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The Relationship between Governance and Economic Development: An Empirical Analysis from 1996 to 2019 for Albania

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Abstract: There is an on-going debate on the effect of governance on the economic development of a country. In an effort to shed some light on this matter, this article aims to identify the relationship between good governance and economic growth in Albania, considering that good governance might create the right habitat for economic growth. The values for the good governance index are calculated using the Principal Component Analysis and the values for the World Governance Indicators – WGI for Albania, taken from the World Bank database for 1996-2019 time periods. This period coincides with a series of important transformations undertaken by governments in Albania after the fall of the communist regime in 1990. The methods used are the regression analysis and the Granger Causality test. Main results: By analyzing the 1996-2019 time period data, we conclude that Good Governance is not a statistically significant factor for economic development in Albania and the Granger causality test indicates that neither of variables causes the other.

Keywords: Good Governance, economic growth, indicators, principal component analysis, Granger causality.

Introduction

Good governance is an important tool for stimulating sustainable development and is widely considered a significant instrument that should be included in development strategies. Good governance promotes transparency, accountability, efficiency and the rule of law at all levels and permits a fair and non-partisan management of natural, human, economic and financial resources by guaranteeing the participation of civil society in the decision – making processes. Sustainable development and good governance are two closely related concepts. Although good governance does not guarantee sustainable development, its absence considerably limits it. The definition of good governance and how to measure it has been the object of many institutions. In this paper we will refer mainly to the definition of good governance given by the World Bank, but not excluding other resources. In the 1992 report entitled “Governance and Development”, the World Bank set out its definition of good governance. This term is defined as “the manner in which power is exercised in the management of a country’s economic and social resources for development”.

There is an ongoing debate on the effect of governance on the economic development of a country. Many scholars and policymakers argue that the good governance is a necessity for the economic development of a country but some others argue that the so-called good governance policies are relevant only if countries reach an adequate level of economic and social development that enable institutions of good governance to boost growth (Mira & Hammadache, 2017). But what happens in Albanian situation? Is the good governance a factor that explains the

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economic growth? This paper aims to respond this question using data for World Governance Indicators and economic growth taken from World Bank database, for 1996-2019 time period. Based on the Freedom House report 2020, entitled “Democracy under Lockdown”, the democracy and human rights has worsened in 80 countries, including Albania. The president of Freedom House, Michael J. Abramowitz, said: “What started as a worldwide health crisis has become part of the global crisis for democracy. Governments around the world have abused their power in the name of public health, grabbing the opportunity to undermine democracy and human rights”.

In the Freedom House report “Freedom in the World – Albania Country Report 2020”, the score for Global Freedom in Albania is presented 67/100, so characterising Albania as partly free country. Corruption and organized crime remain serious problems despite recent government efforts to address them. Referring to the same report, there are problems with the implementation of the law on access to information, the underfunded courts are often subject to political pressure and influence, and public trust in judicial institutions is low. Also, in the Transparency International report for 2019, Albania ranked 106th out of 180 countries in total, ranking last in Europe and the Balkans. This result shows that Albania, with a CPI score of 35, is still far from the average score of 50, not to mention almost a third of the way to a corruption-free country with good governance. The economic effect is the most touchable effect of corruption, because it directly affects both the country's economy and life of the individual citizens. After the fall of the communist dictatorship, economic growth in Albania has had irregular patterns. There have been large fluctuations, reflecting the specifics of the Albanian transition. The country experienced a growth rate 5-6% in 1994-96, negative growth rate in 1997, almost 8% in 2008, plummeting to 1.3% in 2012 and 0.9% in 2013. The 2013-2018 period was characterized by a positive growth tendency, reaching 4.2% in 2018 (World Bank).

The economic growth in Albania has been based mostly on consumption, remittances and imports, but not on production, investments and exports. This growth rate has had more of a quantitative rather than a qualitative nature, coming from sectors and activities with high efficiency and modern technology and innovation. According to the Normative Act “On some changes in Law No.88/2019 “For the 2020 budget”, it is projected that the real economic growth for 2020, previously forecasted at 4.1%, will drop to 2%. The earthquake of November 2019 and most importantly COVID-19 pandemic, severely impacted the Albanian economy. The most affected sectors have been tourism, the wholesale sector, and the manufacturing industry. The present-day situation raises the need to design wise policies that would foster job creation and resurrect the economy. This paper does not aim to draw universal conclusion on the relationship between good governance and economic growth, but only to illustrate the relationship between these variables on Albania during 1996-2019 period. This paper is organized as follows: Section 2 contains the literature review. Section 3 contains the data and graphic presentations about the six components of good governance for Albania. Section 4 contains the methodology and empirical analysis and in the section 5 are the conclusions.

Literature Review

There are many studies evaluating the relationship between economic growth and good governance. After all this historical point of view, there is a clear understanding that good governance is one of the main factors on the economic progress. From a general review on the literature, a positive trend has been obtained between these two variables on developed countries. According to neo-institutionalism economists, there are two main theories related to the relationship between these two concepts in developing countries:

The first theory, defended by neo-institutionalism authors, considers the government as having an independent role and being a well-being government. The function of trade market is correlated with the function of state governance and all institutions derive. Consequently, low economic growth performance and underdevelopment of countries could be explained by “state failure” due to the increase in corruption, instability of property rights, market distortions, and lack of democracy.

The second theory, developed by Mushtaq Khan and Dany Rodrik, concerns the capability of the government to implement social changes and follow a controlled strategy of economic development: They need to establish efficient institutions in relation of sharing the political power in such countries to transit the developing countries towards a capitalist system similar to that of developed countries. Otherwise,

those countries would face state failure as a result of an inconsistency between institutions and an economic policy of development. (Mira. R, Hammadache. A, 2018)

Based on these approaches, the results of Hall and Jones (1998) have revealed that a country's long-run productivity, capital accumulation, and thereby productivity per worker are influenced the most by institutions and government policies. The main hypothesis of Hall and Jones describe that the major factor for a long-term economic growth is its social infrastructure (institutions and government policies). Alam, Kitenge and Bedane (2017), using a panel of 81 countries, found a significant positive effect of government effectiveness on economic growth.

AlBassam (2013) present that the global economic crisis has had an unnoticeable influence on the relationship between good governance and economic growth. However, this study found that different levels of development of nations affect the relationship between governance and growth in various ways during times of crisis. According to Aikins (2009), without appropriate economic strategy and regulatory structure, a nation's financial system becomes vulnerable to crisis and exposes the stability of the entire economy.

Usual, governments respond to crises with short-term remedial plans, potentially resulting in a harmful long-term economy recovery (Davidoff & Zaring, 2008; Reinhart & Rogoff, 2009). Davidoff and Zaring (2008) said that governments focus more on economic growth than on governance development during economic crises. Consequently, governments can be encouraged to adopt strategies that will improve governance quality and economic growth in the long term without sacrificing good governance practices in short term, if the influence of economic crises on the relationship between governance and growth is understood. So, studying economic growth and its relationship to the governing process will help explain the factors that influence it during times of crisis and the ways in which it might be improved.

Many authors describe the positive effect of the good governance on economic growth, but this correlation is not always positive in overall countries and in any conditions. Daniel Kaufmann and Aart Kraayl (2010) indicate that there is not a positive relationship between capital income and governance. The positive or negative causality depends on the implementation of a good strategy of governance that builds a set of efficient institutions and forward improvement the so-called good governance. His thesis involve that causality could not be automatically positive without considering the political will and the existence of feedback mechanisms between economic growth and good governance, to create a "virtuous circle" of good governance and national wealth. Kaufmann followed in a certain way the thesis developed by Mushtaq Khan (1995) on the role of the political factor in economic growth: in effect, the theory of Mushtaq Khan explain that good governance can only occur if one overcomes the symptoms of "state failure".

Hashem (2019), in his paper "The Impact of Governance on Economic Growth and Human Development During Crisis in Middle East and North Africa" concluded that there is no relationship between governance and economic growth in MENA countries and no impact of the global financial crisis in 2008 on the relationship between governance and economic growth. Pere (2015), using a panel data for western Balkan countries for the period (1996-2012), concludes that not all aspects of good governance have the same impact on economic growth and for some of them this impact is faster than others. The statistical analysis shows that political stability, absence of violence (stb) and the strengthening of law enforcement (law) affect the growth of the same period, but it is not evident for other indicators. The analysis by Pere (2015) concluded that the impact of good governance in economic development cannot be interpreted in short term, only 12 years study. Overcoming from this interpretation we have analyzed 23 years of data, period that coincides with a series of important transformations undertaken by governments in Albania after the fall of the communist regime in 1990.

Indicators of good governance according to the world bank and the values of these indicators for Albania

The Worldwide Governance Indicators (WGI) project reports aggregate and individual governance indicators for over 200 countries and territories over the period 1996–2019, for six dimensions of governance:

- Voice and Accountability
- Political Stability and Absence of Violence
- Government Effectiveness

Regulatory Quality
 Rule of Law
 Control of Corruption

These indicators were developed by Kaufmann et al. (2011) and have been published since 1996 by the World Bank. They are based on several hundred variables obtained from 31 different data sources, capturing governance perceptions as reported by survey respondents, nongovernmental organizations, commercial business information providers, and public sector organizations worldwide (Kraay, Kaufmann & Mastruzzi, 2010). Each component takes values between -2.5 and +2.5 and the values near +2.5 are interpreted as a positive development in the related good governance component. The WGI tends to be the most widely-used indicators of good governance by policymakers and academics. The purpose of the construction of these indicators is to measure the evolution of good governance by country and implement a policy to improve these indices in order to ensure that improving good governance could reduce the failure of the state.

Table 1: The values for six indicators (or components) of good governance for Albania during 1996-2019 period

| Year | Political | | | | | |
|------|--------------------------|------------------------|--------------------------|--------------------|-------------|-----------------------|
| | Voice and Accountability | Stability/ No Violence | Government Effectiveness | Regulatory Quality | Rule of Law | Control of Corruption |
| 1996 | -0.648 | -0.330 | -0.689 | -0.474 | -0.684 | -0.894 |
| 1997 | -0.518 | -0.436 | -0.660 | -0.324 | -0.804 | -0.964 |
| 1998 | -0.387 | -0.543 | -0.631 | -0.173 | -0.924 | -1.033 |
| 1999 | -0.336 | -0.540 | -0.693 | -0.214 | -0.967 | -0.945 |
| 2000 | -0.285 | -0.538 | -0.755 | -0.254 | -1.009 | -0.857 |
| 2001 | -0.147 | -0.416 | -0.644 | -0.240 | -0.885 | -0.863 |
| 2002 | -0.008 | -0.295 | -0.533 | -0.225 | -0.762 | -0.869 |
| 2003 | 0.070 | -0.309 | -0.538 | -0.448 | -0.723 | -0.812 |
| 2004 | 0.007 | -0.428 | -0.416 | -0.166 | -0.688 | -0.699 |
| 2005 | 0.004 | -0.507 | -0.659 | -0.372 | -0.736 | -0.786 |
| 2006 | 0.076 | -0.508 | -0.524 | -0.102 | -0.685 | -0.804 |
| 2007 | 0.113 | -0.203 | -0.407 | 0.061 | -0.646 | -0.688 |
| 2008 | 0.175 | -0.031 | -0.357 | 0.148 | -0.589 | -0.594 |
| 2009 | 0.141 | -0.045 | -0.258 | 0.238 | -0.500 | -0.538 |
| 2010 | 0.124 | -0.191 | -0.283 | 0.229 | -0.407 | -0.525 |
| 2011 | 0.062 | -0.282 | -0.208 | 0.233 | -0.455 | -0.683 |
| 2012 | 0.022 | -0.144 | -0.268 | 0.199 | -0.520 | -0.727 |
| 2013 | 0.049 | 0.092 | -0.317 | 0.210 | -0.518 | -0.699 |
| 2014 | 0.144 | 0.486 | -0.086 | 0.222 | -0.338 | -0.548 |
| 2015 | 0.157 | 0.346 | 0.010 | 0.187 | -0.328 | -0.479 |
| 2016 | 0.171 | 0.345 | 0.013 | 0.189 | -0.329 | -0.405 |
| 2017 | 0.203 | 0.378 | 0.084 | 0.223 | -0.402 | -0.418 |
| 2018 | 0.208 | 0.378 | 0.115 | 0.268 | -0.392 | -0.522 |
| 2019 | 0.152 | 0.119 | -0.061 | 0.274 | -0.411 | -0.529 |

Below are the graphs of six components for Albania, during 1996-2019 period. A lack of stability is observed in the behavior of these indicators for the period analyzed and the values of all six indicators have deteriorated in 2019.

Voice and Accountability and Regulatory Quality Indicators have a positive trend and positive values after 2005.

Rule of Law and Control of Corruption indicators have only negative values. For more, the values in 2019 are lower than the values in 2018.

Political Stability and Absence of Violence indicators, although has a stability in period 2014-2018, while there is a decline in 2019.

Government Effectiveness indicator, has positive values only in period 2015-2018. In 2019, the value goes to negative again.

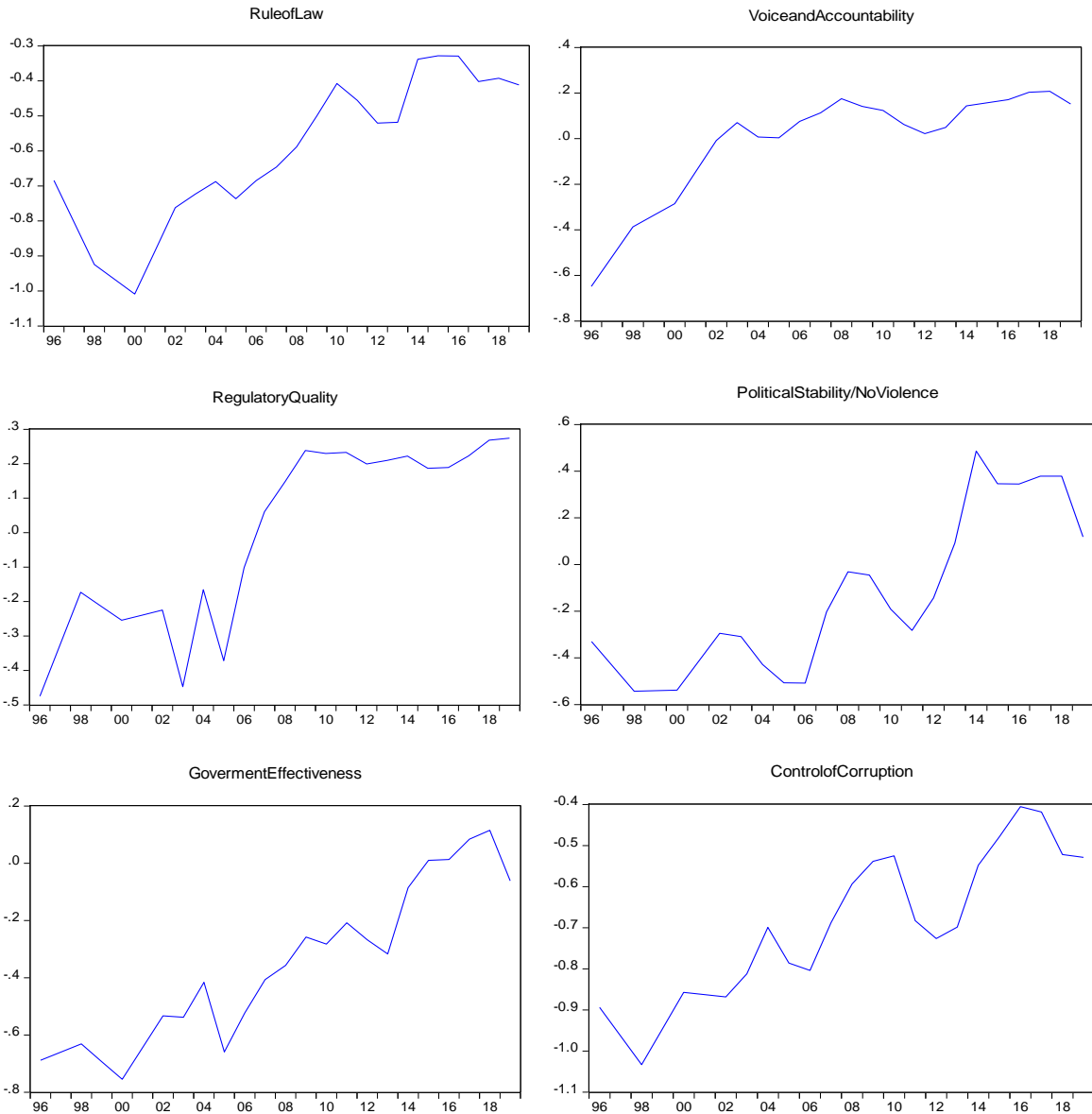


Figure 1: The graphs of six components for Albania, during 1996-2019 period

Methodology and Empirical Analysis

Methodology

In this study the relationship between good governance and economic development is tested using regression analysis. In order to define the good governance, is used the database of World Bank for six different World Governance Indicators (WGI), which are: government effectiveness, political stability, control of corruption and regulatory quality, voice and accountability, and rule of law.

In order to avoid the multicollinearity problem, caused by the correlation between the six components (see table 2), is calculated a unique composite index using principal component analysis, and this index was named the Good Governance Index (GGI). Firstly, since the values for the six components are missing for years 1997, 1999 and 2001, they are supplemented by the average of the neighboring values. For example, the missing value for Control

of Corruption for the year 1997 is calculated as the average of values for Control of Corruption for years 1996 and 1998.

After that, using Principal Component Analysis, is constructed the Good Governance Index (GGI), which will be used to perform regression analysis. The principal Component Analysis is a statistical technique which is used for to reduce the dimensionality of large data sets, by transforming the original set of correlated variables into a new smaller set of uncorrelated ones. The PCA is recommended in cases when the researcher is interested to determine the minimum number of factors that explain the maximum variance in original data. The first component founded by PCA, which is linear combination of original variables, is the one that explain the most variability in the original data, after the second and so on. After performing the PCA, is identified the unique component that explain about the 85% of variability in the original data. This component is called Good Governance Index and is taken into consideration to test for the relationship between Good Governance and economic growth.

Table 2: The correlation matrix for the 6 components values for Albania for 1996-2019 time period

| Correlation Coefficient | Voiceand Accountability | Political Stability | Government Effectiveness | Regulatory Quality | Ruleof Law | Controlof Corruption |
|--------------------------|-------------------------|---------------------|--------------------------|--------------------|------------|----------------------|
| Voiceand Accountability | 1 | 0.639 | 0.757 | 0.726 | 0.717 | 0.818 |
| PoliticalStability | 0.639 | 1 | 0.916 | 0.753 | 0.869 | 0.855 |
| Government Effectiveness | 0.757 | 0.916 | 1 | 0.865 | 0.925 | 0.912 |
| RegulatoryQuality | 0.726 | 0.753 | 0.865 | 1 | 0.812 | 0.814 |
| RuleofLaw | 0.717 | 0.869 | 0.925 | 0.812 | 1 | 0.903 |
| ControlofCorruption | 0.818 | 0.855 | 0.912 | 0.814 | 0.903 | 1 |

The values for economic growth were transform into logarithmic form to improve the distribution and avoid the effect of outliers. In order to avoid the spurious regression, before performing the regression analysis, the variables are tested for stationarity. The test used for stationarity is Augmented Dickey Fuller test (ADF). As the both series: Good Governance Index $(GGI)_t$ and economic growth $(lnEG)_t$ result non stationary, they are differenced. After that, the new series $d(GGI)_t$ and $d(lnEG)_t$, result stationary. On the other hand, the simple regression analysis is used to test for the effect of good governance to economic growth. The model of simple linear regression is:

$$d(lnEG)_t = \gamma_0 + \gamma_1 d(GGI)_t + \varepsilon_t, \text{ where } \varepsilon_t \text{ is the error term.} \quad (1)$$

Finally, the Granger Causality Test was performed to test which kind of causality exists between two stationary variables $d(GGI)_t$ and $d(EG)_t$: Unidirectional causality, bilateral causality or the series are independent.

Data Analysis

In order to study the relationship between the two variables good governance and economic growth in the Albanian context, we have utilized data taken from the website of the World Bank, corresponding to the 1996-2019 time period. The data for economic growth are in (%) while the values for each of six different World Governance Indicators (WGI): government effectiveness, political stability, control of corruption and regulatory quality, voice and accountability, and rule of law are between -2.5 and +2.5. The Table 3 below presents the result from Kaiser – Meyer – Olkin measure of sampling Adequacy and Bartlett’s Test of Sphericity.

Table 3: KMO and bartlett's test

| | |
|--|-------|
| Kaiser-Meyer-Olkin Measure of Sampling Adequacy. | 0.887 |
| Approx. Chi-Square | 169.4 |
| Bartlett's Test of Sphericity | df |
| | 15 |
| | Sig. |
| | 0 |

As the value of KMO is greater than 0.8, this is an indication that principal Component Analysis is useful in our case. This result can be stressed by the result from Bartlett’s test of Sphericity as the significance value is 0.000, smaller than $\alpha=0.05$. This result demonstrate that there is a certain redundancy between the variables that can

summarize with a few number of components. Based on the findings of PCA, conducted on original data, only a single principal component was obtained, with an eigenvalue of 5.105.

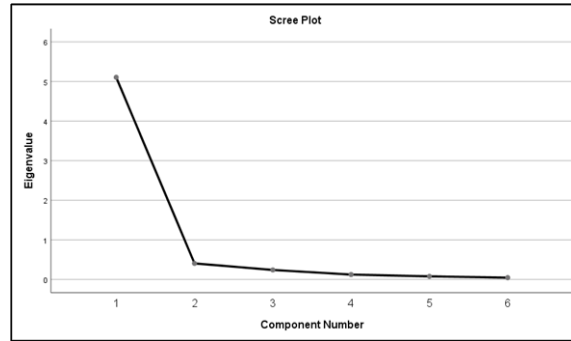


Figure 2: The scree plot identifies one component

From Table 4, can be seen that the principal component explains about 85.084% of variances from the original data set.

Table 4: The result from principal component analysis

| Component | Initial Eigenvalues | | | Extraction Sums of Squared Loadings | | |
|-----------|---------------------|---------------|--------------|-------------------------------------|---------------|--------------|
| | Total | % of Variance | Cumulative % | Total | % of Variance | Cumulative % |
| 1 | 5.105 | 85.084 | 85.084 | 5.105 | 85.084 | 85.084 |
| 2 | 0.406 | 6.76 | 91.844 | | | |
| 3 | 0.241 | 4.009 | 95.854 | | | |
| 4 | 0.124 | 2.063 | 97.917 | | | |
| 5 | 0.079 | 1.31 | 99.227 | | | |
| 6 | 0.046 | 0.773 | 100 | | | |

Extraction Method: Principal Component Analysis.

Also, the variables are loaded on the principal component with very high loading values ranging between 83.7% and 97.4%.

Table 5: The component matrix

| | Component 1 |
|-------------------------|-------------|
| VoiceandAccountability | 0.837 |
| PoliticalStability | 0.913 |
| GovernmentEffectiveness | 0.974 |
| RegulatoryQuality | 0.898 |
| RuleofLaw | 0.947 |
| ControlofCorruption | 0.959 |

Extraction Method: Principal Component Analysis.

a. 1 components extracted.

So, for further analysis, is taken into consideration the first component identified by principal component analysis and this component is called Good Governance Index. In order to avoid spurious regression, before performing the regression analysis, is necessary doing the stationary tests for both variables. The test used is the Augmented Dickey

– Fuller for unit roots.

The results for all three cases, for both series $(GGI)_t$ and $(lnEG)_t$ are shown below.

Table 6: ADF test results for unit roots for $(GGI)_t$ and for $(lnEG)_t$

| Null Hypothesis: $(GGI)_t$ has a unit root | | | Null Hypothesis: $(lnEG)_t$ has a unit root | | |
|--|------------------|------------|---|------------------|------------|
| Exogenous: | | | Exogenous: | | |
| Exogenous: | Constant, Linear | Exogenous: | Exogenous: | Constant, Linear | Exogenous: |
| None | Trend | Constant | None | Trend | Constant |
| p=0.2850 | p=0.0517 | p=0.7572 | p=0.3354 | p=0.5967 | p=0.0521 |

As p-values are greater than $\alpha=0.05$, we conclude that both series are not stationary. After that, the variables are tested in first difference for stationarity using again the ADF test and both variables became stationary at 5% level of significance.

Table 7: ADF test results for unit roots for $d(GGI)_t$ and for $d(\ln EG)_t$

| Null Hypothesis: $d(GGI)_t$ has a unit root | | | Null Hypothesis: $d(\ln EG)_t$ has a unit root | | |
|---|---|------------------------|--|---|------------------------|
| Exogenous: None | Exogenous: Constant, Linear Trend | Exogenous: Constant | Exogenous: None | Exogenous: Constant, Linear Trend | Exogenous: Constant |
| p=0.0014 | p= 0.0350 | p=0.0063 | p=0.000 | p=0.000 | p=0.000 |

So, both series $d(GGI)_t$ and $d(\ln EG)_t$ are stationary.

The table 8 presents the result from regression analysis, considering as dependent variable $d(\ln EG)_t$ and as independent variable $d(GGI)_t$.

Table 8: The estimated equation of model (1)

| Variable | Estimated coefficients | S.E | t-statistic | P-value |
|------------|---------------------------|----------|-------------|---------|
| c | -0.022379 | 0.205078 | -0.10912 | 0.9141 |
| $d(GGI)_t$ | 0.050968 | 0.700725 | 0.072736 | 0.9427 |

So, the estimated equation is: $\hat{y} = - 0.022 + 0.051 x$

The result from table 8 shows that although the sign before the independent variable $d(GGI)_t$ is positive, this variable is not statistically significant as the p-value is 0.9427. This result shows that the variable Good Governance Index is not statistically important to explain the variability of economic growth. Before testing for direction of causality between variables $d(\ln EG)_t$ and $d(GGI)_t$ using Granger Causality test, it is necessary to select an appropriate lag order of the variables.

Table 9: Lag order selection criteria

| VAR Lag Order Selection Criteria | | | | | | |
|--|-----------|-----------|-----------|------------|------------|------------|
| Endogenous variables: GOODGOVERNANCEINDEX LNECONOMICGROWTH | | | | | | |
| Exogenous variables: C | | | | | | |
| Date: 10/14/20 Time: 00:37 | | | | | | |
| Sample: 1996 2019 | | | | | | |
| Included observations: 20 | | | | | | |
| Lag | LogL | LR | FPE | AIC | SC | HQ |
| 0 | -6.150517 | NA | 0.007746 | 0.815052 | 0.914625 | 0.834489 |
| 1 | 21.02558 | 46.19937* | 0.000766* | -1.502558* | -1.203838* | -1.444245* |
| 2 | 23.69811 | 4.008790 | 0.000890 | -1.369811 | -0.871945 | -1.272622 |
| 3 | 24.40727 | 0.921904 | 0.001288 | -1.040727 | -0.343714 | -0.904662 |
| 4 | 26.91496 | 2.758467 | 0.001615 | -0.891496 | 0.004663 | -0.716557 |

* indicates lag order selected by the criterion
 LR: sequential modified LR test statistic (each test at 5% level)
 FPE: Final prediction error
 AIC: Akaike information criterion
 SC: Schwarz information criterion
 HQ: Hannan-Quinn information criterion

Table 9 presents the lag order of the variables selected by different tests. We have selected the lag 1, as it is suggested from all criteria: LR, FPE, AIC, SC and HQ.

The final step is identifying the direction of causality between variables $(GGI)_t$ and $(\ln EG)_t$. To test for causality, we will use the Granger causality test. As for this test the variables are assumed to be stationary, it is necessary to operate with the variables $d(GGI)_t$ and $d(\ln EG)_t$. Using the results of table 9, the lag order of variables is 1. The Granger Causality test involves estimating the pair of regressions:

$$d(GGI)_t = c + \alpha_1 d(\ln EG)_{t-1} + \alpha_2 d(GGI)_{t-1} + u_{1t} \quad (2)$$

$$d(\ln EG)_t = k + \beta_1 d(GGI)_{t-1} + \beta_2 d(\ln EG)_{t-1} + u_{2t} \quad (3)$$

Where it is assumed that the disturbances u_{1t} and u_{2t} are uncorrelated. Equation (2) postulates that the current $(GGI)_t$ is related to past values of itself as well as that of $(\ln EG)_t$ and equation (3) postulates a similar behavior of $(\ln EG)_t$. The Table 10 shows the results of the Granger Causality test.

Table 10: Granger Causality test results

| Granger Causality test results | | |
|--------------------------------|---|--------|
| Lag 1 | Null Hypothesis | Prob |
| | d(GGI) _t does not Granger Cause | |
| | d(lnEG) _t | 0.5302 |
| | d(lnEG) _t does not Granger Cause | |
| | d(GGI) _t | 0.9324 |

From Table 10, as the p values are both greater than $\alpha=5\%$, the null hypothesis is not rejected. In other words, the $d(GGI)_t$ does not Granger Cause $d(\ln EG)_t$ and vice versa. So, we conclude that the data-generating processes for the two series: $(GGI)_t$ and $(\ln EG)_t$, are independent variables.

Conclusions

This study used Principal Component Analysis and the simple regression analysis to examine the relationship between Good Governance and Economic Development in Albania, using data from World Bank for 1996-2019 time period. Through Principal Component Analysis, using all the data for six indicators: government effectiveness, political stability, control of corruption and regulatory quality, voice and accountability, and rule of law, is identified the unique component that explain about the 85% of variability in the original data. This component is called Good Governance Index and is taken in consideration for regression analysis. The results indicate that Good Governance is not statistically important to explain economic growth in Albania. For more, using Granger Causality test results that neither of variables cause the other. This result can be explained with the current model of economic growth in Albania that is based mainly on remittances, public debt, donations, soft loans and foreign aid. It is time to implement wise and solid policies for economic growth to guarantee its long term sustainability.

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