Comparative Economic Development: Albania-Western Balkan

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Abstract. The purpose of this paper is to make an economic comparison, both theoretical and empirical, for different development aspects of Albania aside Western Balkan countries. The theoretical development of the subject gives an overview of recent macroeconomic and structural developments in the countries of the Western Balkan region by dissecting the various contributors of growth. Another important point, that is developed includes the trends of economic, political and institutional development of the Western Balkan countries with relation to two major factors shaping the region's context, the international economic and financial crisis and the process of European integration reflected in the fiscal and structural reforms undertaken in the respective countries.

The descriptive statistics illustrates the relationship between economic growth and selected macroeconomic indicators by the explaining of the econometric model built and studied.

Keywords: Growth and development, GDP, FDI, public sector

1. Introduction

Economic growth and development process of a country can be evaluated according to the data found for the main macroeconomic indicators of growth. Even though it may be seen s a very complex process including not only economic, but also social, political and other growing aspects, the main emphasis is put on the economic aspects since it is easier to make an empirical evaluation of the situation. This part illustrates the development of economies in Western Balkans before and during the global crisis, (2008-2010) since this overall economic situation is relevant indicator in the growing and developing process of a country. Based on the macroeconomics figures, the analyze intends to explain the impact of each macroeconomic indicator taken in the overall economic growth for the western Balkan countries, showing for example growth of GDP, unemployment rate, inflation, trade balance, budget deficit, etc and how each of them affects the sustained economic growth in these countries.

Another important point, that is developed includes the trends of economic, political and institutional development of the Western Balkan countries with relation to two major factors shaping the region's context, the international economic and financial crisis and the process of European integration reflected in the fiscal and structural reforms undertaken in the respective countries. At this point, it is put emphasis on the contribution and effect the government plays in growth and development of a country by making possible, through the proper instruments, the efficient imposing of the policies and reforms promoting them. The public sector development can be stated as the other face of development for a country and is usually been forgone in the sense that not much emphasis is put on it. In this manner, the development of public sector, that is seen as an important aspect of the overall country's development is further explained and illustrated in the paper.

From the various contributors to economic growth, it is important to focus on the government's contribution to economic growth. There are two points that must be distinguished from each-other:

- the positive impact of making available public services and infrastructure and creating efficient institutions that foster an adequate business environment
- the burden represented by government with the risk of imposing too high taxes, distorting market incentives and interfering negatively in the economy by assuming roles most appropriate for the private sector.

2. Literature Review

Economic theory presents growth and development as ultimately driven by individual behavior of households and enterprises, propensity for saving and investment, capital accumulation and technological progress. It thus assigns to public policies only an indirect, but yet important, role. Even though challenged by some economic theories, the availability of adequate infrastructure, the provision of public goods and the settlement of the externalities issue are equally important so that the society benefits to the maximum from individual decisions.

The government intervention and its crucial role in economic development and especially growth is reviewed by different schools of economic thought, theories and authors. Austrian school of economics (Carl Menger, Eugen Von Bohm-Baweker, late-19th and early 20th century) views a limited role of government in development process justified by the need to tackle market failures and social inequity, as argued by the new welfare economics. According to the neo-classical economics, (Harrod and Domar 1946, Solow, Robert M. 1956) government intervention is justified not only to provide external and domestic security for its citizens, a fair and efficient judicial system and the enforcement of rules creating a level playing field for entrepreneurship, but also to solve the problem of externalities, ensure macroeconomic stability and promote a redistribution of incomes that corresponds to the prevalent preference of the society.

However, other studies (Slemrod, Gale and Easterly (1995), Levine and Renelt (1992), Sala-i-Martin (1997) or Mendoza (1997) did not find the partial correlation between the size of public sector or taxes and economic growth statistically significant. The positive impact may come from public investment in infrastructure (Aschauer,1989), Barro,1990), Barro and Sala-i-Martin (1992), Loayza and Soto (2002),general government investment (Aschauer,1989), Easterly and Rebelo (1993) or spending on education (Aschauer,1989), Easterly and Rebelo,1993). Some authors find a less favorable impact on growth deriving from government consumption expenditure (Barro,1990), Slemrod, Gale and Easterly,1995), non-productive expenditure (Kneller, Bleaney and Gemmell,1999) public welfare expenditure (Jones,1990) and excessive burden on the private sector (Loayza and Soto,2002).

3. Sustained economic growth in the Western Balkans. Main macroeconomic indicators of growth

Western Balkan Countries have been characterized mostly as developing economies, with relatively low level of openness to world markets, with perhaps a stable banking system, which has been almost not affected by risky and unsafe financial instruments. Also, in an other point of view, the Western Balkans Countries are still not quite stable economies suffering from the lack of "automatic stabilizers" of social welfare systems and also the access to the easier financing and support mechanisms.
The indicators are explained and illustrated as follows:

3.1. Real GDP growth

In terms of macroeconomic indicators, the Gross Domestic Product (GDP) has been one of the most positive and sustainable one in Western Balkan. The growth of GDP in the Region, compared to the average GDP growth of the 27 European members (EU 27) shows that all Balkan countries experienced rapid increase of economic output. In the years 2005-2007 the GDP growth in Western Balkan Countries was higher than that of the EU. In 2007 the real growth of GDP was in Monte Negro 10.7%; Serbia 6,9%; Bosnia and Herzegovina 6,2%; Macedonia 6,1%; Albania 5,9%; Croatia 5,5% and Kosovo 3,9% (the lowest).
Even though in 2008 European Countries felt in economic downturn, Western Balkan economies were still driven positively. Although there was a slowdown in their economic growth, it was still suitable growth with an average about 5,5%; certainly not that sharp as the one leading to an EU average of 0.7%. Particularly in this year Albania had a real growth of 7,7% and Monte Negro 6,9%; the lowest increase was in Croatia by about 2,4%. The data shows that Western Balkan Countries felt in economic downturn in the year 2009. It is typical for all countries in the Region, which expresses the likeness of economic development of these countries. The downturn has been substantial. It has been more obviously for Macedonia 8.0% from 5.0% in 2008, Croatia -5.8% from 2.4% (2008); Montenegro -5.7% from 6.9% (2008); Serbia by 5.5% -3.1% (2008), etc. The growth has been positive only Kosovo 4.0% and Albania 3.3%.

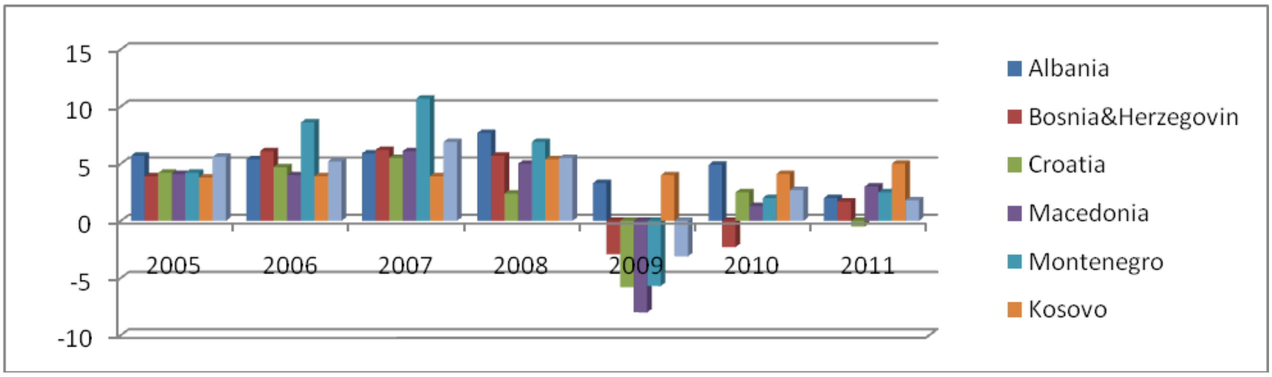

Figure 1. GDP real growth 2005-2011 (%)

3.2. Unemployment rate

Another indicator, which is used to evaluate the impact of the economic crisis, is the unemployment rate. Increasing rate of unemployment has been one of the main negative aspects affecting development in many industrialized countries and in West Balkan countries as well due to the lack the "automatic stabilizers". The unemployment data indicate that the Western Balkans had serious unemployment levels even before the crisis, and they got worse after 2008. All countries had higher unemployment rates than the EU. However, figure 2, shows a clear tendency of diminishing rate of unemployment for the entire period before crisis, from 2005 to 2008. But in 2009 its level reached higher rates for all countries. But while most of the countries have high, yet still manageable problems, Macedonia, Bosnia & Herzegovina and Kosovo have more than a third, quarter and nearly half of the working force unemployed; respectively 32.2% for Macedonia, 42.7% for Bosnia and Herzegovina and 45.4% for Kosovo (for 2008).

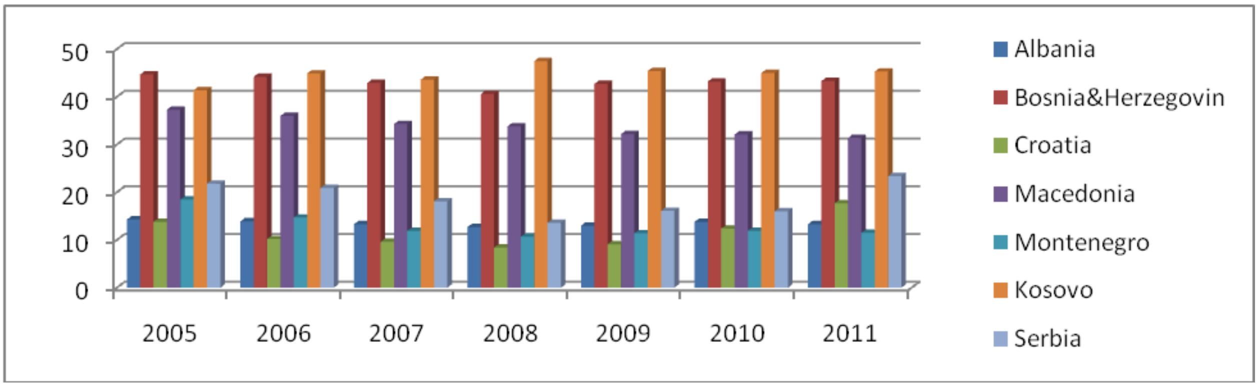

Figure 2. Unemployment rate 2005 – 2011

3.3. Budget deficit

This is another important indicator of growth and development of a country and it is evident that even the economic crisis will have a negative impact on the budget deficit, since the economic downturn will be reflected in decreasing of tax revenues as well. Data shows (figure 3) that keeping under control the budget deficit, has been always an important part of the macroeconomic stabilization for Western Balkan. In 2008 except Albania, all other countries have had a very sustainable deficit. But 2009 noticed a significant increase of budget deficit as a percentage of GDP, which has reached -6.8% in Albania; -8,0% in Kosovo; -4,1 in Croatia and Serbia, etc. The intention to argue this negative increasing is not easy, because it is combine with a decline of GDP treated above, which brought an increase of the negative ratio of budget deficit to GDP that explain it somehow.

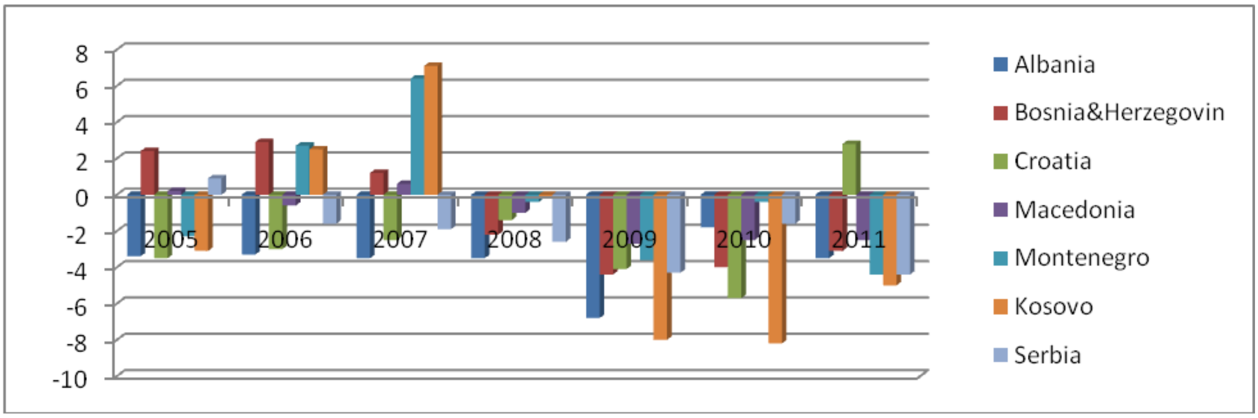

Figure 3. Budget deficit to GDP 2005 – 2011 (%)

3.4. Remittances from emigrants

In Western Balkan Countries remittances sent home by emigrants working abroad are an important part of overall GDP. Particularly those are significant for Serbia (5,6 billion USD, about 12,6% of GDP); Bosnia Herzegovina (2,2 billion USD, about 12,7% of GDP) and Albania (1,3 billion USD, about 10,9% of GDP), countries which are included in 10 top remittance recipients countries in

“Europe and Central Asia” Region. In these economies they have been in important levels, which served to reduce the deficit of payments balance and also an important source for financing domestic demand.

As figure 4 illustrates, in 2009, remittances for the first time suffered a decrease for all Western Balkan countries. Anyway the situation seems to be change in 2010.Officially recorded remittance flows to developing countries are estimated to increase by

6,0% in 2010. This marks a healthy recovery from a 5,5% decline registered in 2009. Remittance flows increase by 6,2% in 2011 and 8,1% in 2012.

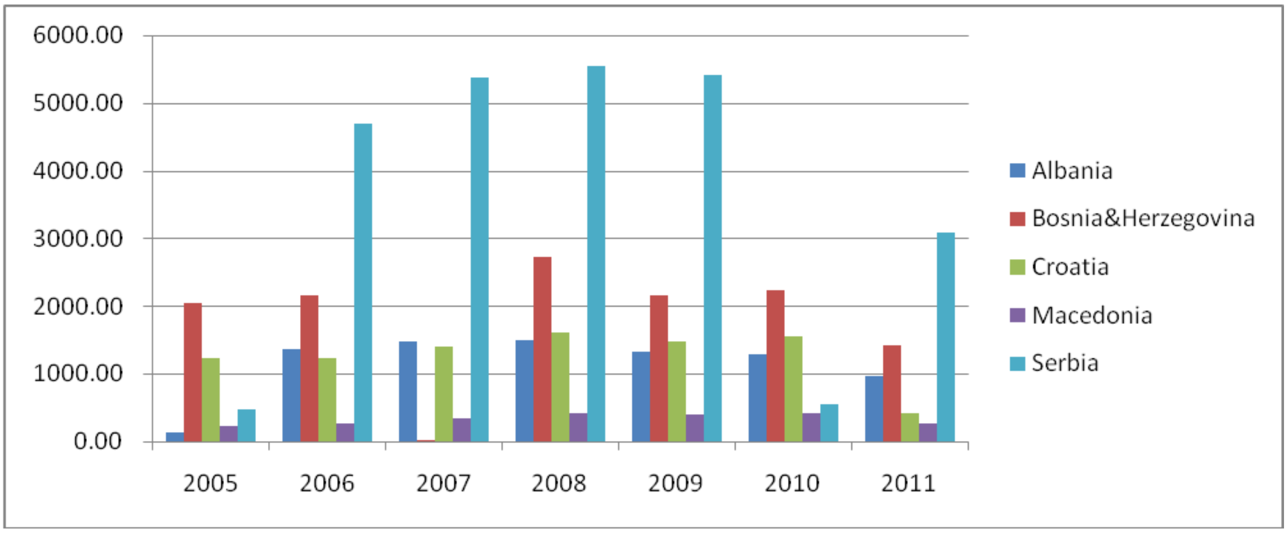

Figure 4. Remittances in Western Balkan (2005 -2012) (million USD)

3.5. Foreign direct Investment (FDI)

Foreign direct Investment is a factor that strongly affects the development process of a country by helping the development of the business sectors and bringing growth of the overall performance of an economy.

Data in figure 5(appendix) shows decreasing of FDI for the most of countries of Western Balkans. The exception is only Montenegro and Albania where in 2009 the growth rates of FDI have been positive (respectively 61% and 12%). Decreasing of FDI in the Region has followed the world general trend of FDI during the crisis years.

The graph shows a comparison of FDI changes among the Western Balkan countries. As can be seen, Bosnia Herzegovina had a level of FDI of (-71%), Croatia (-63%) and Macedonia (-60%). On the other side, Western Balkan Countries have relatively low level of FDI compared to other countries in South Eastern Europe. So, for the South Eastern Europe region only Croatia, Serbia and Montenegro belong to the second group, which includes countries with FDI from 1.0 to 4.9 billion USD, while Albania and Bosnia Herzegovina are included in the third group (with FDI between 0.5 to 0.9 billion USD) and Macedonia belongs to the fourth group (the last), with FDI less than 0.5 billion USD.

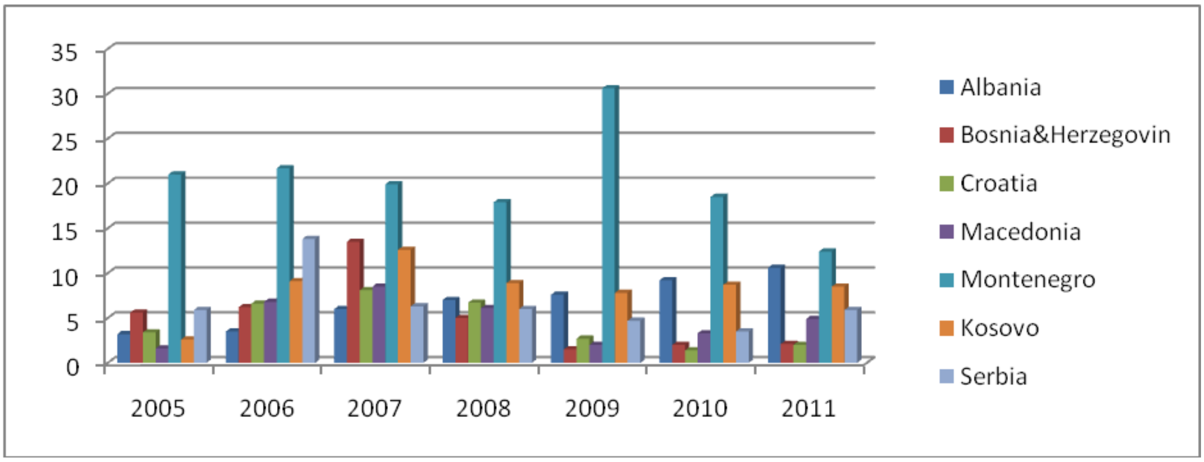

Figure 5: Foreign direct investment (FDI, net) % GDP

3.6. Credit Growth and the Financial Sector Development (Banks)

In Western Balkan, the economic activity coming from banking sector is much lower than in other countries. Thus for example while in EU countries the percentage of financial system assets to GDP is over 150%, in Albania its weight is about 82%.

The graph illustrates the credit growth development in Western Balkan countries by taking into account the performance of loans from the banks, since the banks are the main financial institutions developed in these countries. The increasing of percentage of bad loans and decreasing of deposits in 2008 and 2009, tighten loans during these years. In this regards, in Albania bad loans (non performing loans) has been increasing from 3,2% in 2007 to 4,7% in 2008 and 9,1% in 2009.

The negative trend seems to continue also in the two first quarters of 2010, getting at a level of 12%. Also in Monte Negro non performing loans are increase from 3,7% in 2007 to 7,2%(2008); 13,5% (2009); 16,6% (2010). For some other countries a negative development is reflected in tightening of banks' deposits; for example in Croatia rate of deposits have been decreasing from 27,2% in 2007 to 7,4% in 2008; -15,2% in 2009; even more in 2010; -25,7%. Bad loans and decreasing of deposits follow a restriction of the loans and investment and finally economic growth.

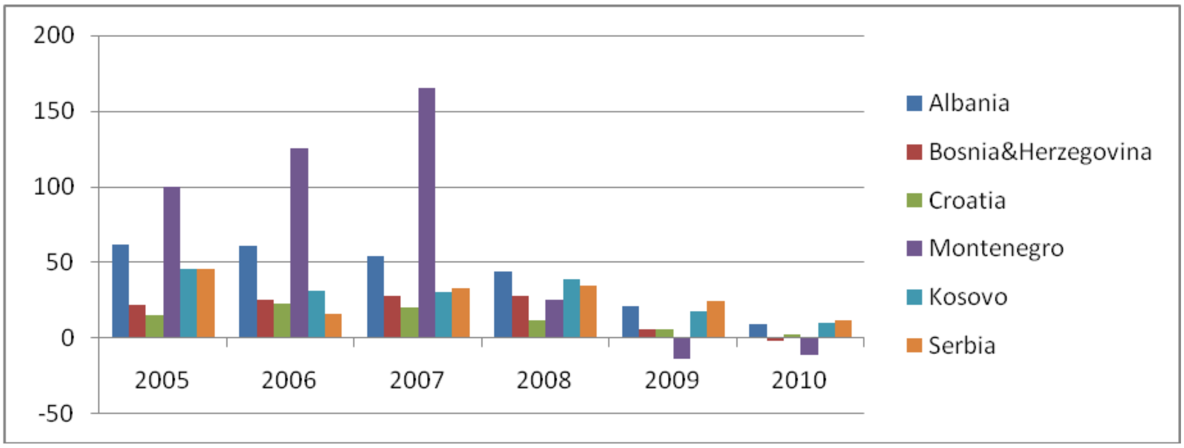

Figure 6: Credit Growth

3.7. The level of integration with the global economy (the openness index)

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One of the most important factors, that can overtake the international economics developments into a specific country, is of course the level of integration of this country related to world economy. The economic level of integration of a country is demonstrated in the "openness index", which represents the percentage of the volume of exports and imports to GDP.
In the light of global crisis, a smaller openness index would be a positive factor limiting the negative effect of the crisis on the economy. Data shows that Bosnia and Herzegovina; Montenegro and Macedonia have a higher openness index, even higher than West European Countries. It means that trade relation of these countries with the rest of the World has been more intensive, which represents more potential for over passing a negative effect of global crisis on the economies of these countries.

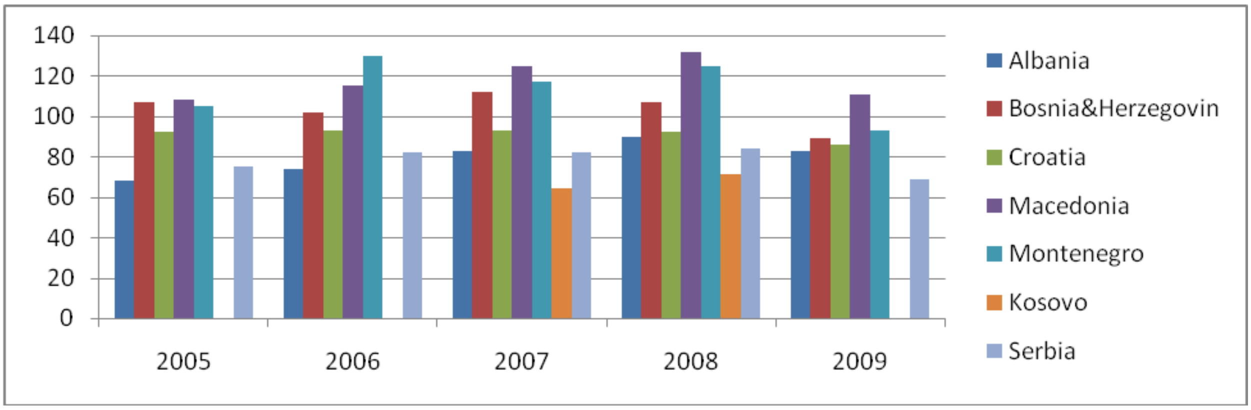


Figure 7: The Openness Index

4. Economic growth and government. Public Sector Growth, the other face of a country development.

Before starting to evaluate each of the factors independently, must be stated that there are some features in Western Balkan countries have in common in this fact. First, most countries were previously part of one national economy (Yugoslavia) and significant economic gains can be reaped from reintegrating fragments of former regional system. Second, a number of geographic and ethnic factors increase the interdependency between these countries: common languages, common ethnic minorities, and the crescent-shape geography of Croatia, which wraps around Bosnia and Herzegovina. Third, all Western Balkan countries aspire to EU membership. From the various contributors to economic growth, it is important to focus on the government's contribution to economic growth. There are two points that must be distinguished from each-other:
- the positive impact of making available public services and infrastructure and creating efficient institutions that foster an adequate business environment
- the burden represented by government with the risk of imposing too high taxes, distorting market incentives and interfering negatively in the economy by assuming roles most appropriate for the private sector.

There are three important measures described and illustrated for western Balkan countries that have an impact in overall growing and developing process for them:

4.1. Institutional efficiency:

Western Balkan countries in their part on public administration reform suffer from the same problems. The common issue eating at the effectiveness of the institutional system in the Western Balkans is that the governments lack political will.

First, the adopted legislative framework and reform strategy either do not start or start inadvertently, and their implementation is slow, problematic, and in the end they do not come true(Albania). **Second**, the administrative capacity of the Department of Public Administration is as a rule weak and contains no plan for human resources management. **Third**, political appointments with temporary contracts of loyal party activists is common in the administration.

Institutions are mostly new and have not taken a well formed shape and functioning, many of them were adopted hastily, under urgent procedure, with the sole purpose of getting it done to make eyes in front of the European Commission.

Also many institutions with the same functions exist at many levels of government(case of Croatia). To mention is also the case of Kosovo, where there is no effective combination of legislation adoption and adequate implementation afterwards.

The most serious problem is, of course, their ethnocentric essence, existing in countries as Macedonia and Montenegro.

Macedonia has had the legacy of fairly developed Yugoslav institutions. The institutional system is a slow, unkind and chaotic extension of the state, offering and executing low-quality services. Montenegro's young institutions have the benefit of being successors of the strong Yugoslav institutional apparatus, but at the same time face the classic difficulties of all institutions in transitional societies: weakness, insufficient administrative capacity, inefficiency and corruption.

The country's institutional infrastructure has at any point in time been better placed even than that of current EU member states Bulgaria and Romania.

4.2. Corruption and organized crime

Western Balkan countries are part of the United Nations Convention against Corruption (UNCAC). Both the Council of Europe Civil Law and Criminal Law Conventions on Corruption have also been ratified.

Corruption is pervasive, and the EU has called for rigorous implementation of anticorruption measures, also weak state institutions have augmented the power of crime syndicates.

Among the factors effecting corruption are the legacy of the centralized socialist state and the privileged access to its resources of the party elites; the bloated public administration, the practices of war profiteering and the ensuing culture among ethno-nationalist elites(like in Bosnia & Herzegovina, Serbia and Kosovo) the lack of coherent anti-corruption legislation and of political will on the part not only of the elites, but of the entire society to combat the phenomenon; the complicated court system and the dependence of the media on the political oligarchies and on the state enterprises.

As regards organized crime, it is closely related to corruption as it is often the case that public officials are on the payroll of crime groups in exchange of favors and turning a blind eye on their activities(as happens in Croatia).

There are some features in common regarding this issue in Western Balkan countries. **First,** the lack of political will for decisive action, **second**, the lack of efficient implementation of the existing and newly adopted legislation (like in Kosovo, Macedonia and Albania) and **third**, the lack of coordination among institutions aimed at complementarily and common action.

Insufficient effort in combating corruption and organized crime has been one of the most vocal criticisms made by the European Commission to countries as Montenegro.

Some rankings according to the Transparency International's corruption Perception Index, list Western Balkan countries in high levels of corruption. Serbia ranked 83rd, Bosnia & Herzegovina stands as the country with the highest corruption levels and Montenegro ranks 69th out of 180 countries.

4.3. Public administration functioning

Public administration is the key agent of the entire European integration process for Western Balkan countries. It must have the necessary capacity and be efficient enough in carrying it on its shoulders, in order to bring further on the growing and developing process for a country. Public administration reform is thus one of the greatest challenges for Western Balkan countries' reform agenda, especially for Bosnia and Herzegovina as a potential candidate for EU. Therefore, there exist many problems in this sector development. The main problems pertaining to public administration reform are lack of political will for reform, slowing down of the reform process, lack of institutional and legal capacity for administrative training, and insufficient funds allocated for conducting the reform, also the party and political influence over the public administration is obvious. Another persisting problem with the administration is the lack of career prospects for young qualified staff, enforced by an absence of incentives for horizontal mobility and weak accountability mechanisms, seen more obvious in Croatia, owing to relatively low salaries in public administration. The newly appointed persons in public administration and in the municipalities have poorer qualification, often do not have the minimum necessary office space and are not provided with clear description of their tasks, a concrete case would be Macedonia, or Montenegro where this situation is more problematic.

5. Regression analysis. The relationship between economic growth and selected macroeconomic indicators, case of Albania.

5.1. Methodology and Data

In order to measure the relationship and the effect that the real growth rate has on foreign direct investments, we have used linear regression data equation obtained from the World Bank and Bank of Albania. Let's examine the statistical regression between the Real Growth Rate & Foreign Direct Investments :

$$Y=\alpha +\beta_1 X_1+ u$$

where : Y= GDP-Real Growth rate

α –is the coefficient used in the regression method

β_1 – is the slope parameter in the relationship between *y* and *x* holding the other factors in *u* fixed

u - error term or disturbance in the relationship, represent factors other than x that affect y

X= is the dependent(explained variable), FDI (Foreign Direct Investment)

Regression Statistics	
Multiple R	0.359987043
R Square	0.129590671
Adjusted R Square	0.071563383
Standard Error	2.573608627
Observations	17

The 35% R square shown below indicates the meaning that the line did not fit well so there is not a strong relation between our independent and dependent variable.

Percentage that Net FDI effects in the GDP-Real Growth Rate is approximately 37% (R Square).

Even though the standard error is a considerable number, the relation is shown statistically by the numbers and the diagrams of the graph.

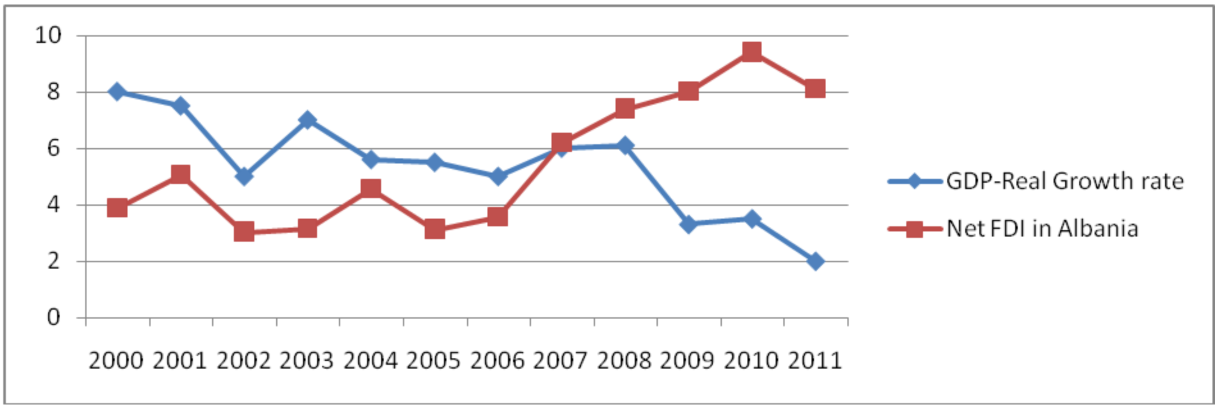


Figure 8: Relationship between GDP-Real growth rate and net FDI

Statistical analysis, multiple regression:

Impact of Unemployment in Real Growth Rate & Foreign Direct Investments using the statistical analysis:

$$Y=\alpha + \beta X1 + \beta X2,$$

where: Y-Unemployment

α –is the coefficient used in the regression method

β_1 – is the slope parameter in the relationship between *y* and x_1 holding the other factors in *u* fixed

β_2 – is the slope parameter in the relationship between *y* and x_2 holding the other factors in *u* fixed

u - error term or disturbance in the relationship, represent factors other than x that affect y

X1- Real Growth Rate

X2-FDI

Regression Statistics	
Multiple R	0.831712138
R Square	0.69174508
Adjusted R Square	0.647708663
Standard Error	1.585321522
Observations	17

This summary output table shows the variable measures derived from the regression analysis made for the data taken to study. The 83% R square shown below indicates the meaning that the line fitted very well so there is a strong relation between our independent and dependent variables.

Percentage that Unemployment is affected from GDP-Real Growth rate and FDI is 69% (R Square).

Even though the standard error is a considerable number, the relation is shown statistically by the numbers and the diagrams of the graph.

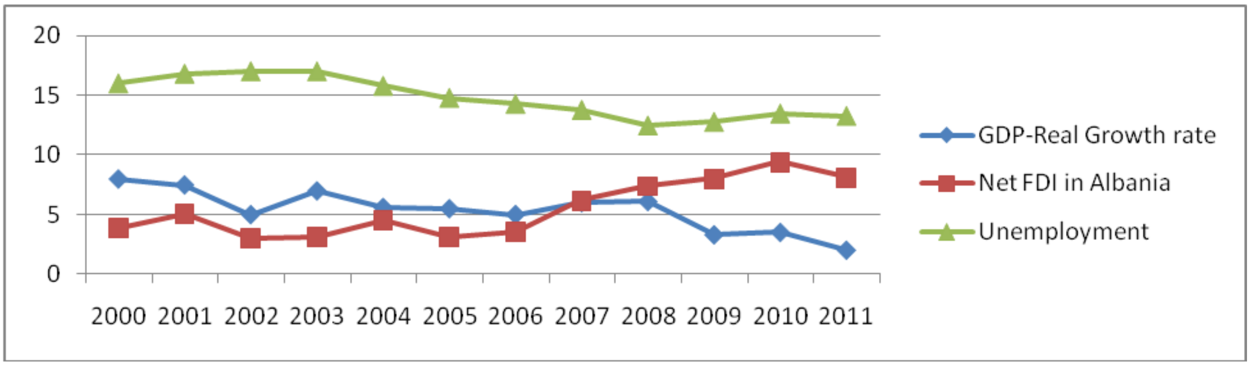
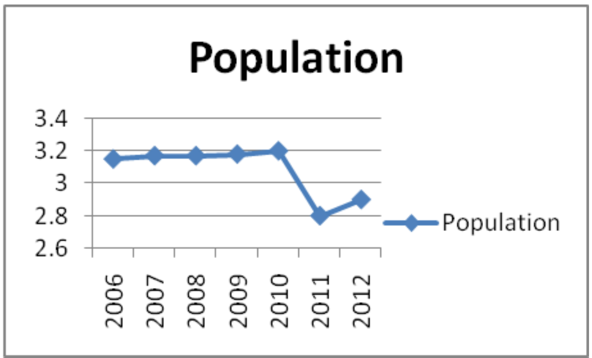
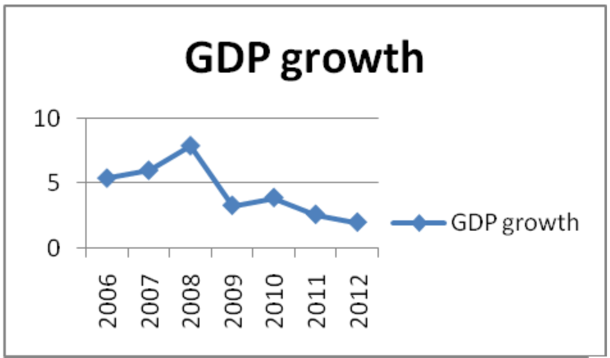
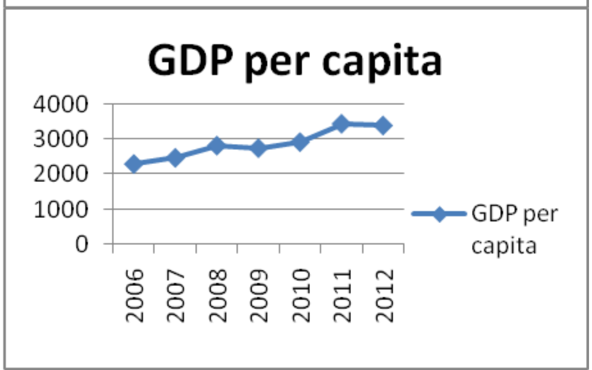


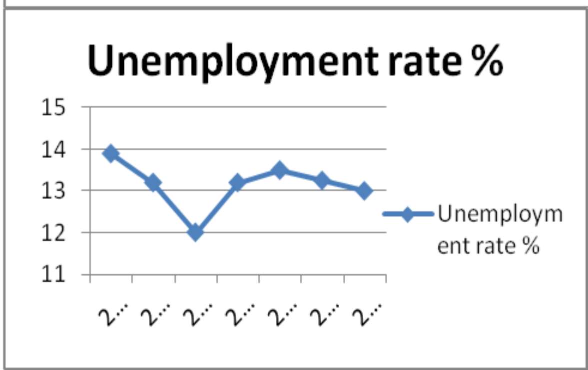
Figure 9: Relationship between Unemployment and GDP-real growth rate, net FDI

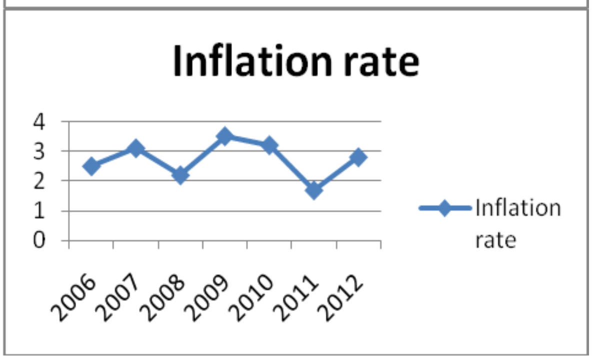
5.2. Graphical presentation of macroeconomic and growth indicators, case of Albania

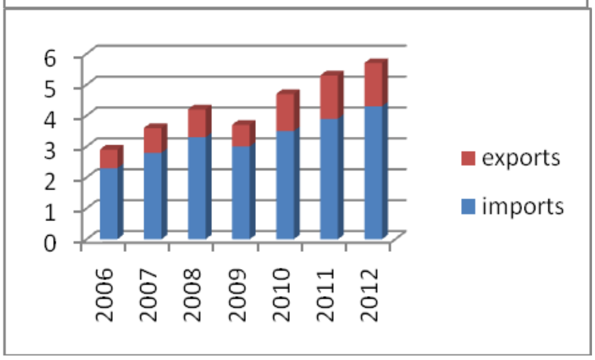


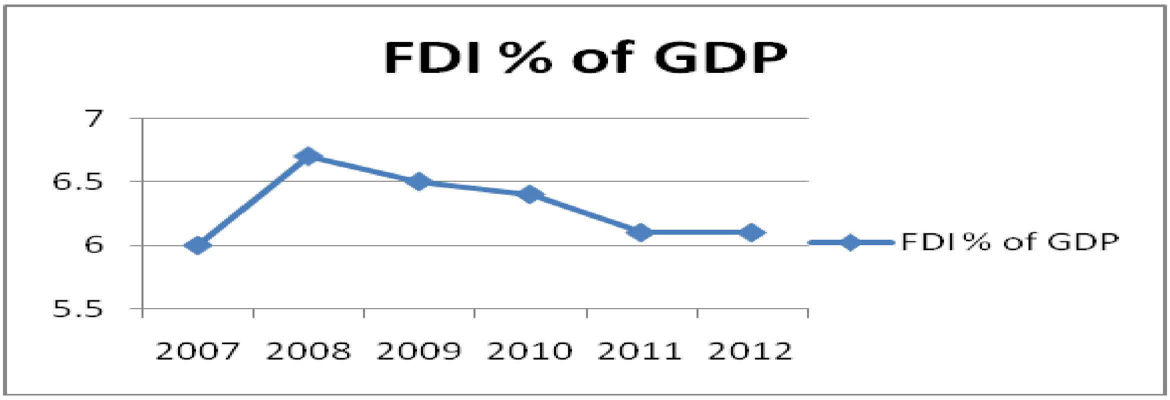




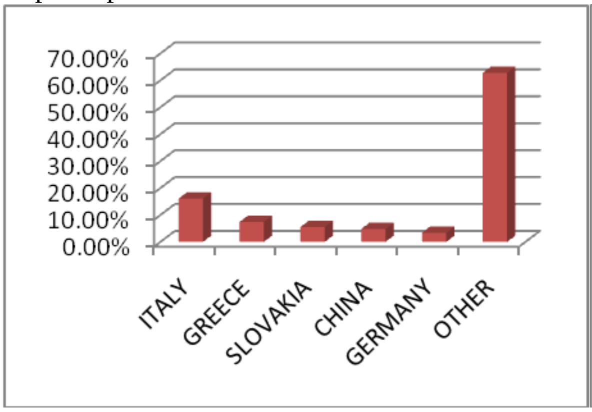




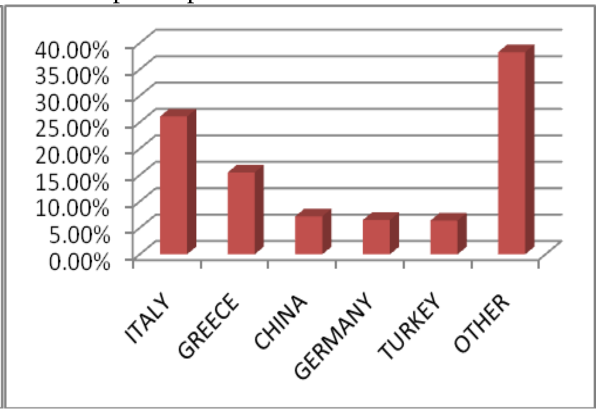




Top 5 export countries with ALBANIA:



Top 5 import countries with ALBANIA:



6. Conclusions

Based on the macroeconomics figures, the analyze intends to explain the impact of each macroeconomic indicator taken in the overall economic growth for the western Balkan countries, showing for example growth of GDP, unemployment rate, inflation, trade balance, budget deficit, etc and how each of them affects the sustained economic growth in these countries.

In terms of macroeconomic indicators, the Gross Domestic Product (GDP) has been one of the most positive and sustainable one in Western Balkan. The growth of GDP in the Region, compared to the average GDP growth of the 27 European members (EU 27) shows that all Balkan countries experienced rapid increase of economic output. Bosnia and Herzegovina 6,2%; Macedonia 6,1%; Albania 5,9%; Croatia 5,5% and Kosovo 3,9% (the lowest).

The unemployment data indicate that the Western Balkans had serious unemployment levels even before the crisis, and they got worse after 2008. All countries had higher unemployment rates than the EU.

The budget deficit is another important indicator of growth and development of a country and it is evident that even the economic crisis will have a negative impact on the budget deficit, since the economic downturn will be reflected in decreasing of tax revenues as well.

The same may be said about the other macroeconomic variables taken in the study, that are explained and illustrated above in the paper.

With regard to the public sector development as the other face of development, must be said that western Balkan countries have much more to do in order to improve the development in this sector. Governments still need to take better reforms to improve the institutional efficiency and to increase the reforms against corruption and organized crime. This process can be done with the help of the European Union institutions and reforms that the Western Balkan countries need to undertake to even help their integration process and give an incentive to their growth and development.

The regression analysis taken in consideration is for the case of Albania. The analysis is made to study the relationship between the Real Growth Rate & Foreign Direct Investments, as simple regression and the relationship between Unemployment with Real Growth Rate & Foreign Direct Investments. The outcomes show a positive relationship between the dependent and independent variables for Albania, as is explained in the paper.

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