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The impact of political instability in attracting foreign investment (Case of Albania)

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Abstract

The aim of this study is to define the impact of political instability on economic growth. Considering the multidimensionality of a factor like political instability, the study employs only four variables to measure it. The variables used to measure political instability are civil liberties, political rights, number of women in parliament and the government changes during years. Regarding the economic growth this study employs the variable of real GDP growth rate as the best factor indicating economic growth. The data are obtained from national and international sources like "INSTAT", "Bank of Albania" and "The Global Economy", and takes into consideration the period from 1990-2015. According to the literature it was expected to have a significant negative impact of political instability on economic growth. Through the results obtained from the econometric model the expectation holds. What is interesting is the insignificance of all explanatory variables beside the variable of civil liberty, which is found to be highly significant. The analysis reveals that an increase in civil liberties would have a positive impact on GDP growth rate. The study also concluded that the importance of civil liberties as a transmission channel of political instability can be justified with the weakness of the judicial system and the classification of Albania as a partly-free country. The comparative method was used in this study. The topics discussed and addressed are freedom and rights, their development over the years, women in politics, participation and increased representation, economic changes, crises and their causes and how it has evolved with democratic developments.

Keywords: Political instability, Economic Growth, Civil Liberties, Political Rights, Woman in Parliament, Government changes.

Entrance

This research paper is focused impact of political instability on the economic growth specifically in Albania. This country has experienced a tremendous change on its political and regulatory policies, over the last 26 years it has had a significant political instability. Since the fall of communist system in year 1991 up to now days, Albania has experienced 12 cabinet changes/government changes. The period from year 1990 up to year 1998 can be considered as the period with the highest level of instability, lowest level of economic growth and the lowest level of human rights. The fall of communism as it was expected has been associated with violent demonstrations, civil protest, and many injured people. The period after 1992 elections witnessed the real starting of democracy in Albania. Many economic indicators improved, human rights were sanctioned by law, but still the level of illiteracy and the poverty rates were high. During 1993 in Albania started to incorporate some financial institutions which were latter known as the "Pyramidal Firms".

These firms started to operate mainly like depository institutions and were becoming very competitive to banks because of the high interests paid on deposits. From year to year these firms enjoyed a great popularity, not only because of high interest rates paid on deposits, but also because of the government support. The majority of population found them very attractive and in hope to get a quick profit and to escape from poverty, they sold their houses, their properties and deposited everything they had in these firms. The first signs of default for these firms started in the end of year 1996 and in the first months of 1997 they defaulted. The overall cost was estimated to be around 1.2 billion of dollars and the majority of Albanian people lost almost everything. This situation served as the main incentive for demonstrations and violent protest, which later turned into a proper civil war. The period of conflict was associated with many tremendous economic costs, many dead people, many injured and the existing infrastructure of the country was destroyed. Every economic indicator, democratic indicator, etc, had been pushed to the most negative levels and the country was facing a real chaos.

The year of 1997 made the government to renounce and the socialist party came into power. Because of the great instability there have been very frequent cabinet changes during the period 1997-2001. After year 2001 the country could be considered more politically stable. The impact of such political instability will be evaluated in this study is by employing the variables of civil liberties, political rights, government change and the number of woman in parliament to explain the level of political instability.

Case Study

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Albanian GDP during our 26 annually observations has experienced many ups and downs. Like the graph indicates the period from 1990-1993 has been one of the worst periods of Albanian economy with a negative growth rate, especially in 1992 where the negative growth rate was found to be -29.9%. This pessimistic situation resulted from the political transition during that period where Albania moved from a communist system to a democratic system. The great instability created in 1991 as a result of student protests to bring the regime down, created big uncertainties for the country and its economic growth stopped. This period witnessed great changes after the fall of regime, but also increased the level of political instability as a result of frequent government changes during a short period of time. The situation looked optimistic for the coming years up to 1996 where the growth rate was estimated to be positive at an average of 9.5% per year. Unfortunately a significant decline of growth rate in 1997 transformed all the optimistic expectations into pessimistic ones, and the Albanian economy was facing serious difficulties. During 1993-1997 in Albania, have operated some financial firms which were structured like proper bank, and were acting generally as depository institutions. These firms became very popular at that time and gained a comparative advantage toward proper banks, because they were paying very high interest rates for the deposits. Stimulated by the popularity and the support that the government gave to these firms at that time, the people of Albania deposited millions of dollars with the hope of getting some profit to get out of the poverty.

Economic Growth

The big promotion of these firms made everyone blind in front of a pyramidal scheme which started to give its default signs in the beginning of 1997. Moreover the situation worsened with the violent protests of the population and caused the exploitation of a civil war, which resulted into a real tragedy with many people dead, injured and the country lost its stability. This period of conflict created the biggest instability during the democracy years of Albania and left the country hopeless, lawless, and poorer than before. From the dark period of 1997 the Albanian economy experienced a significant growth up to 2001. Also in the consecutive years the situation was good with a positive growth rate and a good trend. In addition, another thing noticed by looking to the data provided from World Bank is that economic growth is increasing at a smaller rate year by year especially in the last five years where GDP growth rate in 2013 and 2014 is only 1.1% and 2.17% respectively. We can say that this situation is caused by economic crises of 2008 which had impacts generally in USA and later in Europe. Even though this is a factor Albania faced the minimum consequences by this

crises, and other factors such as the increase of public debt and the wrong economic policies are some other causes of this slow down.

The variable of civil liberties is considered as an important factor in determining the level of political instability within a country. According to the oxford dictionary civil liberty is the state of being subject only to laws established for the good of the community, especially with regard to freedom of action and speech. Civil liberty has a multidimensional nature and according to (Skaaning, 2006) it is composed by five dimensions which are:

Independence of courts

Freedom of opinion and expression

Freedom of assembly and association

Freedom of thought, conscience and religion

Freedom of movement and residence

Returning to the case of Albania we can say that in a period of 25 years the situation has been very disturbing and the civil liberty levels have witnessed a great improvement since 1990. Our paper starts its observations from 1990 where Albania was still a communist country and it is not surprising to find that the rating of civil liberty was 6.0. This has been the worst rating since 1990 and at that time Albania was considered as a country with very restrictive civil liberties, where the freedom of expression and association were strongly denied. The only freedom that could exist at its minimum level was the freedom of some private discussion, otherwise the rating would move to 7.0. Thankfully as the data reveal, the situation totally changed one year later when Albania embraced democracy. The rating moved to 4.0 and the first pluralist elections took place.

Even though 1991-1992 were associated with a high level of instability the picture improved in 1992 where the second elections took place and the "Democratic party" came into power. At that time Albania witnessed the best level of civil liberties ratings during its whole history at the level of 3.0. Unfortunately this picture would not improve anymore for the coming years where different conflicts took place and many of the governments renounced by creating more and more instability. This situation continued up to year 2000 where the rating was 5.0.

From that time up to 2015 the civil liberties enjoyed a stable level of 3.0 which leaves Albania in the category of partly free countries, but it is important to mention that it is on its border and the possibilities of improving are high. The reasons for this classification can be generally found on the first dimension of civil liberties which is courts independence and the judicial system. Hopefully with the assistance of European Union and United States ambassadors this problem will be improved during 2016 with the reform in the judicial system.

Civil Liberties

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The variable of political rights enjoys many similarities with the previous variable of civil liberties and for this reason there exists a correlation between them but, they also have points where they differ. According to (Johannes Fedderke, 2010) political rights are considered to be claims that the population has against the government in terms of the political system. In order for a system to be considered ideal it must complete some requirements which are:

Full participatory democracy

Free elections

Legally accountable governments

Woman in Parliament

The case of Albania demonstrates the gradual improvements that a developing country is trying to make in order to promote equality and eliminate the gender discrimination. It is considered as one of the biggest objectives and in order to give life to this objective and to make it more reachable, it has been sanctioned by law that

20% of the members in parliament must be women. During years Albania has suffered from all of the above factors who contributed in a low participation of women in politics. A low level of socio-economic development, a lack of culture, lack of emancipation and the weak democracy led to a small representation of women in parliament. As the graph indicates year 1990 represents the highest participation level of women and this was during the last years of the communist regime. In year 1992 the picture changed with a dramatic fall to 4% which was considered to be the lowest level. From 1991 up to 1998 the graph indicates many ups and downs. From year 1998 up to now days the situation changed and the graph indicates an increasing trend. In year 2015 the participation level is found to be 20%, which is mainly as a result of the law for women participation in parliament.

Conclusion

The variables of civil liberty, political rights and number of women in parliament, were expected to contribute positively to economic growth. As the model suggests our expectations turned out to be wrong for the variables of political rights and number of women in parliament, since they were highly insignificant. Considering the problem of multi-collinearity between political rights and civil liberties, and also the problem of stationarity for the latter variable, the model has been constructed by taking the first difference of civil liberty. Even after this adjustment the situation did not change and only the variable of civil liberty was found to be significant. While analyzing the dimensions of civil liberty the study noted that the main reason why the instability may go through this factor is the corruption level and the weakness of the Albanian judicial system.

Regarding the number of women in parliament expressed as a percentage of total parliament members, we can say that the reason for its insignificance may lie on the fact that it has been increased significantly not because of emancipation, but mainly because it has been defined by law that at least 20% of the parliament members should be women. The fact that this number is an artificial product rather than a natural product may be a reason for the result obtained.

There are certain limitations for the study which are summarized as follows:

1. The low number of observations does not provide a clear view of the situation. This limited number of observations comes as a result of limited number of data before year 1990.
2. Political instability is a multidimensional factor and its explanation by only four factors decreases the accuracy. The inclusion of only 4 variables comes as a result of limited information and unavailability of information regarding other determinants of political instability for the case of Albania.

To sum up the impact of political instability on economic growth according to the study is found to be negative. For the case of Albania political instability is transmitted

through the variable of civil liberties, which is found to have a significant contribution on economic growth. The civil liberties factor must be investigated more deeply in its first dimensions of courts independence and judicial system quality. Because of its characteristics, the case of Albania in the coming studies should not be investigated by employing the factors of political rights, government changes and the number of women in parliament. An important indication derived from this study is that, a considerable effect of political instability can be offset if the government creates appropriate policies for the improvement of civil liberties.

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