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PAPER

The Impact of Corruption and Good Governance on the Economic Growth of the Balkan Countries

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Abstract The aim of this paper is to investigate the effect of good governance on economic growth in Balkan countries. In particular, we investigate the impact of corruption on the growth of GDP per capita. The results show that in some of the countries of the Balkan area such as Albania, Bosnia, Croatia, Greece, the Republic of North Macedonia, Romania, Serbia, and Turkey, corruption is negatively correlated with GDP per capita growth. This paper also shows that corruption, in some Balkan countries, tends to decrease before joining the European Union and continues to decrease even after joining. This is due to the fact that, with EU membership, governance tends to improve and adapt more easily to EU rules. The main policy implication is that improved governance is more effective in terms of both reducing corruption and improving the growth potential of an economy and also EU integration.

Keywords: Corruption, economic growth, good governance, integration, Balkan countries.

JEL Classification: O11, P43, P52.

1. Introduction

Grand corruption is one of the biggest threats to sustainable development. It is difficult to see any other crime resulting in more victims globally (Benestad, 2020). Corruption exists in all countries and can affect a given region or a specific level of development (Abed and Gupta, 2002). It occurs when the public and private sectors interact; in this situation, bureaucrats may abuse their public position to gain private gains by accepting bribes or even actively extorting bribes. According to the existing

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literature, this behavior is defined as an act of bureaucratic corruption that can promote growth (Asian paradox) by helping firms bypass the burden of the public sector or can postpone it by increasing that burden and reducing the efficiency of public spending that contributes to productivity (Dzhumashev, 2014). The prevailing literature (Mauro, 1997; Friedman et al., 2000; Dreher and Schneider, 2010; Leff, 1964; Huntington, 1968; Rock and Bonnett, 2004) highlights that the positive or negative effect of corruption on growth depends mainly on: (i) the quality of governance and (ii) the level of institutional development, which results in strong and independent instigations that exist in a given country. This means that corruption is driven by the institutional environment. Corruption depends on the extent to which bureaucrats coordinate their rent-seeking behavior. Some countries with organized corruption networks are likely to display lower levels of bribes, higher levels of research activity, and higher rates of growth than countries with disorganized corruption arrangements (Blackburn and Forgues-Puccio, 2009).

Another strand of literature states that corruption modifies the effects of institutions on the economy, such as the burden imposed or the productivity input provided by the public sector, thereby impacting economic growth (Acemoglu and Verdier, 2000; Aidt, 2009).

Based on these facts, this paper tries to investigate: (i) the impact of corruption on the growth of GDP per capita in Balkan countries region through the correlation between GDP growth per capita and good governance indicator measured by CPI. We focus on the Balkan countries for the following reasons. First, with few exceptions, corruption in Balkan countries is systemic (Muço and Balliu, 2018). This allows us to study the correlation between systemic corruption and GDP growth per capita. Balkan countries are generally characterized by weak institutions; for this reason, in this article, we will try to study how the performance of good governance indicator affects GDP per capita growth.

Secondly, some of the Balkan countries have joined the EU; the others try to join it. Taking these countries into consideration allows us to understand what happens with corruption and with the governability of a country after joining the EU.

The rest of the paper will proceed as follows. Sections 2 and 3 discuss the overview of the Balkan area and its theoretical background. In Section 4, we show the statistical analysis, and the last section concludes and summarizes.

2. Overview of the Balkan area

The area under examination represents a strategic point as it constitutes a bridge between Europe and the East. The years following the Balkan conflicts have been characterized by the intervention of both the European Union and the international political community that have tried to promote economic growth and regional stability.

The Balkan area has been perceived by the international community as a problematic area made up of small states constantly fighting each other. The Balkan region was called

the Powder Keg of Europe because it was characterized by unstable political situations and constant disorder. In this analysis, we consider states that belong to the European Union (Greece, Slovenia, Bulgaria, Romania, and Croatia) and states that are candidates (the Republic of North Macedonia, Turkey, Albania, and Serbia)[1].

In the Balkan intra-regional context, efforts were made to implement reforms by the intervention of cooperative and political means. The variables that are a problem for this area (in political and economic terms) cannot be overlooked, and environmental conditions must be taken into account, as well as the shift from a difficult conflict phase to solve and the formation of new political entities, which have tried to legitimize themselves by leveraging ethnic-political elements (Gligorov et al., 1999).

The reasons for the integration policy in the Balkan area consist in trying to link their development to that of the European Union, achieving social cohesion (eliminating discrimination, poverty and exclusion), raising social and human capital (affirmation of human rights) and empowering citizens with the democratization of political structures.

3. Literature review

Over the years, there has been an attempt to understand how corruption can influence the defining contexts for a country's economic growth. This has led several scholars in two opposite directions: the first group of scholars argue that corruption facilitates trade and promotes efficiency by allowing private sector agents to bypass cumbersome regulations (Leff, 1964; Huntington, 1968; Rock and Bonnett, 2004). Several studies (Egger and Winner, 2005; Levy, 2007) support this hypothesis, demonstrating that in highly restrictive regulatory environments, corruption can foster economic growth by stimulating entrepreneurship and efficiency. Corruption acts as a way to fight the bureaucracy of public sector tenders. Countries with high levels of public bureaucracy have the tendency to restrict and discourage production activities. Entrepreneurs, through corruption, enhance the benefit of necessary authorizations in order to continue their planned activities that stimulate employment and economic development (Acemoglu e Verdier, 1998; Huntington, 2002; Rock e Bonnett, 2004).

The second line of thought argues that corruption hinders economic growth (Mauro, 1997) and reduces investment in most developing countries and especially in small open economies. Moreover, corruption reduces foreign direct investments (FDI) and productivity (Lambsdorff, 2003).

Fisman and Svensson (2007) estimate that a one percent increase in corruption leads to a three percent reduction in business growth.

According to Sylos Labini (1989), scientific, technical progress and education

[1] Greece joined the EU in 1981; Slovenia in 2004; Bulgaria and Romania in 2007; Croatia in 2013; Turkey has been a candidate since 1999; the Republic of North Macedonia has been a candidate since 2005; and finally, Albania and Serbia have been candidates since 2012.

stimulate economic development; however, if there is corruption, this tends to negatively affect these factors, also affecting the increase in the social well-being of citizens.

Mauro (1995), in his empirical model comes to the conclusion that corruption is like an income tax and worsens economic growth.

Tanzi and Davoodi (2002a) state that corruption can reduce spending on health and education. The authors also affirm that corruption can lead to a reduction in the level of quality of public infrastructure. Akai et al. (2005) arrive at a similar result; according to them, corruption tends to increase government spending on infrastructure, diverting funds from other sectors such as education and health. Another problem is that corruption causes an increase in cost, a decrease in the quality of investments but also an increase in informal economic growth and distortion of the tax burden as the ability of the government to collect tariffs and taxes is compromised (Friedman et al., 2000; Del Monte and Pagnani, 2007; Dreher and Schneider, 2010).

Several other studies link corruption to the economic conditions of a particular country; in fact, a country with poor economic conditions will tend to have high levels of corruption, which will further worsen development (Shleifer and Vishny, 1993; Ali and Isse, 2003). These studies also state that a country with satisfactory macroeconomic performance is more sensitive to reduce bureaucracy and corruption, consequently having a robust development.

Acemoglu et al. (2008) create a connection between corruption and the level of democracy in a country, which means that the more democratic the country is, the less corrupted and most economically advanced it will be. Corruption and democracy, according to the authors mentioned above, have a negative correlation. According to Brunetti et al. (1998) there exists a negative connection between the credibility of laws and economic growth. As claimed by the authors, corruption worsens the distribution of wealth within a country.

According to North (1991), the growth that occurs in a country is not only hindered by the presence of corruption by public officials but also depends on the efficiency of the judicial system. The corruption phenomenon is very often also connected to informal activities, and it is also characterized by a reduction in tax revenues and consequently by increased tax evasion (Friedman et al., 2000).

Corruption and decreasing tax revenues are related to the government's lesser ability to provide public services and goods (Mauro, 1997).

According to Kaufmann (2010), policymakers seek to encourage large investments that are placed in public works, thereby also increasing public spending.

4. Statistical analysis

In this analysis, we investigate how Corruption Perception Index (CPI) affects GDP growth per capita in a group of Balkan countries[2]; Kosovo and Montenegro are

[2] The countries considered in this analysis are: Albania; Bosnia; Bulgaria; Croatia; Greece; the Republic of

disregarded due to the lack of data that does not allow us to perform statistical and empirical checks.

To analyze graphically the effect of corruption on economic growth we use the following relationship:

$$GDP_{pt} = \alpha + \beta_1 CPI + \varepsilon_t$$

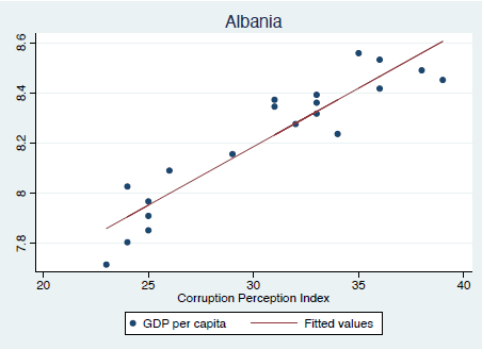
where GDP_t is the annual GDP per capita and our dependent variable. Instead, CPI represents the perceived level of corruption. CPI is the most widely used measurement tool at global level and is issued annually by Transparency International. It estimates levels of corruption in the public sector using a set of surveys and interviews of businesspeople, professionals, and experts.

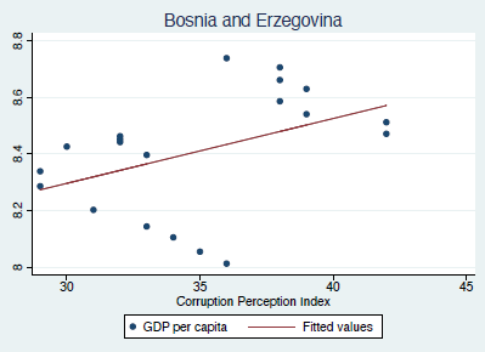
The CPI is calculated using 13 different data sources. Data collected by the CPI cover the following topics: bribery; diversion of public funds; diversion of public funds; use of public office for private gains; nepotism in the civil service, and finally, state capture.

The index ranks 180 countries and territories according to the perceived levels of corruption in their public sector. It ranges from 0 to 100, with 0 indicating highly corrupt and 100 indicating very clean. Graphs below show the correlation between GDP per capita, released periodically by the World Bank, and the CPI.

The data show that the trend in GDP per capita tends to increase in all countries, except for some fluctuations during 2008-2009, only in Greece the trend tends to decrease for the period 2009-2016. On the contrary, the trend of the corruption perception index tends to fluctuate for all countries during the period 1996-2018.

By carefully observing the data, one can clearly see a gradual reduction in corruption (the increase in the value of the index in question) before the EU membership for some countries of the Balkan area (Bulgaria, Romania, and Croatia) and Greece after the start of the 2008-2009 crisis.





North Macedonia, Romania; Slovenia; Serbia and Turkey.

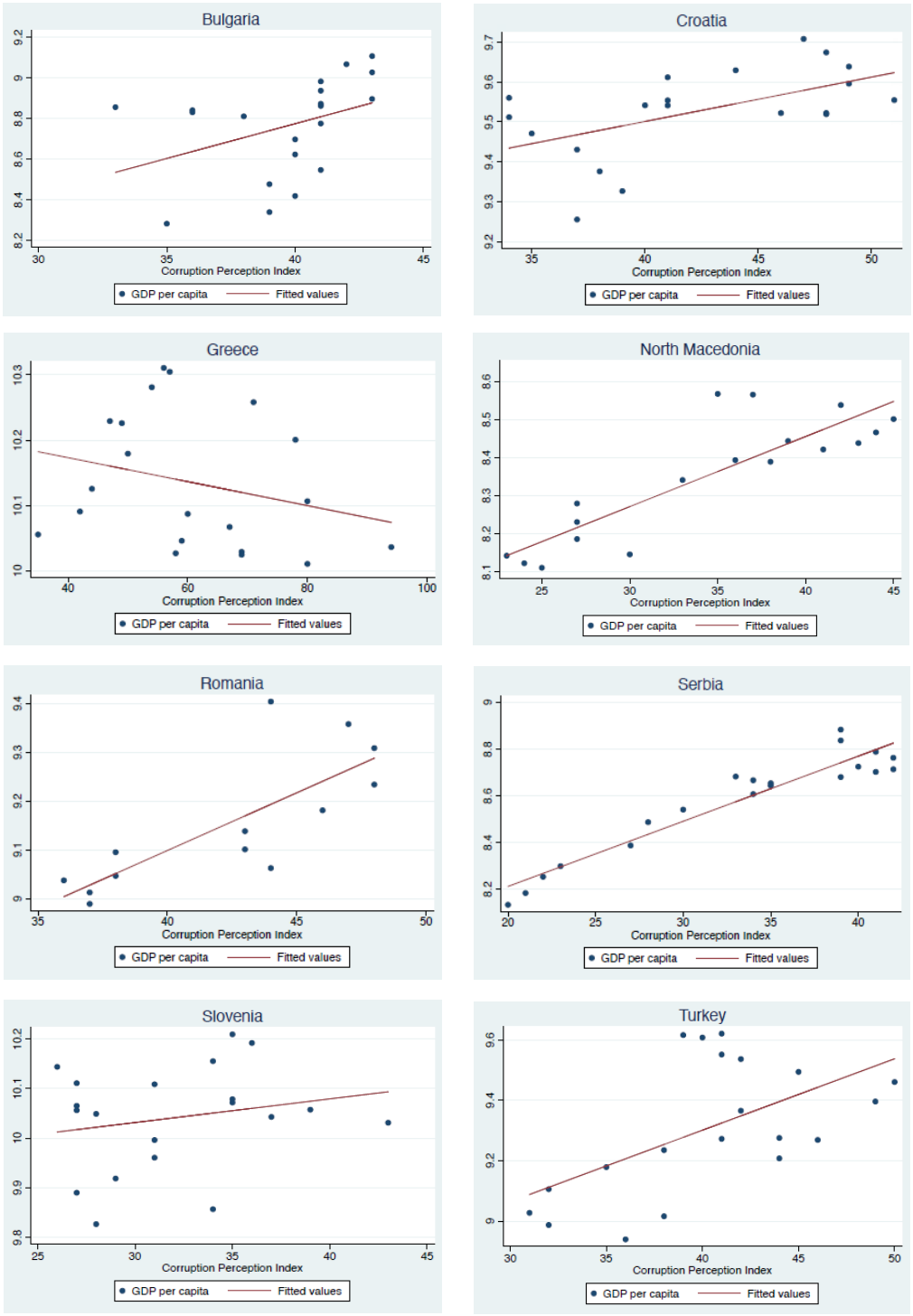


Figure 1. Correlation between the Corruption Perception Index and GDP per capita

Figure 1 shows that in Albania, Bosnia, Croatia, the Republic of North Macedonia, Romania, Serbia, and Turkey, even if the trends differ in the period considered, corruption tends to increase, i.e., the CPI has a decreasing trend[3]. In the long run, this correlates positively with GDP per capita, which could be due to the slowdown in GDP growth. In other words, corruption is negatively correlated with the growth of GDP per capita. In countries like Bulgaria, Slovenia and Greece, there does not seem to be a correlation between the CPI and GDP per capita.

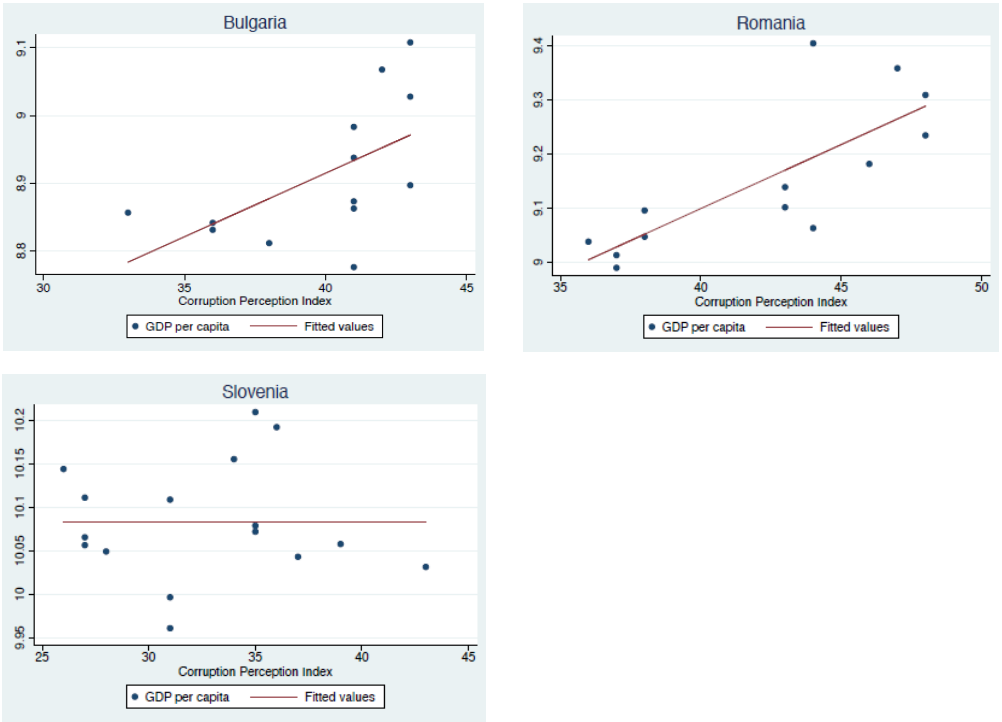


Figure 2. Correlation between the Corruption Perception Index and GDP per capita of countries after joining the European Union

Figure 2 contains the correlation between GDP per capita and CPI of some countries that belong to the EU, namely Bulgaria, Romania, and Slovenia. We focus on these countries to understand whether the EU membership of these countries has any impact on corruption trends.

For this purpose, the baseline year of our analysis is the year of the EU membership, that is to say, 2004 for Slovenia and 2007 for Bulgaria and Romania. We exclude Greece as it became a member of the EU in 1981 and Croatia, which joined the EU in 2013. As can also be seen in Figure 2, Bulgaria for the period in which it was

[3] CPI ranges from 0 to 100, where 0 is highly corrupt and 100 is very clean.

already a member of the EU (2007-2019), has a significant and negative correlation between corruption and the growth of GDP per capita. This means that the decrease in corruption leads to faster growth in GDP per capita.

On the contrary, Slovenia, even after joining the EU, shows a non-significant correlation. This result probably depends on the fact that Slovenia differs from other Balkan countries; in fact, it is characterized by a different government culture, a higher level of development, and the influence of neighboring countries such as Austria and Italy, which have a low corruption rate.

5. Conclusions

The results obtained in this paper can be summarized as follows. First, corruption has always been present to an important degree in the countries of the Balkan area, thus suggesting that corruption in these countries often becomes a cultural factor that is difficult to prevent and fight.

Second, in most of the Balkan countries (Albania, Bosnia, Croatia, the Republic of North Macedonia, Romania, Serbia, and Turkey), there is an inverse correlation between corruption and growth of GDP per capita. That is to say, the reduction in corruption tends to positively influence the growth of GDP per capita.

In some countries of the Balkan area, such as Bulgaria, Slovenia and Greece, there seems to be neither a negative nor a positive correlation between corruption and GDP per capita.

Third, the corruption of the various countries of the Balkan area is also correlated with the process of integration into the European Union. That is to say, corruption in some countries tends to decline in the early years before joining the EU and continues to decline even after joining.

Bulgaria, in the period in which it was already a member of the EU (2007-2019), has a significant correlation between corruption and the growth of GDP per capita, the decrease in corruption in the GDP per capita tends to grow faster.

In Slovenia, the correlation is not significant even in the period in which it is a member of the EU. This is probably because Slovenia, unlike the other Balkan countries, has another type of governing and developing the country. This is most likely because it is influenced by neighboring countries such as Austria and Italy, which are considered as low corruption countries.

In conclusion, we can say that the integration of the Balkan countries into the EU tends to improve governance, and this leads to a reduction in corruption both in short and in the long term. This leads us to the conclusion that improving governability is more effective in terms of both reducing corruption and improving the growth potential of an economy and also have a positive impact on integrating into the EU.

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Appendix

Table A1 Correlation between the Corruption Perception Index and GDP per capita

Albania	
Variable	**GDP per captita**
Corruption	0.047***
Constant	6.788***
R-squared	0.859
Number of Observations	20
Bosnia and Erxegovina	
Variable	**GDP per captita**
Corruption	0.023***
Constant	7.609***
R-squared	0.182
Number of Observations	20
Bulgaria	
Variable	**GDP per captita**
Corruption	0.034
Constant	7.406***
R-squared	0.156
Number of Observations	20

Croatia	
Variable	**GDP per captita**
Corruption	0.011***
Constant	9.056***
R-squared	0.301
Number of Observations	20
Greece	
Variable	**GDP per captita**
Corruption	-0.002
Constant	10.247***
R-squared	0.07
Number of Observations	20
North of Macedonia	
Variable	**GDP per captita**
Corruption	0.018***
Constant	7.719***
R-squared	0.736
Number of Observations	18
Romania	
Variable	**GDP per captita**
Corruption	0.032***
Constant	7.793***
R-squared	0.851
Number of Observations	20
Serbia	
Variable	**GDP per captita**
Corruption	0.028***
Constant	7.654***
R-squared	0.900
Number of Observations	20

Slovenia	
Variable	**GDP per captita**
Corruption	0.005
Constant	9.889***
R-squared	0.045
Number of Observations	20
Turkey	
Variable	**GDP per captita**
Corruption	0.024***
Constant	8.356***
R-squared	0.322
Number of Observations	20