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THE ROLE OF BILATERAL INVESTMENT TREATIES IN PROMOTING THE INTERNATIONALIZATION OF ENTERPRISES IN SERBIA

Uloga bilateralnih investicionih sporazuma u podsticanju internacionalizacije preduzeća u Srbiji

Abstract

Bilateral investment treaties are traditionally considered to be an instrument for attracting foreign direct investment in Serbia. However, their provisions may also support the internationalization of its enterprises. In this paper, we explore how effective bilateral investment treaties are in promoting the most challenging aspect of the internationalization of enterprises in Serbia – foreign direct investment outflows. Additionally, we investigate the role of other main motivations for the investment outflows. We conduct our analysis by estimating a gravity model using the panel data on Serbia and its 147 partner economies, observed in the period between 2011 and 2019. The gravity model was estimated using the Poisson pseudo-maximum likelihood estimator. We find that bilateral investment treaties have a statistically significant positive effect on bilateral foreign direct investment outflows. Furthermore, the outflows are particularly affected by the treaties containing higher anti-discrimination standards and providing a more liberal investment regime. Unilateral liberalization of the host countries' investment regime is also found to be positively associated with the investment outflows, whereas both the geographic and psychic distances have negative effects. Market-seeking motives of the internationalizing enterprises in Serbia are revealed to be the dominant driver of the investment. The results provide useful implications for the policymakers aiming to support the internationalizing efforts of the enterprises and the consequent improvement of the international competitiveness of Serbian economy.

Keywords: *internationalization, bilateral investment treaty (BIT), outward foreign direct investment (OFDI), unilateral liberalization, Serbia*

Sažetak

Bilateralni investicioni sporazumi se po pravilu smatraju jednim od instrumenata za privlačenje stranih direktnih investicija u Srbiji. Međutim, odredbe ovih sporazuma mogu pozitivno uticati i na proces internacionalizacije domaćih preduzeća. U ovom radu, razmotrili smo efektivnost bilateralnih investicionih sporazuma za unapređenje najkompleksnije faze procesa internacionalizacije preduzeća u Srbiji – izlaznih tokova stranih direktnih investicija. Pri tome, ispitali smo i ulogu drugih značajnih motiva ovih tokova. Analiza je sprovedena ocenjivanjem gravitacionog modela upotrebom podataka panela koji se odnose na Srbiju i njenih 147 partnerskih privreda, posmatranih u periodu između 2011. i 2019. godine. Gravitacioni model ocenjen je primenom Poasanovog metoda pseudomaksimalne verodostojnosti. Analizom je utvrđeno da bilateralni investicioni sporazumi imaju statistički značajan pozitivan uticaj na bilateralne izlazne tokove stranih direktnih investicija u Srbiji. Osim toga, na izlazne tokove investicija posebno snažno utiču odredbe koje se odnose na standarde sprečavanja diskriminacije stranih filijala i odredbe kojima se liberalizuje režim stranih ulaganja. Jednostrana liberalizacija režima stranih ulaganja zemalja domaćina takođe je povezana sa intenzivnijim izlaznim tokovima stranih direktnih investicija iz Srbije, dok je za geografsku i kulturološku distancu utvrđen negativan uticaj na tokove investicija. Utvrđeno je i da pristup tržištu predstavlja jedan od ključnih motiva stranih ulaganja srpskih preduzeća koja internacionalizuju svoje poslovanje. Rezultati istraživanja pružaju korisne implikacije za nosioce ekonomske politike zainteresovane za pružanje podrške internacionalizaciji preduzeća u Srbiji i posledičnom unapređenju međunarodne konkurentnosti privrede Republike Srbije.

Ključne reči: *internacionalizacija, bilateralni investiconi sporazum (BIT), strane direktne investicije (SDI), unilateralna liberalizacija, Srbija*

Introduction

Traditionally, parent companies of multinational enterprises and the outward foreign direct investment activities are concentrated in the most developed economies. Since Serbia liberalized its foreign investment regime, it has primarily had the role of the host country and the efforts of the policymakers were directed toward attracting the investment. However, over the past two decades, there has been an increasing internationalization of the enterprises and growth in the number of multinational enterprises in transition economies, including Serbia [14], [30].

Outward foreign direct investment can bring certain advantages to the home country's economy. It allows the enterprises conducting the investment to acquire strategic assets and resources not domestically available. The investment can also provide them with better access to foreign markets, offering better growth opportunities, helping them diversify their sales, enabling them to take advantage of the economies of scale, and increasing their resilience [23], [43]. Through internationalization, enterprises accumulate experience allowing them to be more competitive in the international markets [33]. On the macro level, the home country benefits from the internationalization and outward foreign investment of its enterprises as it leads to productivity growth, reverse spillovers, long-term capital inflows through profit repatriation, and, in general, increased competitiveness of the economy [7].

Bilateral investment treaties are one of the few non-financial policy measures which can directly affect foreign direct investment flows. In Serbia, the treaties are mainly used to attract foreign direct investment by guaranteeing standards of treatment for foreign affiliates, providing the transparency of the regulation, and offering dispute settlement rules [20]. However, the provisions work in directions, facilitating foreign investment for Serbian enterprises, reducing the corresponding risks, and protecting the assets of their foreign affiliates. How effective the treaties are in encouraging the internationalization of enterprises is debatable and the empirical evidence is mixed [26], [46], [54].

The aim of this paper is to examine the motivations behind the internationalization decisions of enterprises in Serbia. In particular, we investigate how effective bilateral investment treaties are in supporting these activities. The study allows us to better understand the motivations of multinational enterprises in Serbia, which is useful for defining the measures pertaining to support their internationalization efforts. To achieve these aims, we operationalize internationalization with outward foreign direct investment and employ a gravity model of foreign investment flows to analyze the outflows from Serbia. We use the sample of Serbia and its 147 partner economies observed in the period between 2011 and 2019. Our empirical model is estimated using the Poisson pseudo-maximum likelihood estimator. The results show that bilateral investment treaties positively affect the outflows of foreign direct investment in Serbia, promoting the internationalization of the enterprises. Moreover, it was shown that certain provisions related to the liberalization of the investment regime and anti-discrimination standards are particularly important for the effectiveness of the treaties in this context. In addition, we find that the unilateral liberalization of the investment regime in the host country has positive effects on the outward investment from Serbia.

Our research differs from the related literature in several important aspects. Generally, the focus of the related studies is on inwards foreign direct investment and the ability of host countries to attract the investment. The focus on outward foreign direct investment research is much less prevalent in the literature and the few existing studies focus mainly on the most developed countries or larger samples of countries with different levels of economic development and different motivations for internationalizing enterprises which often obfuscates the results. According to the literature review we conducted, Serbia has not yet been the focus of a similar analysis. We also add to the related literature by considering the role of the provisions of the treaties, rather than assuming that all the treaties are homogeneous, which is the most common approach in the related literature. In addition to considering bilateral liberalization of foreign investment, we analyze the effects of unilateral liberalization of the investment regime in

the host countries, a factor which is rarely controlled for in other studies. Finally, in comparison to the majority of the related studies, we estimate our gravity model in its original multiplicative form using the most suitable econometric technique.

We structure the remainder of our paper as follows. In the following section, we explain the conceptual framework of our study and derive the main hypothesis we test in our analysis. Next, we provide an overview of the related empirical literature. This is followed by the description of the methodology and the sample used in our analysis. The results of the descriptive analysis are then presented, followed by a discussion on the main empirical results. The final section concludes.

Conceptual framework

The internationalization process is important for internationalizing enterprises and home countries alike. The process is often considered to lead to the sustainable growth of enterprises [55], and there is ample evidence of positive, albeit small effects of internationalization on firm performances, particularly profitability and international competitiveness [2], [40]. By internationalizing their activities, enterprises no longer need to rely solely on the domestic market, which enables them to take better advantage of the economies of scale. Additionally, it allows the internationalizing enterprises to use the locational advantages, such as access to the foreign markets or resources available in the host country. Finally, the enterprises accumulate experience and knowledge in international business, making them more internationally competitive and resilient.

The home country also benefits from the internationalization of its enterprises. The internationalizing enterprises directly contribute to the home country's economic growth, technological capabilities, and export competitiveness. Moreover, the internationalizing enterprises may indirectly affect the development of other enterprises in the home country through reverse spillovers [23]. Namely, the experience and other strategic advantages obtained by foreign affiliates are often transferred to the parent company in the home country, which provides

opportunities for the local companies to learn from the internationalizing ones, leading to spillover effects. These spillovers can be a way to overcome the initial hurdles of internationalization that other firms in the home country face [49].

For these reasons, the internationalization decision is critical for the expansion strategy of enterprises [17]. However, there are many uncertainties connected with this decision. The costs of organizing foreign affiliates and the challenges of their successful coordination stem from both physical and psychic distance between the home and host country [1]. The internationalizing enterprise needs to adjust its organizational practices and adapt to local culture and regulatory framework [50]. These challenges are further exacerbated if the institutional environment of host countries is of insufficient quality.

The information asymmetries faced by the enterprises preparing to expand their business abroad make the endeavor risky and costly. For this reason, firms often have a preference to internationalize their activities to the countries which are geographically and culturally closer to their home country [38]. This idea relates closely to the gravity model of trade, which is often adjusted for the analysis of internationalization in the related literature [47], [51]. The main idea of this theoretical framework is that all objects, including economies, attract each other according to their respective size and distance. Translating the concept to the process of internationalization would mean that larger and geographically closer economies should exhibit larger trade and investment flows between each other.

Bilateral investment treaties can act as an instrument to reduce the aforesaid information asymmetries and psychic distance between the home and host countries, by making the host country's regulatory framework more transparent and by signaling the credibility of the host country's commitment to the liberal regime of foreign investment and the protection of investors' interests [37], [45]. Most importantly, the treaties typically provide a dispute settlement mechanism, which reduces the reliance of the internationalizing enterprise on the host country's legal system, which can, to a certain extent, substitute for the weak institutional quality of the host country.

The Uppsala theoretical framework is also relevant for the relationship between bilateral investment treaties and the internationalization of the firm. The framework views the internationalization choice as a gradual multistage process of increasing involvement in foreign markets, dependent on the accumulation of experience [33]. It provides the explanation of the foreign market entry and expansion process, where the firm gradually progresses from indirect exports to internationalization via foreign direct investment. In this process, the transition from exporting to foreign investment is generally considered to be the most challenging [22]. Namely, foreign investment is a high-risk strategy compared to exports, as it cannot be easily reversed and is related to the problem of obsolescing bargain [53]. The firm needs sufficient resources and experience to make the shift towards a higher commitment to internationalization. However, these resources also interact with the institutional environment of the home country and pull factors in host countries. Bilateral investment treaties are particularly important for guaranteeing stable environment in this crucial step of the internationalization process, facilitating foreign direct investment flows. After overcoming initial barriers, foreign operations are generally maintained over a long period, leading to further experience accumulation and more ambitious expansion projects on both domestic and foreign markets.

Not all enterprises internationalize gradually. In the age of digitalization, the concept of "Born Globals" has become highly relevant [39]. This subset of companies immediately seeks new opportunities for expansion across borders. Regardless, foreign investment is still a risky strategy for these enterprises, and psychic and physical distances between home and host countries remain an important barrier to foreign direct investment [29]. For this reason, the role of bilateral investment treaties in the internationalization of these firms is also interesting to explore, as the treaties, if effective, should reduce risks for firms that gradually internationalize as well as for "Born Globals".

Dunning's eclectic paradigm also provides a useful framework for explaining the decision of internationalization via foreign direct investment and its relationship with bilateral investment treaties [16]. All enterprises which do business abroad face additional risks and costs in comparison to their domestic counterparts. These additional costs need to be offset by advantages, which are related to ownership, location, and internalization. Ownership advantage is related to the firms' own resources required to successfully conduct internationalizing, such as superior technology, know-how, and marketing. There is also a need for a locational advantage, which includes all the pull factors of the host country which provide benefits for the internationalizing enterprise and which combined with ownership advantage allows the multinational enterprise to be internationally competitive. Bilateral investment treaties affect the locational advantages, by providing a more stable legal environment, which allows the enterprises to fully utilize other locational and ownership advantages. Finally, internalization refers to keeping maximum control over the ownership advantage, rather than trading it on the open market. The rules on expropriations and standards of non-discrimination provided by the bilateral investment treaties increase the likelihood of multinational enterprises establishing a foreign affiliate, as it reduces the risks of losing the ownership advantage, thereby increasing the attractiveness of the internalization as a mode of ownership advantage transfer.

New trade theory provides a framework for deriving the relationship between bilateral investment treaties and firm internationalization. According to this framework, there are various motivations for foreign direct investment, depending on which the investment can be categorized into horizontal and vertical. Horizontal foreign direct investment is closely related to the concentration-proximity trade-off, as the main motivation of the investors is to locate close to foreign consumers and circumvent the trade barriers at the expense of lost economies of scale and fragmentation of the same type of production capacities over several countries. In other words, this strategy leads to an increase in fixed costs and the lowering of variable trade costs. The increased fixed costs are covered by market access and increased foreign sales. Therefore, market size is the key determinant of this type of investment [41].

Contrastingly, vertical foreign direct investment fragments the production process into phases which are then located in various countries according to their respective

factor endowments [27], [28]. This type of investment increases variable trade costs but allows for more efficient and concentrated production and the increased use of economies of scale. For this type of investment, resource endowments are the major drivers.

Horizontal and vertical foreign direct investment can be analyzed jointly by using the Knowledge-capital model, which provides an integrative conceptual framework [9]. As the official foreign direct investment data makes no distinction between the types of investment, empirical specification of the Knowledge-capital model relies on the gravity-type equation, which includes market size and differences in resource endowments as explanatory values [26], [52]. This framework is also used in our study.

Finally, one extension of the new trade models is particularly worth mentioning as it directly establishes the relationship between bilateral investment treaties and multinational activity. Egger and Merlo based this model on the trade model of heterogeneous firms [42]. They show that bilateral investment treaties effectively reduce the fixed costs of investing abroad, thereby reducing the minimal productivity required to enter a foreign market [18]. As a result, both the number of internationalizing firms and the number of foreign affiliates increase in the home country.

All the considered theoretical frameworks suggest a similar conclusion – that bilateral investment treaties positively affect the internationalization of enterprises in the home country. Considering that the theory suggests the major step in internationalization is the shift from export to foreign direct investment, and initialization of foreign investment, and taking into account the data availability considerations, we define our main initial hypothesis as follows:

H1. Bilateral investment treaties have a positive effect on outward foreign direct investment in Serbia.

Apart from the mere existence of bilateral investment treaties, their contents may also play an important role in determining the effects on the internationalization of Serbian enterprises. For this reason, in our analysis we also consider the quality of the bilateral investment treaties, expecting that higher-quality treaties have a stronger effect on investment outflows. The host country's

environment for foreign investment can be improved not only through bilateral but also by unilateral measures. Thus, we also investigate the role of unilateral foreign investment liberalization. Additionally, we test the relevance of other factors outlined in this conceptual framework. This will allow us to identify the main motivations for the internationalization of enterprises in Serbia. Finally, our empirical model allows us to explore the importance of geographic and psychic distance in determining the foreign investment outflows in Serbia.

Literature review

With the global increase in the number of concluded bilateral investment treaties, researchers focused their interests on examining how effective these treaties are in promoting investment flows. The majority of the studies in this body of literature are concerned with the effects treaties have on foreign direct investment inflows, analyzing the problem from the perspective of the host country [8], [21], [36]. However, the most closely related to our analysis are the studies that analyze the effects of the treaties on the home country's foreign direct investment outflows. Most commonly, these studies are based on gravity-type empirical models [25], [32], [46]. They provide mixed evidence.

The related empirical studies can broadly be divided into two categories: multi-country studies and single-country studies. Most of the early studies on this topic are multi-country studies reporting positive effects of bilateral investment treaties of varying intensity. One of the earliest examples of such a study was conducted by Egger and Pfaffermayr [20]. They found positive effects of bilateral investment treaties on outflows of foreign direct investment from the member countries of the Organization of Economic Cooperation and Development, which were observed in the period between 1959 and 1999. They found that the existence of the treaty increases the outward stock of the foreign direct investment toward the partner economy by nearly 30%. The analysis based on the similar, albeit more recent sample, indicated that bilateral investment treaties lead to an increase in foreign direct investment outflows between 12.4% and 51.0%,

depending on the specification [32]. This set of countries, expanded with transition countries, was observed in the period 1980-2001 by Egger and Merlo, who found that foreign direct investment is highly persistent and that bilateral investment treaties increase the investment by 6.66-5.93% in the short run and from 6.69% to 10.13% in the long run [19]. Guerin analyzed the sample of 14 European Union member countries, observed in the period between 1992 and 2004 [25]. She found that bilateral investment treaties on average increase the investment outflows in these countries by 32%. Finally, Dixon and Haslam considered the role of bilateral investment treaties' quality in promoting the flows of foreign investment in the case of 18 Latin American countries [15]. They found that higher-quality bilateral investment treaties lead to higher flows of investment.

The empirical results of single-country studies are more mixed. In general, enterprises in developing countries appear to react more strongly and positively to bilateral investment treaties their home country concludes. Contrastingly, the effects in developed countries are insignificant and, in some instances, negative.

For instance, Das and Banik analyzed the case of India [13]. By observing its investment outflows toward its 102 partner economies in the period between 2008 and 2012, they found a positive impact of bilateral investment treaties. In contrast, Bhasin and Jain found no significant effects in the same country [5]. The discrepancy could be attributed to the differences in the sample, as Bhasin and Jain observed only 15 partner economies in the period 2000-2009.

In South Korea, both signed and ratified bilateral investment treaties were found to positively affect the country's foreign investment into developing countries in the period 2001-2012, whereas the outflows to developed countries were much less pronounced [34]. The finding was corroborated by Park and Jung who used a slightly different analytical approach and a more recent sample [46]. Finally, bilateral investment treaties were found to positively affect the decision of Chinese enterprises to invest abroad [37].

A couple of studies indicate distinctly negative effects of bilateral investment treaties. The results of these studies suggest that the investment outflows are primarily driven by fundamental economic factors such as market size and resource endowments. For example, Yackee reported insignificant and, in some specifications negative effects in the case of France, which he observed for the period between 1985 to 2013 [54]. Similar results were found by Gurshev and Hamza who analyzed the British multinationals' outward foreign direct investment towards 140 partner economies in the period 2009-2017 [26], pointing out that colonial ties are a major driver of the internationalization of British enterprises.

Due to limited data availability, few studies investigate the effects of bilateral investment treaties on the micro-level. The only example of such a study to this date was conducted by Egger and Merlo, who used foreign affiliates' trade statistics of German multinational enterprises in the period 1996-2005 [18]. By estimating an empirical model using 15,728 firm-host pairs, they found that ratification of bilateral investment treaties by Germany leads to an increase in the number of German foreign affiliates, as well as the number of employees in the said affiliates.

There is also a gap in the related literature related to the lack of studies focusing on the region of Southeastern Europe. The only studies which observed this region analyzed all the countries aggregately and focused on foreign direct investment inflows and some of their major determinants. The results single out the relevance of geographic and cultural factors in determining the investment flows in the region [14], [24].

There are several reasons why various studies report different results. There are significant differences in studies in terms of the research design. Some results could be affected by the relatively small sample size. The characteristics of the home countries on which the studies focus also play an important role in the results determined. Finally, the control variables considered in the specification and the methodological approach followed also reflect on the empirical results.

With the exception of the study conducted by Haslam and Dixon, the related empirical literature implicitly assumes that all the bilateral investment treaties are made equal. However, different treaties offer different provisions and levels of investment protection. In addition, the studies

covered in this literature review do not control for unilateral liberalization which may bias the result to a certain extent. Moreover, despite being based on the gravity model, the majority of the reviewed studies do not account for the non-linearity of the model and neglect zero investment outflows in the analysis. Finally, Serbia has not been the focus of the related empirical studies. We address all these issues in the analysis that follows.

Methodology

As we previously outlined in the conceptual framework, we operationalize the internationalization of enterprises in Serbia by using the outflows of foreign direct investment, as it most closely reflects the most challenging phase of the internationalization process where the bilateral investment treaties are the most likely to benefit the internationalizing enterprises. We base the analysis on the gravity model of foreign direct investment outflows. The main aim of the analysis is to isolate and estimate the effects of bilateral investment treaties while controlling for the effects of other relevant determinants considered in the conceptual framework.

Gravity models are predominantly used in trade analysis. However, their application can be extended to the analysis of foreign direct investment [38], [44]. Uttama discusses how the model can also be derived from the Knowledge-capital model, allowing it to incorporate both the horizontal and vertical types of foreign direct investment in the analysis [9], [52]. The model is generally considered to be a well-suited and flexible framework for the analysis of foreign direct investment patterns using the dyadic approach, allowing the inclusion of all major macro-level determinants of the flows [6], [12].

The baseline model we use in the analysis can be represented by the following equation:

$$FDI_{ijt} = \beta_0 \, FDI_{ijt-1}^{\beta_1} \, BIT_{ijt}^{\beta_2} \, CI_{jt}^{\beta_3} GDP_{ijt}^{\beta_4} \, DGDPpc_{ijt}^{\beta_5} \, D_{ij}^{\beta_6}$$
$$\exp(\delta_1 \, HIST_{ij} + \lambda_t) \, \varepsilon_{it} \qquad (1)$$

where FDI_{ijt} denotes the outflows of foreign direct investment from Serbia (denoted by i) to the partner economy j in the year t, BIT_{ijt} denotes bilateral investment treaty variables, CI_{jt} denotes the level of unilateral liberalization of the host country, GDP_{ijt} refers to the size of the home and host

country's economy, $DGDPpc_{ijt}$ refers to difference in gross domestic product *per capita*, D refers to the geographic distance, HIST refers to the dummy variable capturing the psychic distance, the λ_t refers to the time effects and the ε_{it} denotes the error term.

The dependent variable is outward foreign direct investment (FDI_{ijt}). This is the most widely used operationalization of internationalization in the related literature [4], [19], [54]. Thereby, we adopt the definition of the International Monetary Fund where outward investment entails all investment where Serbian residents acquire more than 10% in equity abroad. All the values are expressed in millions of EUR.

The independent variables in the focus of our research refer to bilateral investment treaties (BIT_{ijt}). The main and the most basic variable is defined as a dummy variable that takes the value of 1 if Serbia has a ratified bilateral investment treaty with a partner economy, and 0 otherwise. This is the most commonly used approach in the related empirical literature [26], [34], [46]. However, the use of a dummy variable implicitly assumes that all the bilateral investment treaties are homogenous in terms of their content. As this is often not the case, we expand the analysis, by analyzing the effects of bilateral investment treaties' contents and quality on promoting the investment outflows. Greater reduction of the entry barriers through more favorable provisions of the treaty should lead to the greater investment of Serbian enterprises to host countries that offer such conditions. All the bilateral treaties in which Serbia participates were mapped following the content analysis approach and their quality was quantified using the BITSel index developed by Chaisse and Bellak [10]. In addition to the most widely defined measurement of quality ($BITSel_{ijt}$), we also consider the effects of subindices measuring the scope of liberalization ($BITSel\text{-}lib_{ijt}$), anti-discriminatory measures ($BITSel\text{-}ad_{ijt}$), the breath of the investment definition ($BITSel\text{-}br_{ijt}$), and the regulations related to dispute settlement ($BITSel\text{-}reg_{ijt}$).

In addition to the bilateral approach, the foreign investment regime can also be liberalized unilaterally. This is important to take into account in order not to overestimate the effects of bilateral liberalization. One of the most common approaches for measuring the level of

unilateral foreign investment liberalization in the related literature is the use of the Chinn-Ito index (CI_{jt}), based on the information provided by the International Monetary Funds in its Annual Reports on Exchange Arrangements and Exchange Restrictions [11], [31]. More liberal investment regimes in the host countries are expected to attract higher investment from Serbian enterprises.

Other control variables include all the common gravity model determinants, including the drivers of vertical and horizontal foreign direct investment as well as proxies for geographic and psychic distance. The market-seeking motive of the horizontal foreign direct investment is encompassed by the market size variable. It is approximated as the product of the market size of the home and host country (GDP_{ijt}). A similar market size variable was used in numerous related studies [20], [32], [37]. Generally, larger markets allow for taking advantage of economies of scale which, in turn, enables firms to internationalize their operations more efficiently leading to higher flows of foreign direct investment. The variable also reflects the main idea of the gravity model – that larger economies establish larger investment flows. As a robustness check, we also approximated the market size using population (POP_{ijt}), following the approach of Jong and Kim and Neumayer and Spess [34], [45]. Vertical foreign direct investment is encapsulated using the variable difference in gross domestic product *per capita* ($DGDPpc_{ijt}$). The variable reflects differences in factor endowments. It can be considered as a proxy for relative skill differences as well as the labor cost difference between the home and host country [15], [32]. Both differences are important drivers of vertical foreign direct investment having a positive effect on their outflows. Geographic distance (D_{ij}) is a standard control variable in all the related empirical work based on gravity-type models [26], [32], [54]. The distance is approximated using the circle formula and the data on latitudes and longitudes between the capitals of the home country and host economies. Greater distance is expected to increase transportation costs which should particularly impede the vertical foreign direct investment. In addition, it makes the coordination of business activities more difficult. However, some countries may choose to cut the transport and trade costs by organizing sales through foreign affiliates, which would positively affect the investment outflows. For this reason, the net effect of distance is a priori ambiguous and will be reflected by the corresponding coefficient. The psychic distance is considered through the use of history (HIST) and language (LANG) variables. Both variables are defined as dummy variables that take the value of 1 if the countries share a common language or history, and 0 otherwise. The variable reflects cultural proximity between the countries. A more familiar environment should mean lower entry barriers for Serbian investors, as they need fewer resources to adapt to the host country's culture. The relevance of this factor is explored in greater depth, and it was shown to be particularly important in the case of former Yugoslavia [3], [14]. As the two variables are highly correlated, we estimate them in separate specifications.

Finally, it is worth mentioning that history matters for foreign direct investment flows [15]. Namely, foreign investment entails fixed sunk costs when establishing affiliates and distribution networks abroad. These sunk costs motivate multinationals to sustain the activities of their foreign affiliates over long periods of time. For this reason, outward foreign investment frequently exhibits significant persistence. We model this explicitly by introducing the lagged foreign direct investment as one of the independent variables. The theoretical motivation for this is the study of Koizumi and Kopecky and the Uppsala theoretical framework [33], [35].

We estimate our gravity model using a Poisson pseudo-maximum likelihood estimator. The estimator is the most consistent option for obtaining unbiased estimates for gravity models estimated using the samples containing a large portion of zero values [48]. The estimation of gravity models with such samples using simpler methods such as generalized least squares could bias the results. The approach mitigates the problem of Jensen's inequality, which is an important issue in estimating log-linearized models. The estimator is consistent in the presence of heteroskedasticity and allows us to consider all available data giving equal weights to all observations (including the cases where there are no outflows of foreign direct investment from Serbia to a particular economy which makes up for over 70% of our sample).

Table 1: Descriptive statistics

Variable	Obs.	Mean	Std. dev.	Min	Max
$OFDI_{ijt}$	1980	1.188	9.191	-39.926	191.94
BIT_{ijt}	1980	0.223	0.416	0	1
$BITSel_{ijt}$	1980	0.333	0.625	0	1.727
$BITSel\text{-}lib_{ijt}$	1980	0.344	0.650	0	2
$BITSel\text{-}ad_{ijt}$	1980	0.221	0.414	0	1
$BITSel\text{-}br_{ijt}$	1980	0.954	1.804	0	6
$BITSel\text{-}reg_{ijt}$	1980	0.516	1.002	0	4
CI_{jt}	1715	0.527	0.379	0	1
GDP_{ijt}	1969	1.708	7.542	0	106.753
POP_{ijt}	1978	328.606	1244.93	0.044	12577.48
$DGDPpc_{ijt}$	1969	10.45	26.689	-5.959	176.023
$DIST_{ij}$	1980	6.046	4.092	0.197	18.002
$LANG_{ij}$	1980	0.025	0.157	0	1
$HIST_{ij}$	1980	0.025	0.157	0	1

Source: Authors' calculation

Our analysis covers the period between 2011 and 2019. We restrict the analysis to this period because the methodology of compiling foreign direct investment data in Serbia was changed in 2010 and the inclusion of observation prior to this year could lead to comparability problems. We observe 147 partner economies of Serbia in this period which yields a total sample size of 1323 annual observations. The descriptive statistics for the variables included in our model are provided in Table 1.

The sample is constructed by merging data from several sources. The data on foreign direct investment outflows are sourced from the National Bank of Serbia. All the variables related to bilateral investment treaties were constructed using the data provided by the International Investment Agreements Navigator database. The index values for the unilateral liberalization variable were obtained from Chinn and Ito [11], [31]. Gross domestic product and population data come from the UNCTADStat database of the United Nations Conference on Trade and Development. Finally, all the distance variables are obtained from *Centre D'Etudes Prospectives et d'Informations Inernationales* (CEPII).

Bilateral investment treaties and foreign direct investment outflows in Serbia

The liberalization of the foreign investment regulatory framework was followed by large inflows of foreign investment in Serbia. However, many domestic enterprises were lacking the capacity to conduct foreign investment,

so the outflows of the investment remained negligible. However, in an effort to improve the environment for foreign investment, Serbia ratified 30 bilateral investment treaties during the 2000s, making it a country with the most extensive network of treaties in the Western Balkans region. These treaties not only protected foreign investors' interests in Serbia but also improved conditions for the investment of Serbian enterprises abroad. An increase in investment outflows ensued, surpassing the level of 100 million EUR in 2007. The global financial crisis negatively affected these outflows, bringing them to a halt in 2009. This was followed by an unsteady recovery, described in Figure 1.

Figure 1: Foreign direct investment outflows in Serbia and their bilateral investment treaty coverage (2010-2019)
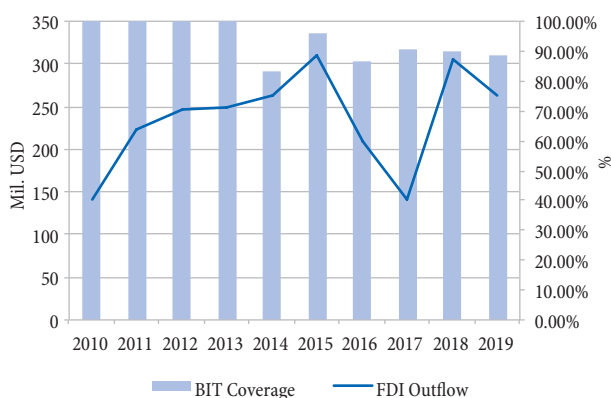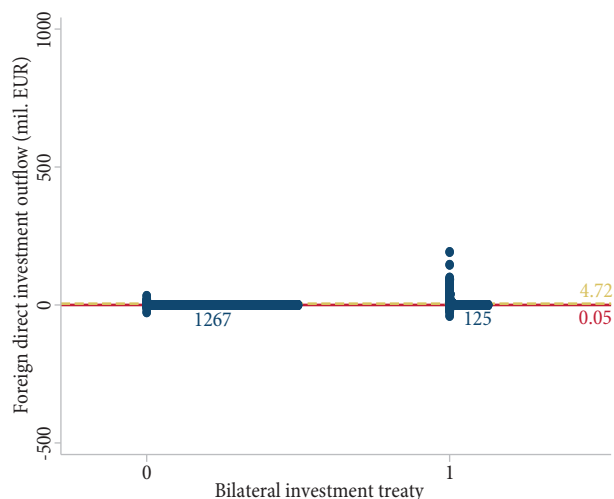

Source: Authors' calculation

Enterprises in Serbia appear to have accumulated sufficient experience and resources and the institutional framework stabilized enough for more significant investment outflows during the 2010s. This placed Serbia in the leading position in the region in terms of foreign investment outward stocks. However, these stocks are still relatively insignificant when compared to global stocks, which is expected considering the relative size of the Serbian economy. As Serbia ratified bilateral investment treaties with most of its major economic partners, the treaties covered the majority of foreign investment outflows in the observed period. Still, there are some important economies, such as Russia, India, Italy, Japan, and most of the economies on the American continent, which provide ample investment opportunities but where Serbian enterprises might lack sufficient support due to

the lack of bilateral investment treaties. Conclusions of the treaties with such countries could promote further internationalization of enterprises in Serbia.

Our sample reveals some interesting patterns regarding the use of bilateral investment treaties and their relationship with multinational activity. We compare the observations of foreign direct investment bilateral outflows of Serbia based on the ratification status of bilateral investment treaties. The results of the comparison are graphically presented in Figure 2.

Figure 2: Foreign direct investment outflows from Serbia conditional on the bilateral investment treaty status

Source: Authors' calculation

We can notice that the majority of zero investment outflows observations (1267) are concentrated in the set of countries with which Serbia has not ratified a bilateral investment treaty. Such zero investment outflows are much less frequent in the other subset. Furthermore, enterprises in Serbia, on average, invest 4.66 million EUR more annually in economies that have a ratified bilateral investment treaty with Serbia than in the other economies. The difference is statistically significant at the 1% level.

Results and discussion

We present the estimation results for our baseline model in Table 2. Model 1 refers to the baseline model represented by Equation 1, and the estimated coefficients reflect the impact of the explanatory variables on foreign direct investment outflows in Serbia. Models 2-4 refer to the

same baseline model where the alternative approximation is used for economy size. In the column denoted by Model 5, we present the results of the robustness check, where the baseline model was estimated using the subsample for the period 2011-2018. All the specifications apart from the aforesaid robustness checks are estimated using the full sample of 1323 observations. The specifications are statistically significant as a whole, as evidenced by the Wald test statistics and the corresponding p-values. The values of the coefficient of determination suggest that the data fit the models well. Finally, Ramsey's Regression Equation Specification Error Test does not show problems with any of the specifications.

The coefficients pertaining to the bilateral investment treaties show that the treaties could have a significant impact on foreign direct investment outflows in Serbia. The results are statistically significant at least at a 10% level in all the specifications. This suggests that the ratification of the bilateral investment treaty leads to an increase in foreign direct investment outflows by between 47.8% and 75.4%. The economic size of the effect is comparable to the results reported in the related single-country studies that found statistically significant positive effects. However, it should be noted that average outflows of foreign direct investment in Serbia are modest, so the increase in absolute values is much less pronounced. Regardless, the results imply that bilateral investment treaties lower fixed costs of investment and reduce risks for enterprises in Serbia that invest abroad. This supports their internationalization efforts. These conclusions are unaffected by changes in specification and sample, indicating the robustness of the results.

The results show that the unilateral foreign direct investment regime liberalization in host countries has around twice as strong as the effect on foreign direct outflows in Serbia, both statistically and economically. This suggests that unilateral liberalization improves the environment for foreign investment in the host country, to which the investors in Serbia react favorably. This finding is statistically significant at least at 5% level in all specifications, suggesting the stability of the results.

The results related to the control variables also reveal interesting patterns of investment outflows from Serbia.

Table 2: The baseline model estimation results

Model	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
Variable					
$OFDI_{ijt-1}$	0.025***	0.026***	0.029***	0.030***	0.029***
	(0.003)	(0.003)	(0.003)	(0.003)	(0.004)
BIT_{ijt}	0.414*	0.391*	0.401*	0.390*	0.562**
	(0.215)	(0.223)	(0.213)	(0.223)	(0.234)
CI_{jt}	0.737**	0.951***	0.746**	0.970***	1.086***
	(0.323)	(0.312)	(0.314)	(0.321)	(0.315)
GDP_{ijt}	0.046***		0.046***		0.038***
	(0.009)		(0.009)		(0.009)
POP_{ijt}		0.000***		0.000***	
		(0.000)		(0.000)	
$DGDPpc_{ijt}$	0.010*	0.012**	0.008	0.010*	0.012*
	(0.006)	(0.005)	(0.006)	(0.005)	(0.007)
$DIST_{ij}$	-0.699***	-0.678***	-0.745***	-0.724***	-0.609***
	(0.099)	(0.107)	(0.106)	(0.119)	(0.095)
$HIST_{ij}$	1.190***	1.223***			1.404***
	(0.267)	(0.263)			(0.277)
$LANG_{ij}$			0.841***	0.934***	
			(0.291)	(0.301)	
Constant	0.752*	0.586	0.945**	0.754	0.177
	(0.404)	(0.425)	(0.421)	(0.465)	(0.425)
Total Observations	1323	1323	1323	1323	1176
Wald	478.38	464.25	595.92	606.35	472.71
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Pseudo R^2	0.706	0.700	0.695	0.690	0.705
RESET test (p-value)	0.606	0.857	0.789	0.956	0.764

Source: Authors' calculation

Note: Robust standard errors are presented in the parentheses. ***, **, and * denote coefficients significant at 1%, 5%, and 10% significance levels, respectively. Wald denotes the Wald test statistics and the corresponding p-value, provided in the parentheses. RESET test refers to the result of Ramsay Regression Equation Specification Error Test results.

Market size appears to be a major determinant of these flows, regardless of the proxy and sample used. In all cases, the corresponding coefficients are statistically significant at 1% level. This implies that the enterprises in Serbia are primarily conducting market-seeking horizontal foreign direct investment. The vertical foreign direct investment is much less pronounced.

Both geographic and psychic distances are found to be important factors in determining the investment outflows of Serbian enterprises. Larger geographic distances between Serbia and host economies are associated with lower investment outflows to those economies. Namely, the increase in distance between Belgrade and the capital city of the host country by 1,000 kilometers is associated with a foreign direct investment decrease of

between 83.8% and 110.6%. This reflects that a lot of the investment of enterprises in Serbia is directed toward other countries in the region. It also implies that investment in infrastructure and information and communication technology, which generally mitigate the problems of geographic distance could positively affect the investment outflows of enterprises in Serbia. Taken together with the significance of market size, these results also imply that the gravity model is indeed a suitable framework for our analysis. The psychic distance is also relevant for foreign direct investment outflows from Serbia, as indicated by the statistical significance of the coefficients for history and language variables, which are in all specifications significant at 1% level. The results suggest that enterprises in Serbia invest in countries with which Serbia shares a common history. The investment in such countries is increased between 228.7% and 307.1%, all other things being equal. Moreover, common language increases the investment outflow by between 131.8% and 154.4%.

Finally, the lagged outward foreign direct investment is also statistically significant in all specifications at 1% level, with stable estimated coefficient values. This indicates persistence and *inertia* in foreign direct investment outflows of the enterprises in Serbia. It could reflect sunk costs of investment and the tendency of the enterprises to continue investing in a particular location after the initial location choice is made. Finally, the results imply that the initial increase in foreign direct investment outflows made by ratifying the bilateral investment treaty also persists in the long run, amplifying the previously established positive effects of the internationalization of enterprises in Serbia.

We explore the role of the quality of bilateral investment treaties in the effects on outward foreign direct investment in Table 3. In all specifications, we use the baseline model represented by Equation 1. In Model 6, we use the widest measure of bilateral investment treaties' quality – the BITSel quality index. Models 7-10 refer to the effects of components of the BITSel quality index: quality of liberalization, the antidiscrimination quality, the breadth of scope, and the regulatory constraint quality of the treaties, respectively. A robustness check was conducted by estimating the specifications where the sub-indices of the BITSel index were found significant for

the subsample constructed for the period 2011-2018. As previously, all the specifications fit the data well, show no signs of specification errors, and are statistically significant at all significance levels.

In general, the quality of the bilateral investment treaty appears not to have significant effects on foreign direct outflows from Serbia. However, the contents of the treaties are heterogeneous and various aspects of the treaties may differ in terms of their relative importance for the prospective internationalizing enterprises. This is confirmed by the statistically significant results for the subindices quality of liberalization, the antidiscrimination quality. Both corresponding coefficients are statistically significant at 5% level and are robust to change in the sample. The results suggest not all provisions within a treaty matter for the investors equally. Internationalizing

enterprises in Serbia are particularly concerned with the prevention of discriminatory treatment of their affiliates in host countries. Bringing this issue to the highest standard in the bilateral investment treaty by guaranteeing fair and equitable treatment of the foreign affiliates of Serbian multinationals, guaranteeing their national treatment in the host country, and removing the limitation to the application of the most favored nation principle, could lead to an increase in bilateral foreign direct investment outflows from Serbia by between 57.3% and 84.0%. Establishing a liberal right to entry for Serbian multinationals and allowing their affiliates to transfer funds without any restriction also positively affects the foreign direct outflows, albeit to a lesser extent. As for the other explanatory variables, their statistical significance and coefficient values are similar to the results of the baseline model estimation

Table 3: The impact of bilateral investment treaties quality on foreign direct investment outflows

Model Variable	Model (6)	Model (7)	Model (8)	Model (9)	Model (10)	Model (11)	Model (12)
$OFDI_{ijt-1}$	0.026***	0.025***	0.025***	0.026***	0.027***	0.029***	0.029***
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.004)	(0.004)
$BITSel_{ijt}$	0.219						
	(0.137)						
$BITSel\text{-}lib_{ijt}$		0.299**				0.404***	
		(0.136)				(0.148)	
$BITSel\text{-}ad_{ijt}$			0.453**				0.610**
			(0.219)				(0.239)
$BITSel\text{-}breath_{ijt}$				0.071			
				(0.052)			
$BITSel\text{-}reg_{ijt}$					0.021		
					(0.075)		
CI_{jt}	0.714**	0.744**	0.742**	0.665**	0.745**	1.096***	1.094***
	(0.320)	(0.321)	(0.324)	(0.316)	(0.311)	(0.313)	(0.316)
GDP_{ijt}	0.047***	0.045***	0.046***	0.047***	0.048***	0.036***	0.037***
	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)
$DGDPpc_{ijt}$	0.010*	0.010*	0.010*	0.010	0.011*	0.012*	0.012*
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.007)	(0.007)
$DIST_{ij}$	-0.717***	-0.677***	-0.692***	-0.727***	-0.768***	-0.581***	-0.600***
	(0.100)	(0.098)	(0.098)	(0.103)	(0.101)	(0.091)	(0.093)
$HIST_{ij}$	1.167***	1.201***	1.192***	1.160***	1.125***	1.413***	1.406***
	(0.265)	(0.265)	(0.266)	(0.263)	(0.262)	(0.272)	(0.275)
Constant	0.858**	0.669	0.716*	0.929**	1.082***	0.067	0.132
	(0.391)	(0.412)	(0.407)	(0.384)	(0.361)	(0.430)	(0.427)
Total Observations	1323	1323	1323	1323	1323	1176	1176
Wald	485.40	491.71	480.80	473.88	486.54	492.26	476.68
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Pseudo R^2	0.705	0.707	0.707	0.705	0.703	0.707	0.706
RESET test (p-value)	0.793	0.793	0.761	0.751	0.806	0.572	0.565

Source: Authors' calculation
Note: Robust standard errors are presented in the parentheses. ***, **, and * denote coefficients significant at 1%, 5%, and 10% significance levels, respectively.

previously presented, further indicating the robustness of the obtained results.

Finally, the results of additional sensitivity analyses are presented in Table 4. Models 13-15 refer to the baseline model represented by Equation 1 and the two baseline specifications with significant results of the BITSel quality subindices. The models are estimated using the restricted sample where all the offshore centers are excluded. Models 16-18 refer to the aforementioned specifications estimated using the subsample where the most geographically distant partner economies were excluded. The threshold used was the distance of 10,000 kilometers between Serbia and the host country. Finally, Model 19 refers to the baseline model estimated using the subsample excluding small economies (with gross domestic product less than one billion USD). All specifications are statistically significant as a whole and show no signs of misspecification.

The sensitivity analysis corroborates our previously discussed findings regarding all the explanatory variables.

The statistical and economic significance of the variables is similar in all the robustness checks. The only slight difference is found for Model 11, where the positive effects of bilateral investment treaties on foreign direct investment outflows are somewhat smaller if the small economies are removed from the sample, which further exemplifies the market-seeking motives of internationalizing enterprises in Serbia. Other than that, the results confirm significant positive effects of bilateral investment treaties as a whole as well as certain aspects of their quality (the level of liberalization standards and the anti-discriminatory measures) on investment outflows. The results also show that the patterns of bilateral foreign direct investment outflows from Serbia conform to the framework of the gravity model. Thereby, not only geographic but also the psychic distance between the economies determines the intensity of the investment flows. Finally, the unilateral liberalization of investment regime in the host country is also an important determinant of the investment

Table 4: Robustness checks

Model	Model (13)	Model (14)	Model (15)	Model (16)	Model (17)	Model (18)	Model (19)
Variable							
$OFDI_{ijt-1}$	0.025***	0.024***	0.025***	0.025***	0.025***	0.025***	0.025***
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
BIT_{ijt}	0.421*			0.405*			0.371*
	(0.215)			(0.215)			(0.224)
$BITSel\text{-}lib_{ijt}$		0.301**			0.292**		
		(0.135)			(0.136)		
$BITSel\text{-}ad_{ijt}$			0.421*			0.444**	
			(0.215)			(0.219)	
CI_{jt}	0.676**	0.688**	0.676**	0.727**	0.735**	0.733**	0.680**
	(0.321)	(0.319)	(0.321)	(0.326)	(0.325)	(0.327)	(0.338)
GDP_{ijt}	0.050***	0.049***	0.050***	0.047***	0.046***	0.047***	0.048***
	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)
$DGDPpc_{ijt}$	0.010*	0.010*	0.010*	0.010*	0.010*	0.010*	0.011*
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
$DIST_{ij}$	-0.786***	-0.761***	-0.786***	-0.716***	-0.694***	-0.709***	-0.734***
	(0.098)	(0.096)	(0.098)	(0.104)	(0.103)	(0.103)	(0.108)
$HIST_{ij}$	1.079***	1.091***	1.079***	1.179***	1.191***	1.181***	1.143***
	(0.258)	(0.256)	(0.258)	(0.268)	(0.267)	(0.267)	(0.282)
Constant	0.935**	0.849**	0.935**	0.783*	0.700*	0.746*	0.875*
	(0.384)	(0.392)	(0.384)	(0.409)	(0.418)	(0.412)	(0.451)
Total Observations	1299	1299	1299	1121	1121	1121	1243
Wald	477.76	494.53	477.77	459.10	470.45	461.13	470.03
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Pseudo R^2	0.722	0.723	0.722	0.692	0.693	0.692	0.706
RESET test (p-value)	0.613	0.632	0.613	0.603	0.625	0.601	0.751

Source: Authors' calculation

Note: Robust standard errors are presented in the parentheses. ***, **, and * denote coefficients significant at 1%, 5%, and 10% significance levels, respectively.

outflows from Serbia, and the effects of all the considered independent variables persist in both the short and the long term.

Conclusion

In this paper, we investigated the role of bilateral investment treaties and unilateral foreign investment liberalization in promoting the internationalization of enterprises in Serbia using the extended gravity model. The model was estimated using the sample of Serbia and its 147 partner economies observed in the period between 2011 and 2019. The results show that bilateral investment treaties positively affect outflows of foreign direct investment from Serbia, supporting the notion that the treaties contribute to the internationalization process of enterprises in Serbia. Moreover, the results reveal that certain provisions, namely the ones related to the anti-discrimination standards and the liberalization of the foreign direct investment regime have a particularly strong positive effect on the investment outflows. Considering that foreign direct investment was found to be characterized by strong *inertia*, the determined positive effects persist in the long run. Unilateral liberalization of the foreign direct investment regime in the host country was also found to be positively associated with bilateral foreign direct investment outflows from Serbia. Our results indicate that the foreign investment of enterprises in Serbia is predominantly horizontal. Finally, both the increases in the geographic and psychic distance were found to negatively affect the internationalization efforts of enterprises in Serbia, suggesting that the gravity model framework is suitable for the analysis of foreign direct investment flows. The results are robust to changes in both the specification and sample.

Our empirical results support the initial hypothesis and all the major conclusions of our conceptual framework. In this regard, the results of our study corroborate the conclusions of the theoretical model of Egger and Merlo, as well as the previous findings in the majority of single-country studies, focused on the developing countries [13], [18], [37], [46]. The results contrast the findings of the studies analyzing some of the most developed countries [26], [54]. This could indicate that the level of economic development

might affect the effectiveness of bilateral investment treaties for the internationalization of enterprises, although the confirmation of this tentative conclusion would require additional multi-country analysis.

Our study provides several interesting implications for policymakers. The results of our study imply that the government can play an active role in encouraging the foreign investment of Serbian enterprises. Namely, the bilateral investment treaties can serve as an effective tool in reducing entry barriers and uncertainties for internationalizing enterprises in Serbia. Through the conclusion of treaties with prospective economic partners, Serbia can open up lucrative investment locations and opportunities, which can greatly contribute to the international competitiveness and resilience of enterprises in Serbia. When concluding new and renegotiating existing bilateral investment treaties, it is important to pay particular attention to securing the national treatment of the foreign affiliates of Serbian enterprises, the free transfer of funds for the said affiliates, maximizing the liberalization of the foreign investment regime in the host country and minimizing any exceptions to these fundamental standards and provisions. Supporting the enterprises to overcome the initial hurdles in internationalizing their activities is particularly important considering the persistence of outward foreign investment found in our study, which suggests that the enterprises accumulate their experience in the international business over time. This accumulation allows them to continue conducting investment projects abroad in the future. Our results also imply that market-seeking motives are the main driver of the foreign investment activities of enterprises in Serbia. The support for internationalization could provide the enterprises in Serbia with access to large markets allowing them to better use the economies of scale, circumvent the trade barriers and improve their performances. Finally, our results suggest that the enterprises in Serbia could be encouraged to internationalize by reducing the negative effects of distance, which can be achieved by investment in infrastructure, greater use of information and communication technologies and generally improving the connectivity between Serbian and other economies.

The aforesaid approaches are important for improving the integration of the Serbian economy into the world economy.

An interesting avenue for future research would be to conduct a similar study using micro-level data. This would require the compiling of outward foreign affiliates' trade statistics in Serbia, which are not available at the moment. The use of such data, however, would enable making a distinction between the effects of the considered determinants according to the enterprise type, which is particularly important for providing the policy recommendations for supporting the internationalization of small and medium enterprises. Additionally, such an approach would allow for determining the industry-specific effects of these measures.

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