohen and Jasna Dragović-Soso (West Lafayette: Purdue University Press, 2008), 132

<sup>58</sup> Dennis Rusinow, “Reopening of the ‘National Question’ in the 1960s,” in *State Collapse in South-eastern Europe: New Perspectives on Yugoslavia’s Disintegration*, ed. Lenard J. Cohen and Jasna Dragović-Soso (West Lafayette: Purdue University Press, 2008), 133

<sup>59</sup> Dennis Rusinow, “Reopening of the ‘National Question’ in the 1960s,” in *State Collapse in South-eastern Europe: New Perspectives on Yugoslavia’s Disintegration*, ed. Lenard J. Cohen and Jasna Dragović-Soso (West Lafayette: Purdue University Press, 2008), xi

successful disintegration and subsequent reintegration of autonomous factions in a greater European community, but rather shed light on what factors affect the overlooked municipal competition for investment in the Republic of Serbia. In the past the federal role in investment allocation in Yugoslavia has been scrutinized as political battles pinned against each other liberals supported by “social entrepreneurs” and their “conservative antireformers” counterparts<sup>60</sup> as they scuffle for political supremacy. This may be a recurring theme as evident in the subsequent review.

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<sup>60</sup> Dennis Rusinow, “Reopening of the ‘National Question’ in the 1960s,” in *State Collapse in South-eastern Europe: New Perspectives on Yugoslavia’s Disintegration*, ed. Lenard J. Cohen and Jasna Dragović-Soso (West Lafayette: Purdue University Press, 2008), 135

## CHAPTER FOUR

### INVESTMENT IN SERBIA'S MUNICIPALITIES

The collapse of communism and the subsequent restructuring of governments and administrative units in the Balkans has been profound and challenging, and is an ongoing process evident in attempts of peaceful integration into a greater European community. The European Union is often said to be a governance system promoting the drafting and implementation of policies at a territorial administrative level as close as possible to those affected by their enactment.<sup>61</sup> One of the proposed frameworks of regional development emphasizes value creation and enhancement rooted in institutional and assets development within global production networks<sup>62</sup>, and for the Western Balkans an importance of export oriented economies supported by investment is championed by the well-wishing international community. In addition a regional export stages framework indicates that entities should focus on their capacity to export since growth in this base will typically be associated with even larger growth in the non-export base.<sup>63</sup> The successful implementation of this proposed shift towards local economic development is not only mandatory, though challenging, for Serbia but is also a trailblazing opportunity for regional leadership. Even though Serbia is arguably the last country in the Balkans to experience a peaceful and democratic change of regimes – it can be contended that it is in some instances ten years arrears its counterparts from Eastern Europe<sup>64</sup> – it must be pointed out that this delay may be a provided opportunity to study and learn from the experiences of other transition economies in order to succeed in its endeavors.<sup>65</sup> Studies suggest political culture in Serbia was one of the major sources of the sluggish changeover.<sup>66</sup> As nation states in the Balkans navigate through the political landscape handed down to them by their predecessors,

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<sup>61</sup> Ray Hudson, "One Europe or Many? Reflections on Becoming European," *Transactions of the Institute of British Geographers*, 25 (2000), <http://www.jstor.org/stable/623280>

<sup>62</sup> Neil M. Coe, et al., "'Globalizing' Regional Development: A Global Production Network Perspective," *Transactions of the Institute of British Geographers*, 29 (2004), <http://www.jstor.org/stable/3804369>

<sup>63</sup> John B. Parr, "Regional Economic Development: An Export Stages Framework," *Land Economics* 75, no.1 (1999), <http://www.jstor.org/stable/3146995>

<sup>64</sup> Florian Bieber, "The Serbian Opposition and Civil Society: Roots of the Delayed Transition in Serbia," *International Journal of Politics, Culture, and Society* 17 (2003), <http://www.jstor.org/stable/20020198>

<sup>65</sup> Miroljub Hadžić, "Rethinking Privatization in Serbia," *Eastern European Economics* 3 (2002), <http://www.jstor.org/stable/4380318>

<sup>66</sup> Shale Horowitz, "Structural Sources of Post-Communist Market Reform: Economic Structure, Political Culture," *International Studies Quarterly* 48 (2004), <http://www.jstor.org/stable/3693534>

current globalizing forces shift attention, rhetoric, and effort to local economic development. The environment in terms of limits, possibilities, and opportunities is often established by a central government dictating the relationships between local level administrations and private investors<sup>67</sup> throughout the global system. In the Serbian context a strong central government stalwartly impacts the above depicted interactions through its designation of autonomy to selected administrative units. Recently there has been a calling for public institutions to strengthen provincial and local development through increased independence over the development and implementation of economic policies at the municipal administrative level. This is deemed necessary in order to address issues of employment, maintenance of economic activities, and promote an increase of citizens and economic groups' participation in defining the main course of public action.<sup>68</sup>

The transition towards local self-government modeled on the European standards has been far from smooth, nonetheless the successful progression of the process could provide lasting stability in the region. Different levels of economic development has made "the transformation of local economies both more painful and slower and has spurred antagonisms ('race to accession') thus hindering the very fundamentals of regional cooperation."<sup>69</sup> Much of the academic literature focused on the geographical area has been qualitative in nature and intended to provide an introduction to the political developments of the region, and further has sought to advocate a search for possible solutions to the various problems that have brought instability and animosity.<sup>70</sup> The majority of the quantitative research has been focused on the national level or the region as a conglomeration of countries, and with few exceptions local economic development within the countries has not been addressed. It is time to shift attention to developments at levels closest to constituents who are gradually being empowered to govern their locales with increased independence from central authority. Economic studies have utilized growth accounting/production function theoretical frameworks,<sup>71</sup> and have almost unanimously

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<sup>67</sup> Kevin R. Cox, "Globalization and the Politics of Local and Regional Development: The Question of Convergence," *Transactions of the Institute of British Geographers* 29 (2004), <http://www.jstor.org/stable/3804553>

<sup>68</sup> Jovan Komsic, ed., *Principles of European Regionalism* (Novi Sad: Association of Multiethnic Cities of Southeast Europe Philia, 2007), 229-232

<sup>69</sup> Vassilis Monastiriotis and George Petrakos, "Local Sustainable Development and Spatial Cohesion in the Post-transition Balkans: in search of a development model," *The Hellenic Observatory: The European Institute*, GreeSE Paper No.29 (2009)

<sup>70</sup> R.J. Crampton, *The Balkans Since The Second World War* (London: Pearson Education Limited, 2002), xvi

<sup>71</sup> Sanjay Kathuria, ed., *Western Balkan Integration and the EU: An Agenda for Trade and Growth* (Washington, D.C.: The World Bank, 2008), 6-7



sought to advocate sustainable economic growth through increased private investment from home and abroad.<sup>72</sup> Barriers, like economic nationalisms, to investment from abroad have also been addressed at the national level,<sup>73</sup> alongside various unfavorable “natural characteristics” the latter of which had been jointly compounded into an index of “distortions” to be analyzed through principle component analysis.<sup>74</sup> Furthermore the role of foreign investment in the industrial development of the Balkan nations is estimated to be broadly similar and relevant to all countries and it is stressed that the factors that guide economic activity are similar to determinants of FDI.<sup>75</sup> In addition, the size of the market, local regulatory frameworks, and technological capability of firms are outlined as host country characteristics that are influential while government incentives and subsidies are thought to be non-pivotal in the implied greater potential for increased technological spillovers.<sup>76</sup> Another theoretical framework seeking to analyze the determinants and effects of foreign investment is the “eclectic theory” based on three sets of potential advantages: 1) ownership in the host country 2) a comparative or transaction cost advantage in terms of tariffs, and 3) internationalization advantage.<sup>77</sup> All of those are relevant factors in the Balkan region as countries, like Serbia, are undertaking reforms aimed at private property rights. And all neighboring nations are actively seeking to provide advantageous to investors tariffs and commercial traffic-friendly border crossings in Southeastern Europe; a region known for lengthy delays, inefficiency and corruption at many national borders. Supplementary research indicates that policy environment is also a contributing factor; however empirical studies’ attempts to estimate the impact of individual policies on FDI has yielded results that are often ambiguous.<sup>78</sup> This analysis further takes into consideration geographical as

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<sup>72</sup> Steven Rattner and Michael B.G. Froman, *Promoting Sustainable Economies in the Balkans* (New York: Council on Foreign Relations, 2000), 15

<sup>73</sup> Robert Bideleux and Ian Jeffries, “Nationalism and the Post-1989 Transition to Democracy and Market Economies in the Balkans: A Historical Perspective,” in *The Problems of Economic and Political Transformation in the Balkans*, ed. Ian Jeffries (New York: Pinter, 1996), 185

<sup>74</sup> Christos Papazoglou, *The Economies of South Eastern Europe: Performance and Challenges* (New York: Palgrave Macmillan, 2005), 27

<sup>75</sup> Rajneesh Narula and Christian Bellak, “EU enlargement and Consequences for FDI Assisted Industrial Development,” *Transnational Corporations* 18, no. 2(2009),

[http://www.unctad.org/en/docs/diaeiia200910a3\\_en.pdf](http://www.unctad.org/en/docs/diaeiia200910a3_en.pdf)

<sup>76</sup> Rajneesh Narula and Christian Bellak, “EU enlargement and Consequences for FDI Assisted Industrial Development,” *Transnational Corporations* 18, no. 2(2009),

[http://www.unctad.org/en/docs/diaeiia200910a3\\_en.pdf](http://www.unctad.org/en/docs/diaeiia200910a3_en.pdf)

<sup>77</sup> Victor M. Gastanaga, Jeffrey B. Nugent, and Bistra Pashamova, “Host Country Reform and FDI Inflows: How Much Difference Do They Make?,” *World Development* 26 (1998): 1300

<sup>78</sup> Dimitri G. Demekas, et al. *Foreign Direct Investment in Southeastern Europe: How (and How Much) Can Policies Help?* (WP/05/110: International Monetary Fund, 2005), 5

well as cultural proximity between the source of investment and host country, in addition to market size, in explaining investment flows in Central and Southeast Europe and the findings are consistent with existing empirical literature on other regions.<sup>79</sup> Proximity in technology advancement is also not omitted from cross-country analyses and expertise and knowledge transfers appear to be affected by institutions with diverging results between heterogeneous non-OECD members versus their homogeneous OECD counterparts.<sup>80</sup> Much of the literature also indicates that many empirical studies seek to outline the determinants of investment, however regional variation is poorly explained,<sup>81</sup> and here too the factors are collectively considered to be a mixture of often utilized variables: GNP, population, infrastructure, barriers and tariffs, political and economic stability, as well as cultural proximity.<sup>82</sup> Furthermore it is often pointed out that there is an observable difference in attitude towards foreign investment among various nations,<sup>83</sup> and that the countries of Southeast Europe recognize its importance and are creating favorable legal frameworks for increased attraction.<sup>84</sup> However in terms of the countries themselves it must also be pointed out that the variation in attitude can be observed not only from country to country, but also from one administration to another in terms of policy implementation. Voters in individual countries can be swayed at the polls by agendas that seek to improve living conditions and prosperity. Hence if an administration implements a set of policies that are deemed ineffective by constituents, a subsequent administration could be voted into power in the next election cycle on a promise to rid the nation of the predecessors' ineffective policy platform.

As evident in order to study foreign investment it is also important to analyze domestic political reactions, or "How does the growth of FDI affect the economic sovereignty of nation-

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<sup>79</sup> Dimitri G. Demekas, et al. *Foreign Direct Investment in Southeastern Europe: How (and How Much) Can Policies Help?* (WP/05/110: International Monetary Fund, 2005), 24

<sup>80</sup> Ruiz R. de Melo, "Foreign Direct Investment-led Growth: Evidence from Time Series and Panel Data," *Oxford Economic Papers* 51 (1999): 134

<sup>81</sup> Deepak Sethi, et al., "Trends in Foreign Direct Investment flows: A Theoretical and Empirical Analysis," *International Business Studies* 34, no.4 (2003), <http://www.jstor.org/stable/3557177>

<sup>82</sup> Deepak Sethi, et al., "Trends in Foreign Direct Investment flows: A Theoretical and Empirical Analysis," *International Business Studies* 34, no.4 (2003), <http://www.jstor.org/stable/3557177>

<sup>83</sup> Trajko Slaveski and Pece Nedanovski, "Foreign Direct Investment in the Balkans: The Case of Albania, FYROM, and Bulgaria," *Eastern European Economics* 40, no.4 (2002), <http://www.jstor.org/stable/4380306>

<sup>84</sup> <sup>84</sup> Trajko Slaveski and Pece Nedanovski, "Foreign Direct Investment in the Balkans: The Case of Albania, FYROM, and Bulgaria," *Eastern European Economics* 40, no.4 (2002), <http://www.jstor.org/stable/4380306>

states?”<sup>85</sup> In many countries the national origin of leading companies may not be a very controversial issue, however it could be a sensitive topic for others. In the case of Serbia in particular this matter is political ammunition and it does cut “into the heart of the issue of what nation-states exist for”<sup>86</sup> in light of rising decentralization sentiments and further potential regional (local administrative level) empowerment and subsequent secession within the former South Slav stronghold. Nationalist parties have in recent years lost ground to more outward European-looking perspectives, however economic (under)performance can easily reverse the trend. In Serbia in particular this could certainly become a central issue in domestic politics as local businesses are portrayed as upset, or even endangered, by an “economic invasion” and are seeking increased government protection for domestic companies. (“As noted by News/From our Bureaus article titled: Serbian Companies Decry ‘Invasion’ by Croatian Firm on August 20<sup>th</sup>, 2010 in *Radio Free Europe* [http://www.rferl.org/content/Serbian\\_Companies\\_Decry\\_Invasion\\_By\\_Croatian\\_Firms\\_/2132905.html](http://www.rferl.org/content/Serbian_Companies_Decry_Invasion_By_Croatian_Firms_/2132905.html)”) Similar developments could have important policy implications in upcoming elections since the current government has sought to implement a long list of EU-supported economic policies focused on attracting foreign investment, and the empowerment of local administrations in providing a better business environment to potential investors. The durability of such policies is tenuously entrenched in a region where a preliminary descriptive research<sup>87</sup> concludes that municipalities appear to punish and reward parties for local economic conditions. Furthermore economic conditions in Serbia were the corner stone of recent antigovernment demonstration staged by Serbian Progressive Party seeking to put on an exhibit of the opposition’s strength and provide a two month ultimatum to the current EU-friendly administration: move forward the scheduled for 2012 parliamentary elections or face further protest and calls for resignation (“As reported by RFE/FL in an article on *Radio Free Europe* on February 5<sup>th</sup>, 2011: [http://www.rferl.org/content/serbia\\_opposition\\_rally/2298291.html](http://www.rferl.org/content/serbia_opposition_rally/2298291.html)”) Thus a rising popularity of nationalist opposition in the domestic political environment of Serbia is to be of concern for durability of the extant policies seeking to foster “...the right business conditions-infrastructure,

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<sup>85</sup> Vincent Cable, “The Diminished Nation-State: A Study in the Loss of Economic Power,” *Daedalus* 124, No.2(1995), <http://www.jstor.org/stable/20027296>

<sup>86</sup> Vincent Cable, “The Diminished Nation-State: A Study in the Loss of Economic Power,” *Daedalus* 124, No.2(1995), <http://www.jstor.org/stable/20027296>

<sup>87</sup> Andrew Konitzer, “Challenges to Democratic Decentralization in CEE: The Case of Serbia,” presented at *Midwest Political Science Association* (2008): 27

deregulation of markets, skilled and educated labor, financial stability-to attract and retain mobile capital,”<sup>88</sup> since at least some of those are portrayed as detrimental to the success of Serbian companies.

#### 4.1 Theoretical Framework

The nation-state is still an essential unit of analysis in comparative studies nonetheless regions are becoming increasingly important in today’s academic research. Forces of globalization and technological advancements are providing patterns of interaction that could rival the nation state’s “supremacy” as a unit of analysis. Recent scholarly works have suggested that “city-regions” are functioning as building blocs of the global economy, and export-oriented means of national growth are supplanting national import-substitution policies.<sup>89</sup> At the same time it is also theorized that nation-states are taking a back seat to transnational regimes and “...new local and regional cultural, social and political movements.”<sup>90</sup> Institutional structures within states are theoretically important for academic research aimed at the advancement of knowledge on development and territorial integrity in the Balkan region. In the beginning of this millennium the Government of Serbia indicated a commitment to decentralization of responsibilities and financial resources to the local municipal level of administration through the adoption of a new law and establishment of a new Ministry of State Administration and Local Self-Government (MSA/LSG.)<sup>91</sup> Nonetheless it is theorized that “by giving local elites considerable autonomy and resources, they also create the possibility that such elites will defect from central hierarchy, and start a polity of their own.”<sup>92</sup> Thus it is not surprising that the central government of Serbia has been hesitant to allow autonomy in policy development that could fuel secessionist aspirations, as this trend is not only historically observable throughout the existence of South Slav unity, but also evident in independence-aspiring regions within the country’s borders today. Institutional theories have previously been used to explain foreign policies and broad trends; however new institutionalism also emphasizes the importance of domestic

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<sup>88</sup> Vincent Cable, “The Diminished Nation-State: A Study in the Loss of Economic Power,” *Daedalus* 124, No.2(1995), <http://www.jstor.org/stable/20027296>

<sup>89</sup> Allen J. Scott, ed., *Global City-Regions: Trends, Theory, Policy* (New York: Oxford University Press, 2001), 4-5

<sup>90</sup> Michael Keating, John Loughlin, and Kris Deschouwer, *Culture, Institutions and Economic Development: A Study of Eight European Regions* (Massachusetts: Edward Elgar Publishing Limited, 2003), 2-3

<sup>91</sup> As reported by the Danish Ministry of Foreign Affairs in its “West Balkans Stabilization and Reintegration Program 2005-2007” (WEBSREP), 2004

<sup>92</sup> Hendrik Spruyt, “New Institutionalism and International Relations,” in *Global Political Economy: Contemporary Theories*, ed. Ronen Palan (New York: Routledge, 2000), 138-139

institutions recognizing that the macro unit of analysis is “in fact composites of various individual preferences, divergent coalitions, and contending institutions. One needs, therefore to ‘unpack’ the state.”<sup>93</sup> This is particularly important in cases where the treatment of aggregate state-level choices as ontologically similar to lower (local) level units’ individual choices is hard to justify.

Political and economic conditions in the Western Balkans are closely interrelated and “evidence shows that the region is capable of growth, should structural reform, trade and foreign investment be boosted.”<sup>94</sup> Serbia is “onboard” the EU-destined regional train seeking to implement the required structural reforms and alike its neighbors is seeking to boost domestic and foreign investment to sustain economic progress. As outlined earlier the determinants of FDI are often “associated with market size and capacity and capability of domestic industries creating a hierarchy of activity in Europe that sends countries furthest away from convergence with EU norms to the bottom.”<sup>95</sup> What is often omitted from analysis is the distribution of the investment within the nations themselves. This is the major contribution of the present work. By “unpacking” the nation-state of Serbia into municipal units we can observe the hierarchy of investment that would reveal whether the typical determinants of FDI for the national unit of analysis have a similar effect on the distribution at lower level administrations. The United Nations and other international bodies show continued support in the area of decentralization and the development of local self-government seeking to improve on central polity making in Serbia “by better aligning it with policy implementation mechanisms of local communities.”<sup>96</sup> Now, the newly empowered municipalities are “competing” for investment as they are gaining autonomy from central authority in policy areas concerned with the creation and fostering of globally compatible business environments. And since “The patterns of decentralization that have prevailed, partly as a response to EU pressures, have often led to local antagonisms and

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<sup>93</sup> Hendrik Spruyt, “New Institutionalism and International Relations,” in *Global Political Economy: Contemporary Theories*, ed. Ronen Palan (New York: Routledge, 2000), 140-141

<sup>94</sup> Grigoris Kafkalas, “Overcoming the Fragmentation of Southeast Europe: An Introductory Overview of Main Themes,” in *Overcoming Fragmentation in Southeast Europe: Spatial Development Trends and Integration Potential*, ed. Panayiotis Getimis and Grigoris Kafkalas (Hampshire: Ashgate Publishing Company, 2007), 12

<sup>95</sup> Rajneesh Narula and Christian Bellak, “EU enlargement and Consequences for FDI Assisted Industrial Development,” *Transnational Corporations* 18, no. 2(2009), [http://www.unctad.org/en/docs/diaeiia200910a3\\_en.pdf](http://www.unctad.org/en/docs/diaeiia200910a3_en.pdf)

<sup>96</sup> As outlined by a United Nations Development Program: Republic of Serbia Ministry for State Administration and Local Self-Government (Support to the Serbian Public Administration Reform Strategy: Second Phase)

counter-productive competition between localities,<sup>97</sup> it is important to be aware of potential polarization. Some local administrations are more successful than others in attracting investment; however this variation is not yet addressed in the academic literature and it is of great importance since historically divergent economic development in the region has been a source of conflict and instability – something all well-wishers strive to avoid.

## 4.2 Descriptive Analysis

This paper's goal is to provide an initial study seeking to propose hypotheses that could be subsequently empirically tested. The descriptive investigation presented here is based on data availability at the time the research was conducted and insufficient for inferential explorations. In order to study the variation of investment among Serbian administrative units of analysis we need to “unpack the state.” The Republic of Serbia consists of regions, districts, and municipalities; the latter have been the focus of domestic and internationally-assisted reforms aimed at improving infrastructure, human capital development, and economic sustainability. In particular most joint and EU-sponsored initiatives seek to strengthen the institutional framework for local government, and to build the local government capacities. The efforts are generally focused on legislative reforms synchronized with goals reflecting European standards regarding means of revenue allocation to local authorities. Thus municipalities are appropriate units of analysis since much of the reforms seek to strengthen their self-government, while the districts appear to be bypassed in terms of importance as legislative institutions. Municipal-focused studies are absent from the literature except for scant research on regional labor market differences,<sup>98</sup> and analyses of the performance management process in the public sector within Serbia.<sup>99</sup>

## 4.3 Data

For the analysis of FDI distribution within Serbia and proposition of hypotheses seeking to explain why some municipalities are more successful at its attraction an inventory of

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<sup>97</sup>Vassilis Monastiriotes and George Petrakos, “Local Sustainable Development and Spatial Cohesion in the Post-transition Balkans: in search of a development model,” *The Hellenic Observatory: The European Institute*, GreeSE Paper No.29 (2009)

<sup>98</sup>Mihail Arandarenko and Milena Jovičić, “Regional Labour Market Differences in Serbia: Assessment and Policy Recommendations,” *The European Journal of Comparative Economics* 4, no.2 (2007), <http://eaces.liuc.it/18242979200702/182429792007040207.pdf>

<sup>99</sup>Željko Šević, (2005) "Measuring performance on a local government level in a transitional country: the case of Serbia", *International Journal of Public Sector Management* 18, no.7 (2005), doi: 10.1108/09513550510624059

investment allocation within the nation is required; however such data is currently not publicly available. Inquiries to the World Bank External Offices in Serbia revealed that the Serbian Statistical Office provides the data used in their publications. Further inquiries to European Bank for Reconstruction and Development's Business Advisory Services Program in Serbia also proved futile in acquiring disaggregated FDI data by municipality. Thus the Serbian Statistical Office database was used since it affords information on investment comparable at the municipal level. Also it must be pointed out that efforts had been taken to approximate the Serbian Statistical System to European Statistical System requirements<sup>100</sup> improving the reliability of the data; credibility and availability of data have often been cited as hindering research in the past. Moreover studies on FDI are best performed on time series data in order to observe trends, and since such is not available (the credibility and availability of data has only recently been synchronized with European standards) this research can be viewed as an initial investigation to be further developed as statistical availability improves.

Realized investments are defined as the value of effectively carried out constructions, or purchases of new objects, equipment, and other.<sup>101</sup> Total realized investments in technical structure for each municipality is disaggregated into construction works, equipment (imported and domestic are differentiated,) and other. Additionally statistical data is collected on: area ( $km^2$ ), agricultural area (percentage of municipal area,) population, employment, salaries, education (higher and university,) roads (total, and modern surface,) and budget. Also supplementary figures on cost of business registration and status of membership in the National Alliance for Local Economic Development (NALED) for each municipality were gathered from the USAID funded Municipal Economic Growth Activity (MEGA) development program. With its emphasis on best EU practices the NALED is a program that strives to provide a certification to municipalities that seek to foster a positive business climate and increase investment. The variation in total realized investment in new fixed assets by technical structure for 165 municipalities varies from \$35 to \$1,040,112<sup>102</sup> with an average of \$37,166 and standard deviation of \$105,693. The distribution for realized investment in imported equipment of technical structure is similarly skewed and differences in municipal success in its attraction

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<sup>100</sup> <http://www.serbiastatistics.rs/objective.html>

<sup>101</sup> The data on investments in fixed assets are collected by an annual survey (INV-01) and are distinguished by ownership type (domestic and imported are of concern in this study.) The data are given at current prices (2009) and disaggregated by construction works, equipment, and other.

<sup>102</sup> The data collected is in Serbian Dinars and converted to US dollars at a rate of: 1 Dinar = 0.0136\$

during 2008 depicted below. 16 of the municipalities were able to attract over \$20,000 in realized investment in fixed assets that consisted of imported equipment:

Table 1: The 16 municipalities that amassed realized investment in fixed assets consisting of imported equipment totaling more than \$20,000 (in US dollars.)

Municipality	Realized investment in new fixed assets: technical structure consisting of imported equipment (in US dollars)
Zemun	\$54,557.45
Lazarevac	\$53,795.3
Novi Beograd	\$27,9131.7
Obrenovac	\$29,788.58
Palilula	\$74,278.14
Savski Venac	\$115,715.5
Stari Grad	\$92,862.09
Cukarica	\$29,374.26
Mali Idoš	\$38,602.55
Pancevo - city	\$22,118.21
Backa Palanka	\$32,536.23
Novi Sad - city	\$91,232.23
Valjevo - city	\$23,022.01
Smederevo - city	\$21,692.88
Požarevac - city	\$49,218.39
Paracin	\$34,727.11

Of those sixteen municipalities 4 are from the region of Vojvodina: Mali Idoš, Pancevo – city, Backa Palanka, and Novi Sad – city. These administrative units are fairly similar in terms of their size and their percentage of agricultural area ranges from 71.5 to 87.1%; well above the average reported nationally of 66.7%. Additionally the unemployed per 1000 inhabitants range from 58 to 123, and the national mean is 108 individuals per 1000, only Backa Palanka’s unemployed per one thousand exceed this average while the other three municipalities are



significantly below it. Budgetary health is quite different among those four municipalities with two reporting significant deficits, and two boasting a healthy surplus. As a percentage of the total realized investment in terms of technical structure the investment in imported equipment for three of the municipalities is at least 10% higher than the national average of 23.6% and in the city of Novi Sad realized investment in imported equipment is 17.7% of the total realized investments for the municipality for the year. In all four localities the salaries per employee exceed the national average and percentage of unskilled unemployed varies from 30 to 45%. The remaining 12 municipalities of this “elite” group are from the Central Serbia region and it must be noted that all but one are members of the National Alliance for Local Economic Development (NALED,) whereas their four Vojvodina counter parts had only one municipality with an active membership in the program. The variation in the size of the municipalities here is much greater, however their areas are rather small in comparison with the four administrative units in the above region, and the percentage of agricultural land varies from none to 78.8%. In terms of unemployment the rates among these municipalities do not deviate significantly and are mostly below the national averages of 12.2%, an exception being the municipality of Paracin in the Pomoravlje district where the rate is at 16.7% and the number of unemployed per one thousand is 146. Municipal fiscal health indicates that only 3 of 12 administrative units face deficits, and investment in imported equipment as a percentage of total investment ranges from 18.7 to 67.5% with only Stari Grad being below the national average. With the exception of the city of Valjevo the salaries per employee are all above the national average and the percentage of unskilled unemployed ranges from 10.9 to 45.8% with only three being above the national average of 39.74%.

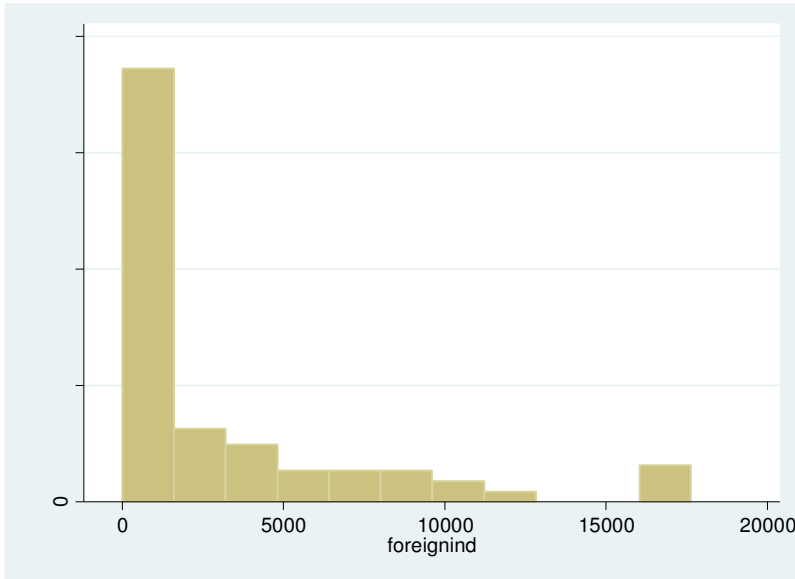


Figure 1: Distribution of Realized Investment in technical structure consisting of imported equipment for 139 municipalities who have attracted less than \$20,000 in 2008 (in US dollars.)

The success of the remaining municipalities is also important and it must be studied in order to achieve the numerous goals set forth for the country and the region as a whole. Almost one third of the municipalities have reported realized investment in imported equipment that amounts to less than \$347 and in light of decentralization-aimed initiatives and governance the municipal ability (or inability) to attract investment and capital will be detrimental for population shifts and economic developments within Serbia. Thus as Vojvodina seeks further autonomy, inhabitants of the Presevo Valley voice desire to be “reunited” in Kosovo, and Sandzak provides the political environment for secessionist rhetoric studies at the local level will provide an account of not only what works, but also what does not, and where attention is due. Initiatives and programs aimed at strengthening local administrations should be welcomed in communities where self-governance is not well established and where central authority over policy development has a strong legacy. Nonetheless it is important to study their effectiveness in achieving their goals. In the 62 municipalities that have adopted an initiative (NALED) the average realized investment of imported equipment in the technical structure of projects is \$17,412 and it ranges from just over \$5 to nearly \$280,000; thus there is much variation in the acquisition success of this type of investment among municipalities who adopt a policy seeking to strengthen their economic standing. Their 90 counterparts who have not adopted the initiative

as of 2010 see an average realized investment of imported equipment in technical structures ranging from less than a dollar to over \$90,000 with a mean of \$3,787 and a much smaller deviation: \$11,205 versus almost \$40,000 reported by the NALED adopters. It is also interesting to note that in municipalities that have administered the NALED initiative fiscal health in terms of annual budget is positively correlated with realized investment in new fixed assets consisting of imported equipment, and even though for non-adopters this relationship is also positive it is much stronger (81 versus 39.9%.) In Vojvodina 15 out of 45 municipalities have adopted the program and their administrations report an average of \$6,144 in realized investment of imported equipment, whereas the remaining thirty's average is slightly greater at almost eight thousand. In Central Serbia the adopters and their counterparts are almost evenly split with the latter numbering four more at 54 versus 50 NALED certified municipalities. The participating administrations report a much greater average of realized investment in terms of imported equipment at \$20,792, while the remaining fifty-four average just under two thousand dollars worth of realized investment in foreign equipment. The unemployment rate is slightly lower for adaptors (11.33%) when compared to municipal units that are not certified by the program: 12.92%. Certified municipalities also report a higher average salary per employee at 30,278 (Serbian Dinars) versus an average of 26,479 in their non-certified neighbors. Not surprisingly the percentage of unskilled job seekers is lower by 7% in administrative units that have adopted NALED (35%).

## CHAPTER FIVE

### CONCLUSION

The international arena's main unit of analysis is still the nation state; however regions are increasingly becoming important in research on various phenomena. A region can be defined in terms of association and cooperation among countries who share geographic proximity, or the arrangement of administrative units within the state itself. The increase in popularity of local self-administration in transition countries with declining central authority provides an opportunity for academic inquiry into policy developments at the local governance level where previous research was scant or broadly absent. Serbia's municipalities have largely been omitted from western academic analyses as central authority historically has rarely provided freedom in decision making that would afford an interest for such studies. However as countries of the Western Balkans are adjusting their administrations in an effort to position themselves in favorable light for a potential EU accession all nation states in the region are seeking to strengthen the local self-governance of their respective administrative units in order to make them more attractive to investors and improve their economic competitiveness in the global arena. The purpose of this research has been to outline the need for an analysis of factors that contribute to the success of certain municipalities in their quest to attract investment from abroad. Since much of the studies on foreign investment are at the nation state level and theoretically there have been calls to "unpack" the state it is necessary to outline why certain municipalities are more capable of attracting investment and capital. In the last decade numerous international organizations and governments have actively sought to assist the Serbian nation in its transition, and a central part of this process has been the empowerment of municipal administrations in the crafting and implementation of local economic policies aimed at strengthening the business sector, and public administration, while making them more attractive for foreign investors. It is argued here that municipal development in Serbia is of increased importance; however there are broader implications for the region as a whole. State boundaries in that part of the world have not been static for much of the last century thus studies at the national level could be supplemented with analyses of local administrative units especially as the political environment provides for such inquiry in light of decentralization initiatives.

Furthermore if we are able to provide an accurate depiction of a successful program implementation it would be easier to address economic inequality that has often been a volatile conflict igniting force in the Western Balkans as a whole. Simply advising nations to increase the inflows of FDI may not be enough to prevent future animosities if the benefits of such successful economic platforms are concentrated in a handful of municipalities while despair and hardship spreads consistently to others.

## **5.1 Future Work**

The initial analysis presented here outlines the disparity in Serbian municipal ability in amassing imported investment and capital. Using regionalism framework to “unpack” the state should prove useful in studying developments in not only Serbia, but the Western Balkans as a whole since all countries have expressed commitments to strengthening local self-governance in attempts to integrate into a broader European framework. Thus future studies should seek to empirically test hypotheses that strive to outline successful municipal efforts in a broader regional context; by gathering statistical data and through representative samples inferences can be made about the population of municipalities that used to be jointly encompassed by the Yugoslav administrative charter. Conceptually frameworks used to study FDI should be used to analyze the distribution of investment from abroad within the states in order to outline factors that influence financiers in their choice of location. For this it would be best if data is collected yearly for a time-series modeling that are common in the literature on FDI. From the present study the following hypotheses are proposed for empirical test:

- 1) Municipalities that adopt international initiatives aimed at strengthening local self-governance by increased autonomy over economic and public policy will be better able to attract investors and capital.

As is the case with the NALED initiative in Serbia it is hypothesized that municipalities in the region that seek to adopt and implement such initiatives will be viewed as “more stable” by investors. For NALED in particular the 62 municipalities that have adopted the initiative are “certified” in their efforts to improve the business climate for private investors. Also an event history analysis (EHA) would be an appropriate way to analyze the diffusion of policy adoption practices within the region; this should also be feasible in the future as data becomes readily available.

- 2) Municipalities in regions with strong autonomy aspirations (not country specific) will be more active in attempts to acquire foreign investment.

This research indicates that only 15 of Vojvodina's 45 municipalities have adopted the NALED initiative, and none in the region of Sanzak; this is surprising because both regions are mentioned in scholarly works as autonomous-seeking – Vojvodina especially. The literature on FDI indicates that regions that seek autonomy would actively be striving to attract foreign investment that would provide them with leverage in terms of domestic economic and political standing.

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