RICHTMANN
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Research Article

Has Albania's Economic Development Stalled? Investigating the Role of Institutional Factors in Albania's Economic Performance

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Abstract

This study focuses on the institutional factors of Albania's economic development, from a comparative, dynamic, and regional European perspective. We use longitudinal data for the years 2002, 2014, and 2019 and a small selection of 13 countries in the region and some EU member states. Descriptive statistics, graphical representation, and econometric modeling are used for data analysis. The purpose of the study is to discuss, in real and comparative terms with the region and beyond, the economic growth of Albania based on the GDP per capita indicator, as well as to identify and evaluate dynamically the role of institutions in the country's development through important institutional factors, such as the effectiveness of government, rule of law, corruption, etc. The analysis shows that Albania's economic performance is weak over the last two decades. This is reflected in the insufficient relative growth of GDP per capita, the small increase in per capita income, and especially in the low increase in income for every 1% of relative growth. In these indicators, Albania continues to be consistently in the lowest positions in the region and beyond. The study highlights the strong link between economic growth and the effectiveness of government, the rule of law, and weak control over corruption. Improving corruption control by one unit in the range (-2.5 to 2.5) is expected to improve GDP per capita by an average of about 2.2 times. Improving the rule of law by one point is expected to improve GDP per capita on average by about 2.4 times. The country's sluggish economic performance is mainly attributed to weak institutions.

Keywords: Corruption, Economic growth, GDP per capita, Econometric model, Government effectiveness, Rule of law

1. Introduction

Albania is part of the group of middle-income countries. According to The GlobalEconomy, per capita income (GDP PPP / capita) was $4486 in1995; it increased to $6462 in 2001; it reached $13724 in 2019. For the entire period under study, 1995-2019, per capita income increased annually by an average of 4.77%. Despite this increase, Albania remains far behind countries such as: Northern

Macedonia, Bosnia & Herzegovina, and Serbia, not to mention Bulgaria, Slovenia, or the Netherlands. In the ranking according to the level of GDP per capita in the region, Albania is currently only ahead of Moldova.

The situation described above means that Albania has not done well and that the economic growth is not satisfactory. It seems as though Albania's economic development lags behind, lacksenergy, and is a process where energies are not used effectively, or do not go in the right direction. Thus, Albaniaremains behind countries used in our comparison that do not perform well economically. Moreover, the developing backwardness fails to be understood in its real dimension. Most are satisfied with the commentaries of relative growth without relating it at all to the rather low comparison base of the beginning of the transition and without properly comparing economic performance with other countries in the region and beyond. Increases of 3% or 4% are often accepted as quite satisfying and even competitive in the region and beyond.

This situation makes one think that there have been and still are important factors hindering the rapid increase in of well-being, and perhaps also a lack of desire and will to properly understand the dynamics of the developments and to engage in actions that bring about substantial and rapid growth.

Factors of revenue growth are many and varied, but in this study, we will focus on the role of factors related to governance and institutions, as catalysts for the development process and increase of the effectiveness and efficiency of all other factors of economic, social, and technological character in the development of a country.

In this study, we include as development factors of interest those of an institutional nature, such as: the effectiveness of governance, the rule of law, corruption and government efforts to control it, the quality of regulations, the degree of political rights of the individual, and the freedom of business.

Learning the real dynamics of economic growth and the effects of these institutional factors, especially in a comparative context with other countries in the region and beyond, is necessary and important to unblock obstacles to faster economic development and substantial growth of income and welfare.

Therefore, the objective of our study is to conduct a real and complete assessment of Albania's economic growth, to assess the role, position, and impact of some of the main factors of institutional character in the economic development of Albania, based on GDP PPP per capita as an indicator of economic development.

2. Conceptual Framework and Review of Literature

GDP expressed through PPP is one of the most important indicators that expresses the rate of growth or economic development of a country. It is the output value of each country calculated in US dollars based on the exchange rates of local currencies to the US dollar. This indicator allows more realistic comparisons to be made between countries because it reflects the price level, which is different in different countries.

The basic factors of economic growth, according to the neo-classics, expressed in the Solow model, are labor, capital, and technology.

In addition to these factors, institutions play an essential role in the economic development of a country (Hussain and Haque, 2014). As Harford puts it in his famous book The Undercover Economist, over the last ten years or so, economists working on development issues have converged on the mantra that "institutions matter" (Harford, 2006).

But what we mean by institutions?

According to Nobel Prize winner Douglass North, institutions consist of formal rules, informal restrictions, and features of their implementation. The official rules, of course, are very straightforward. They are rules, such as laws, constitutions, regulations, that have the character of being specific and that are precisely defined. The economic institutions we have, which directly shape

our world, stem from political institutions. Economists, he points out, do not like to think they are dependent on political science, but they in fact are (North, 2003).

As Acemoglu et al., (2005) emphasize, differences in economic institutions are the root cause of differences in the economic development of countries because economic institutions determine both incentives and constraints of economic actors and incomes. But on the other hand, a big role is also played by political institutions which determine who will *de jure* have political power. Powerful political groups have *de facto* political power.

The role of economic institutions in economic development can occur, according to the above authors, only when political institutions allocate power to groups that have interests in the implementation of property rights on a broad basis, when they place effective restrictions on powerful actors and when opportunities to catch rents are limited.

Further, as Acemoglu et al., (2008) point out, the solution to the development problems requires the reform of these institutions. Unfortunately, this is difficult because economic institutions are collective choices that result from a political process.

Rodrick and other authors see the role of the three basic factors of economic growth not in itself but closely related to other factors. According to them, behind these are other factors that determine what they will really innovate and accumulate, i.e. how different countries will develop, which he summarizes as geography, integration, and institutions. When it comes to institutions it is specifically about property rights and the rule of law. In this trio, the quality of institutions is above all. By itself, not counting the role that institutions have, geography has a weak effect on revenue, but its effect on revenue through the role of institutions increases (Rodrik et al., 2002).

According to studies, more than 80% of the change in GDP per capita in OECD countries can be explained by economic and institutional determinants, so we can say that the appropriate legal and economic environment can explain the changes in economic growth (Khalil et al., 2007).

The role of institutions can not be seen in technological progress as a factor of economic growth, in the context of the effective impetus that institutions can give to research for development, the creation of new knowledge, i.e. technological progress thus promoting economic growth (Romer, 2001).

The UN also emphasizes the importance of institutions in the development of a country when it underlines that without effective, accountable, and inclusive institutions at all levels, there can be no progress in providing essential services such as health, education, clean water provision and sanitation, or transport, among others (UN-DESA).

The governance of a country is realized through institutions, therefore the institutions, political or economic, are the ones that determine how effective the governance of a country will be.

According to the World Bank, the effectiveness of governance is expressed in the quality of public services (such as schools, health care, drinking water supply, etc.) in the quality of civil service (bureaucracy) and its independence from politics, in the quality of formulation and implementation of policies, as well as the public credibility of the government in its commitment to these policies. Institutional effectiveness, i.e. political or non-political institutions, is one of the key indicators of government effectiveness (WB, 2020a).

Effective government is part of good governance, which in this sense plays a role regarding the efficient division of labor, investment effectiveness, implementation of economic and social policies, which in turn promote rapid economic growth (Rafayet et al., 2017).

But good governance is inseparable from political stability. Therefore, the effectiveness of governance, the quality of regulation, and the rule of law depend a lot on political stability, but also on the absence of violence and terrorism, corruption, the voice of citizens, and the accountability of institutions. The literature highlights that this stability is important for economic growth (Samarasinghe, 2018).

On the other hand, the literature also highlights the link between the quality of governance, part of which is the effectiveness of governance, and per capita income, which is positive and strong. This highlights the importance of improving governance to increase a country's income.

The rule of law is one of the most important dimensions of good governance. World literature and experience show that the rule of law is an important factor of economic development.

According to the United Nations, the rule of law is a principle of governance according to which all individuals and public or private institutions, including the government but not only, accountable to the law, which is publicly proclaimed, apply equally to all and independently, and is in line with international norms and standards. The rule of law also includes measures that ensure supremacy and equality before the law, accountability before it, fairness in its implementation, separation of powers, right to participate in decision-making, legal certainty, avoidance of arbitrariness, and procedural and legal transparency (USCIB, 2015).

The rule of law is the exercise of power by published standards that embody widely supported social values and enjoy broad public support. The rule of law also implies an independent judiciary, as well as effective and efficient public institutions (Johnston, 2012).

The main areas related to the study of law that promote economic growth are the administration of justice, the regulatory framework for investment and business, the implementation of contracts, the protection of tangible or intellectual property rights (Stolper and Walker, 2007). The security of property rights and the implementation of contracts encourage investment, and thus economic growth. However, the realization of rights and the implementation of contracts are also related to institutions. (Haggard et al., 2008).

Restricting corruption and a good level of regulation are other aspects of the rule of law (ABA, 2007).

Lack of rule of law is a serious obstacle to the growth of business and the economy. The rule of law not only fosters economic growth, but growth, as well, supports further advancement of the rule of law (ABA, 2007).

The literature emphasizes that respect for the rule of law is a fundamental requirement for creating conditions that promote business development. It is the assurance that the fundamental political and human rights of individuals are protected. But the rule of law gives entrepreneurs and small business owners the confidence they need to enter the formal economy and contribute to economic growth and development across the country. Business and economics are more likely to thrive where laws are clearly defined, are known to the public, and are implemented neutrally and without prejudice to all members and groups of society (ABA, 2007).

The rule of law can be considered an institution. This institution is very important for economic growth because it is directly related to the security of personal property, property rights, impartial enforcement of contracts, and control of corruption (Haggard and Tiede, 2011).

Regulatory quality is another aspect of good governance. According to the World Bank, it is about the government's ability to formulate and enforce good rules and policies that allow and promote private sector development. Some of the variables that underlie this indicator are unfair competitive practices, discriminatory tariffs and fees, regulatory burden, degree of market dominance, investment freedom, financial freedom, ease of starting a business, ease of setting up subsidiaries of foreign companies, tax inconsistencies (e.g. disproportionate or manipulated for political purposes tax code), etc. (WB, 2020b).

Regulatory quality is also important for the development of a country. It is considered an additional quality of governance and an indicator of effective government because it relates to the ability of the government to make effective policy decisions for private sector development (Kaufmann et al., 2010).

The literature discusses extensively the impact of corruption on a country's economic growth. The WB cites corruption as one of the biggest obstacles to economic growth and poverty reduction. But, according to the literature, there are two hypotheses regarding the impact of corruption. According to one of them, corruption promotes performance and economic growth because corruption serves as a lubricant to avoid inefficient and bureaucratic regulations or delays in issuing permits and licenses. According to the second, corruption hinders growth because it hinders innovation and production efficiency.

The literature also provides examples that corruption and economic growth are positively related (South Korea). Experience also provided examples of no relationship between them (Gründler and Potrafke, 2019; Egunjobi, 2013; Aidt, 2009.)

According to Jiang and Nie (2014), corruption is the sale of state property. Corruption can also be defined as the misuse of public functions and resources for profit, whether personal or in group. Some authors point out that the phenomenon of corruption is closely related to the lack of strong political institutions and strong political competition, but also to the poor development of civil society in a country (Bracking, 2010).

Corruption can be a single act of illegal payment but also an endemic phenomenon when the entire political and economic system suffers from corruption. It is often seen as a structural problem but also as a cultural or moral problem. Corruption can also be defined as an act of bribery by a public servant and the transfer of tangible resources (Andvig et al., 2000. Cited in Ahmad et al., 2012).

Corruption occurs not only in public organizations but also in private ones. It can be thought of as selling a decision in favor of the briber and bribery is thought of as compensation for the corrupt official because of the risk and morale he holds by betraying the organization or institution where he works (Søreide, 2014).

The literature broadly states that corruption has major negative effects which reduce the speed of economic growth. This is so because corruption makes the economy inefficient, small businesses face unfair competition from big businesses, resources are not distributed efficiently, the gray economy grows, the level of education and health services is hindered. Corruption often leads to monopolies, which corrupt the government and dictate economic policies in their favor. Corruption is associated with low levels of innovation and foreign direct investment (Mirzaev, 2020). It increases inequality which not only psychologically frustrates the less privileged but also limits productivity growth, investment, and job creation (Mo, 2001).

Corruption also acts as an inefficient tax on businesses, which increases their costs and reduces investment efficiency. Corruption can reduce investment productivity also by reducing the quality of resources used for investment. It directs resources, including labor and talent, to activities and sectors that bring illicit profits. Corruption affects governance and the business environment. There are studies that link the degree of effect of corruption with the characteristics of a country, such as the poor legal and institutional framework, the political regime, and the quality of governance (Chêne, 2014).

One of the worst effects of corruption is also the reduction of consumer and business trust, thus affecting the degradation of the trust of the whole society (Samarasinghe, 2018).

Studies have shown that the factors driving corrupt practices are not only institutional weaknesses, but distorted economic policies as well. On the other hand, theoretical studies have also shown that corruption can act despite government failure and drive growth in the short term if bureaucratic regulations and rules are not so good (Ahmad et al., 2012).

Political rights, according to the Merrim-Webster Dictionary (2021) are three rights that are related to the participation of individuals in the election or administration of a government, which give an individual the right to exercise exclusivity, to hold public office, andthe right to carry out political activities. According to the OSCE (The Commission on Security and Cooperation in Europe), political rights relate to an individual's ability to participate in political and civil life without discrimination or repression. Such rights are the right to vote, the right to join a political party, to administer an office, to participate in meetings, events, or political protests (CSCE, 2021). Political rights are an expression of democracy and in this sense, they can have an effect on economic development.

Experience and literature show that freedom, including the economic one, has great effects on economic growth. Sen (2006) emphasizes that freedom is both the goal and the tool for development, while Fridman Milton emphasizes that political freedom promotes economic freedom, which in turn leads to economic growth (Edlund, 2017).

Empirically, economic freedom is based on several indicators, such as trade freedom, financial

freedom, business freedom, and fiscal freedom (Hussain and Haque, 2014). Thus, business freedom is part of economic freedom.

According to the Heritage Foundation, freedom is a summary indicator of government efficiency in regulating businesses. It is expressed with a series of variables, such as the difficulties that must be overcome to start a business, but also with the difficulties and problems related to managing or even closing the business.

Empirical studies on economic growth and the effect of institutional factors on it are also numerous.

Egunjobi, (2013) using regression analysis with time series finds, in the case of Nigeria, that corruption has a direct negative effect on output and an indirect negative effect on foreign investment and spending on education. Mo (2001), through regressive analysis using panel data for 54 countries for the period (1960-1985) estimates that a 1% increase in the corruption index causes a 0.72% decrease in economic growth. According to him, the main channel of transmission of corruption is political instability.

Using data for 175 countries from 2012 to 2018, based on Transparency International's Perception of Corruption Index (CPI), Gründler and Potrafke, (2019) find that increasing by 1-standard deviation of the inverted CPI has led to lower GDP real per capita by 17%. According to these authors, the negative effect on growth is transmitted through rising inflation and declining foreign direct investment. This effect, as the authors point out, is particularly pronounced in autocratic regimes.

Ahmad et al., (2012) reveal by analyzing panel data that the effect of corruption on economic growth is inverted U-shaped.

Hoinaru et al., (2020) analyzed a database of 185 countries for the period 2005-2015 and found that higher levels of corruption and the shadow economy are associated with lower levels of sustainable economic development. They also found that economic and sustainable development in high-income countries is more strongly and negatively affected by the phenomena of corruption and the shadow economy than in the case of lower-income countries. For lower-income countries, they also found some evidence of the positive effects of corruption and the shadow economy on economic and sustainable development.

Samarasinghe, (2018) noted that control of corruption is a critical factor for economic growth and a unit improvement in the control of corruption causes 6.9% increase in economic growth.

Jiang and Nie (2014) used a large data panel of Chinese manufacturing firms and proved that regional corruption in China has a positive effect on the profitability of private firms but not that of state-owned firms. Moreover, they proved empirically that regional corruption has more positive correlations with firm profitability when regulations are rigid. This positive correlation is most evident in the more competitive industries.

Rafayet et al., (2017) analyzing panel data for 13 years and 81 countries, found significant evidence of the impact of government effectiveness on economic growth. In particular, a 1-unit increase in government effectiveness brings about a 0.68 percentage point increase in the growth rate for high- and low-income countries taken together.

3. Research Hypotheses

Based on the purpose of the study and the results from the literature review we formulate the following research hypotheses:

Hypothesis 1: Governance in Albania during the transition has been characterized by low effectiveness and this has contributed negatively to the protracted and insufficient economic development of Albania.

Hypothesis 2: The high level of corruption and its weak control have contributed negatively to the development of the country.

Hypothesis 3: The rule of law in Albania has been weak and as such has been a determining factor for the low speed of economic development of the country.

Hypothesis 4: The low quality of regulation constitutes an important determinant of the insufficient level of development.

Hypothesis 5: The political rights of the individual in Albania are at low levels compared to other countries in the region and beyond and as such have contributed to the low level of development.

Hypothesis 6: Business freedom in transition has been generally limited and this has been accompanied by negative effects in the development.

4. Data and Method

4.1 Data

To conduct the study, data were collected in the form of a panel for a seample of 13 European countries for three years regarding the variables included in research hypotheses. In order to create a representative sample of countries, their selection was made as follows.

First, for the purposes of this comparison we selectedsome countries in the Balkansthat are not-EU members and Albania's neighbors with a similar level of development and perhaps similar development problems such as Northern Macedonia, Bosnia&Herzegovina, Montenegro, and Serbia. Secondly, we selected countries that are in the EU and at the same time Albania's neighbors, such as Italy and Greece. Albania has distinct economic and trade relations with Greece and Italy. A large group of Albanians has emigrated to these two countries. Third, we selected some countries that entered the EU lately, such as Bulgaria, Romania, Slovakia, and Slovenia, the last two of which, based on the dynamics of GDP per capita, are characterized by faster economic progress. Finally, we thought that the elections should also include EU countries that are at the forefront of economic development in the euro area, such as the Netherlands. In this way, we estimate that the choice we made enables high economic, social, and political variation, which facilitates and makes more effective evaluations, analysis, and comparisons. The data belong to the years 2002, 2014, and 2019.

We chose the years in such a way to allow sufficient time range to perform analyzes in a long-term dynamic. However, the years were also determined to some extent by the availability of data for certain variables and for specific countries. This e.g. determined why the data were collected for 2002 and not for 2000 or 2001. 2014 was designated as an important year also due to important political and economic commitments and expectations after the 2013 parliamentary elections in Albania. Thus, the period under analysis is almost 20 years, which enables more stable findings and conclusions regarding the dynamics, characteristics, sustainability, and speed of economic development of Albania.Table 1 below shows the variables for which data were collected.

Table 1: Variables and their operationalization

GDP per Capita	Rule of Law	Government Effectivenes s	Corruption Përception	Corruption Control	Regulatory Quality	Political Rights	Business Freedom
GDPCAP	**RULE**	**GOV**	**CORP**	**CORCO**	**REGQ**	**POLR**	**FREEB**
PPP US Dollars	(-2.5 weak; 2.5 strong)	(-2.5 weak; 2.5 strong)	100 = no corruption	(-2.5 weak; 2.5 strong)	(-2.5 weak; 2.5 strong)	7 (weak) - 1 (strong),	0-100
The average for 2019 based on 181 countries was 21915.19 U.S. The highest value was in Macao: 123965.29 U.S. dollars and the lowest value was in Burundi: 751.66	The average for 2019 based on 193 countries was -0.04 points. The highest value was in Finland: 2.02 points and the lowest value was in Somalia: -2.35 points	The average for 2019 based on 193 countries was -0.02 points. The highest value was in Singapore: 2.22 points and the lowest value was in Yemen: -2.28 points	The average for 2019 based on 176 countries was 43 points. The highest value was in Denmark: 87 points and the lowest value was in Somalia: 9 points.	The average for 2019 based on 193 countries was -0.04 points. The highest value was in New Zealand: 2.17 points and the lowest value was in Equatorial Guinea: -1.72 points.	The average for 2019 based on 193 countries was -0.03 points. The highest value was in Singapore: 2.16 points and the lowest value was in North Korea: -2.4 points	The average for 2020 based on 190 countries was 4 points. The highest value was in Azerbaijan: 7 points and the lowest value was in Andorra: 1 points.	The average for 2020 based on 181 countries was 63 points. The highest value was in Hong Kong: 96 points and the lowest value was in North Korea: 5 points

Source: The GlobalEconomy

4.2   Method

We apply a comparative study approach instead of an individual one. Based on this approach, we analyze the main institutional reasons for Albania's poor economic development compared to other countries in the context of a community of selected countries in the region and beyond.

The method we used to analyze the data is the descriptive statistical method, mainly averages and graphical representation, as well as econometric modeling. For detailed information on graphic presentation see Osmani (2015) and Keller (2018).

In the case of panel data, as in our case, three different econometric models can be used: the pool model, the fixed effects model (FE), and the random-effects model (RE).

If the panel consists of **n** individuals (locations) and T time periods, the pool model would be:

$Y_{it} = X_{it}B + u_{it}$

Here Y_{it} is the dependent variable for the individual i in period t, X_{it} is a vector of k independent variables, β is a vector of (k + 1) parameters, and u_{it} is an error term for unit i and period t.

The model with fixed effects would be:

$Y_{it} = X_{it}B + \alpha_i + \varepsilon_{it}$

Here α_i are time-invariant fixed effects specific to any of the individuals (country)and $\varepsilon_{it}$the observation-specific error term.

The random effects model would be:

$Y_{it} = X_{it}B + v_i + \varepsilon_{it}$

Here v_i the random (non-fixed) individual-specific effects.

Generally, in a comparison between the Pool model and the FE model, if it is proved (by means of the Fisher test) that the fixed effects do not differ significantly between them then the Pool model is used. The FE model is favored when the number of individuals (states in our study) on the panel is small. The RE model is favored if among the explanatory variables, there are also those that do not change with time (time-invariant). The choice between the FE and RE models can also be aided by specific tests (Breusch-Pagan and Hausman tests). The Breusch-Pagan test helps to select between the FE model and the Pool model, while the Hausman test helps to select between the RE model and the model with fixed effects FE.

For more knowledge and information about the above tests refer to (Cottrell and Lucchetti, 2020; Verbeek, 2017). Data processing was performed with Microsoft Excel and the GRETL econometric package.

5.   Results

Data on economic growth show that in the period 2002-2019 Albania could be qualified as the lowest with per capita income country in the region and beyond in Europe (Table 2).

As this table shows, the Albania's average annual growth of GDP per capita in this period is about 4%, close to the growth of Bosnia (3.6%) and lower than that of Moldova (4.6%).

This increase is low but we should also bear in mind the low base of comparison for these countries. Real comparisons can be made based on the average annual absolute increase in $ and especially the absolute increase in value for 1% of economic growth. The data of Table 2 (last two columns) show that Albania has achieved better results compared to Moldova only, and can be approximated to Bosnia but its achievement is far from other countries in the region (North Macedonia, Montenegro, Serbia) not to mention then other countries, such as Slovenia, Slovakia or the Netherlands.

Table 2: Economic growth of Albania during the years under study

Country	Years			Average increase (%)		Average increase ($)		Average $ Increase per 1%	
	2002	2014	2019	2019/2002	2019/2014	2019/2002	2019/2014	2019/2002	2019/2014
Albania	6776	11624	13724	1.040	1.034	408.7	525.0	102.2	155.5
Bosnia& Herzegovina	7829	12105	14922	1.036	1.043	417.2	704.3	114.4	164.8
Bulgaria	11735	18807	23265	1.039	1.043	678.2	1114.5	175.0	256.4
Greece	31659	28616	30465	0.998	1.013	-70.2	462.3	-329.2	366.8
Italy	44056	40026	42420	0.998	1.012	-96.2	598.5	-458.2	512.2
North Macedonia	9980	14571	16660	1.029	1.027	392.9	522.3	136.1	192.3
Montenegro	12733	17731	21599	1.030	1.040	521.5	967.0	175.0	240.2
Moldova	5830	10314	13050	1.046	1.048	424.7	684.0	92.8	142.0
Netherland	48111	52354	56849	1.009	1.017	514.0	1123.8	551.8	676.5
Romania	13954	23158	29983	1.043	1.053	942.9	1706.3	217.2	321.8
Serbia	10179	15275	18351	1.033	1.037	480.7	769.0	144.4	205.8
Slovenia	28088	33205	39037	1.018	1.033	644.1	1458.0	349.0	443.3
Slovakia	16990	27472	31966	1.036	1.031	880.9	1123.5	246.5	365.2

Source: The GlobalEconomy and author's calculations

In terms of the rule of law, Albania is one of the two countries that has the lowest index in the region and beyond, throughout the period under study. As Figure 1 shows, in 2002 Albania was second after Serbia with the lowest index, while in 2019 Albania is first with the lowest rule of law index. For almost 20 years, the rule of law has improved by only 0.35 units or by almost 0.02 units per year.
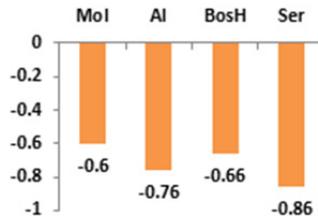

Figure 1: Rule of Law 2002
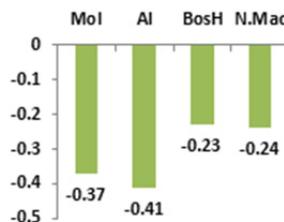**Source:** Author's calculations based on the data

Figure 2: Rule of Law 2019
Source: Author's calculations based on the data

E-ISSN 2281-4612
ISSN 2281-3993

Academic Journal of Interdisciplinary Studies
www.richtmann.org
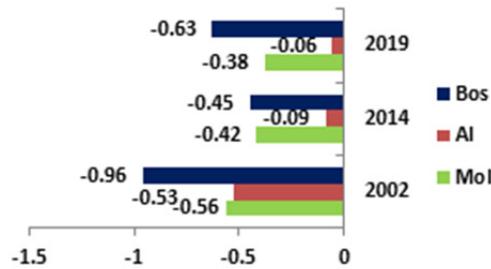
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Figure 3: Government effectiveness 2002-2019
Source: Author's calculations based on the data

Regarding the effectiveness of governance, as shown in Figure 3, it is estimated that for Albania this effectiveness is quite low and is among the countries with the lowest level of this indicator in the region, despite the improving trend over the study period. Albania is at relatively lower levels compared to Northern Macedonia, Montenegro and Serbia, which have better levels and have marked significant improvements ofthese indicators during the period under review.

Regarding corruption, throughout the period 2002-2019 Albania has been the country with the lowest corruption control index and part of the group with the worst indicators in the region and beyond in Europe (Moldova and Bosnia), while in their time dynamics there have been improvements and lower levels of this index for both Serbia and Northern Macedonia (Figures 4-6).
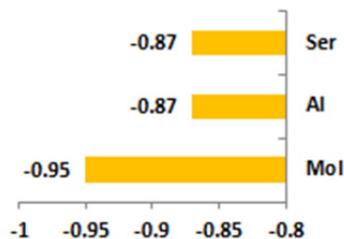

Figure 4: Control of Corruption 2002
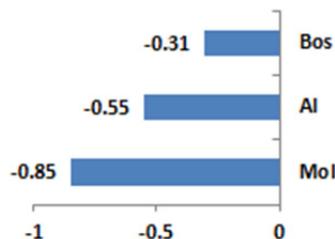**Source:** Author's calculations based on the data

Figure 5: Control of corruption 2014
Source: Author's calculations based on the data
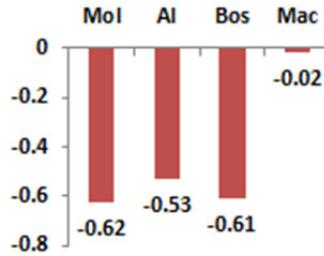
Figure 6: Control of corruption 2019
Source: Author's calculations based on the data
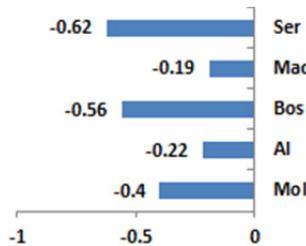

Figure 7: Regulatory Quality 2002
Source: Author's calculations based on the data
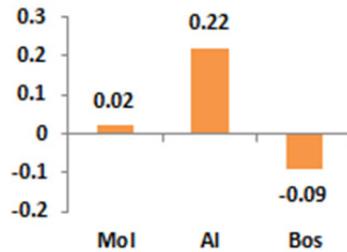

Figure 8: Regulatory quality 2014
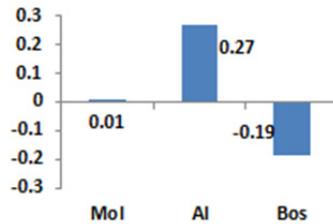**Source:** Author's calculations based on the data

Figure 8: Regulatory Quality 2019
Source: Author's calculations based on the data

In terms of the quality of regulation, low levels of the indicator are found, but better than some countries such as Serbia, Bosnia&Herzegovina, or Moldova and lower than the respective levels of Montenegro and Northern Macedonia (Figures 7-9 below). The fact that there is an improving tendency of this indicator is positive.

In terms of legal rights, Albania is at level 3 out of maximum 7, which is the worst level of rights in the region and beyond in Europe, thus being at the same level with Moldova and slightly higher compared to Northern Macedonia and Montenegro, but worse than Bulgaria, Romania, and quite far from other countries like Slovakia and Slovenia, and certainly very far from Greece, Italy, and the Netherlands. It should be noted that the level of political rights during the study period, specifically for Albania, does not indicate any improvement.

In terms of business freedom, Albania is characterized by an average level, about 66% for the entire period under study, this being significantly better than Bosnia and Serbia, comparable to Bulgaria and Slovakia, but much lower than Northern Macedonia and of course other countries such as Slovenia, the Netherlands, Italy, and Greece (See table in the annex).

In the following lines we analyze the relationship between economic growth and its hypothised factors or determinants.

Table 3 shows the pair correlation coefficients between economic growth represented by GDP PPP per capita and these indicators, as well as between these indicators themselves. There are strong positive correlations between economic growth on the one hand and the rule of law (0.9039), control of corruption (0.8938), quality of regulation (0.8764), effectiveness of governance (0.8706) and less strong relationship with political rights and business freedom.

Table 3: Pair correlation coefficients

GDPCAP	RULE	GOV	CORP	CORCO	REGQ	POLR	FREEB	
1.0000	0.9039	0.8706	0.8706	0.8938	0.8764	-0.7098	0.5516	**GDPCAP**
	1.0000	0.9484	0.9307	0.9589	0.9267	-0.6999	0.5760	**RULE**
		1.0000	0.9002	0.9439	0.9451	-0.7437	0.6513	**GOV**
			1.0000	0.9256	0.8995	-0.5768	0.6487	**CORP**
				1.0000	0.9195	-0.6750	0.5148	**CORCO**
					1.0000	-0.7529	0.6364	**REGQ**
						1.0000	-0.3553	**POLR**
							1.0000	**FREEB**

 Source: Author's calculations based on the data

Then we estimated the econometric models of economic growth depending on these factors using OLS corrected for heteroskedasticity (Table 4). We used panel pool models which have proven suitable based on relevant statistical tests.

Given the size of the determination coefficient R^2, the main determinant of economic growth is the level of corruption control, with a coefficient of 0.853. This indicates that about 85% of the changes in GDP per capita between countries come from changes in the level of corruption control.

The econometric modeling results also show that improving corruption control by one unit in the range (-2.5 to 2.5) is expected to improve GDP per capita by an average of about 2.2 times (Equation 1), while improvedrule of law by one unit in the range (-2.5 to 2.5) is expected to improve GDP per capita on average by about 2.4 times (Equation 2). In these calculations we have not taken into account the interrelationship that may exist between the degree of control of corruption and the degree of rule of law.

Table 4: Regression models between GDPCAP and explanatory variables

Nr	Model	R²	Model's Significance
1	**Ln(GDPCAP)= 9.89 + 0.770CORCO+e**	0.680	***
2	**Ln(GDPCAP)= 9.74 + 0.858RULE +e**	0.750	***
3	**Ln(GDPCAP)= 9.50 + 0.855REGQ +e**	0.737	***
4	**Ln(GDPCAP)= 10.8 - 0.427POLR+e**	0.503	***
5	**Ln(GDPCAP)=9.70 + 0.721GOV+e**	0.736	***
6	**Ln(GDPCAP)= 8.11 + 0.0268FREEB+e**	0.478	***

Note: (***) Significant at 10% level of significance

Source: Author's calculations based on the data

Based on the review of literature presented above, the determinants of economic growth may also be interdependent. To uncover this, we also estimated some econometric models that express the statistical relationship between them (Table 5).

We find that there is a very strong relationship between the rule of law on the one hand and the effectiveness of governance and the quality of regulation on the other; about 93% of the changes in the degree of rule of law in the study area are determined by differences between countries in the effectiveness of governance and the quality of regulation (Equation 7). Also, about 98% of the differences between countries in the effectiveness of governance are determined by the quality of regulation and the degree of political rights of the individual (Equation 8).

Table 5: Regression models between explanatory variables

Nr	Model	R²	Model's Significance
7	**RULE = -0.186 + 0.758GOV(***) + 0.318REGQ(**)+e**	0.933	***
8	**GOV = -0.0724 + 1.07REGQ(***) - 0.0686POLR(*)+e**	0.978	***
9	**CORCO = -0.239 + 0.593RULE(***) + 0.373GOV(***)+e**	0.942	***

Note: (***) Significant at 10%, (**) Significant at 5%, (*) Significant at 10% level of significance

Source: Author's calculations based on the data.

About 94% of the differences between countries in the level of corruption control are determined by differences between them regarding the degree of rule of law and the effectiveness of governance (Equation 9).

6. Discussion and Conclusions

This study focuses on the degree of economic development of Albania and some of its factors with mainly institutional character.

Based on the GDP PPP per capita indicator, the data show that the level of economic development of Albania is low and economic growth is weak and insufficient. For the last 20 years, the average annual growth is around 4%.

Given the low starting point after the fall of communism in Albania, a faster per capita income growth was expected in recent decades. Due to this low starting base, Albania's annual growth of 3%, or 4%, or even 5% is considered low. For this reason, only relative annual increases are not a good basis for comparing Albania's performance with other countries.

Additional indicators to really evaluate the country's economic growth and make comparisons are the average annual growth in value and the average growth in value for every 1% of relative

economic growth. For the entire study period, the average annual growth was about $409 million PPP with a significant improvement to 525 million in the period 2014-2019. But these levels are low compared to countries such as Bosnia&Herzegovina, Montenegro, and Serbia, not to mention countries such as Slovenia, Slovakia which though with relatively lower growth rates than Albania have the above indicators several times better. For the period 2014-2019, there are improvements in these aspects for Albania, however, the improvements made are weaker than those made by all countries in the region and beyond, except Moldova.

Data analysis shows that Albania has very low levels of government effectiveness, rule of law, corruption control, and regulatory quality. There have been improvements during the study period, but they are weak and the distances with other countries in the region and beyond in Europe are large. Thus, the rule of law in almost 20 years seems to have improved by only 0.35 units or about 2.1% per year, and almost equally the control of corruption, while the improvement of government effectiveness has occurred by only 0.47 units or about 2% per year. Changes in regulatory quality are similar.

Econometric modeling confirms the findings from the literature as well as research hypotheses of the strong impact of corruption and failure to reduce it, low degree of rule of law, government effectiveness, business freedom, quality regulation, and political rights in the degree of economic development. These results are especially valuable for Albania, which generally has low or very low levels regarding these indicators.

The study also found that, as expected, there is a high degree of interdependence between institutional determinants of economic growth. Here we distinguish the interdependence between the control of corruption on the one hand and the rule of law and the effectiveness of governance, on the other hand. Equally important is the interdependence between the degree of law enforcement and the effectiveness of governance, or the effectiveness of governance and the quality of regulation, the effectiveness of governance and the degree of political rights of the individual.

In this situation, it seems as though the main problems of development are related to institutions, whether political or non-political, as it is the institutions that exercise governance, to control corruption, to guarantee the rule of law, freedom of business, citizens' freedoms, and that must build and implement effective regulatory reforms. These problemsserve as clear indications for institutions that may have serious problems with law enforcement, effectiveness, efficiency, transparency, and accountability. Suffice it to take as an example the judicial system which has been in a process of reform for years and it is still unclear whether this reform can be called effective.

Based on the results of the study, we can draw some important conclusions.

First, throughout the long period of 30 years of transition, Albania has only dragged on and has not seen rapid development. Its development position compares to the positions of countries that have performed worse in the region and beyond.

Second, Albania is characterized by low levels and poor progress in terms of the institutional factors that determine development, where the effectiveness of governance, rule of law, and control of corruption seem to be major concerns.

Third, the development approach does not appear to have been integral. As Nobel laureate Amartya Sen emphasizes, the different aspects of development should be addressed and analyzed simultaneously, together and not in isolation from each other and not just "one thing at a time" (Sen, 2000). Therefore, the role and quality of institutions must be seen in terms of what freedom and skills of the individual they have made effective, which ultimately translate into economic results.

As the literature points out, good institutions provide a stimulating environment for investment (Samarasinghe, 2018). A good institutional environment, the protection of profitable economic activities, is a fundamental source of economic growth (Douglass North, 1993 in Edlund, 2017). Building effective development policies, improving regulatory mechanisms, reducing corruption, and ensuring law enforcement are basic conditions for both good governance and economic growth. Among all these, it seems that the key problem that needs to be solved is that of corruption. In this respect, the right way is to increase the quality of institutions and to build and implement appropriate regulatory policies (Hoinaru et al., 2020).

Based on the above, the main recommendation we can make is that, if Albania is to develop rapidly, it is necessary to build strong institutions, based on international standards of effectiveness, efficiency, transparency, and accountability, outside of political influences, clientelism, and nepotism.

Without these effective and efficient institutions, the country will not develop rapidly but, on the contrary, its development will resemble a laborious endless creep without a substantial increase in welfare.

Finally, ensuring the participation of all individuals, development actors and social groups in the design, monitoring and evaluation of development policies is essential because, as the literature points out, democracy is a meta-institution for building good institutions, and participatory democracy enables higher-quality growth (Rodrik, 2000).

7. Way Forward

A direct survey and study on concrete issues, weaknesses, and institutional performance would identify and address in a more complete and concrete way the needs for reform, strengthening and support of key Albanian institutions involved in development.

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