Corruption and clientelism are becoming increasingly familiar terms in the Western Balkans, accompanied by the continuous emphasis on the ‘lack of law enforcement’ in all key policy documents (such as the EU Progress Reports). Middle-income countries such as those of the Western Balkans often find themselves in a vicious cycle, where low social and economic development have enabled corruption to fester, which in turn is considered to have had a detrimental impact on social and economic development. Thus, the phenomenon may have a devastating effect on everyday life.

From the corruption perception scores presented in the table below one can see that Albania and Kosovo, the subjects of this study, have remained more or less in the same position with regard to corruption levels over the years.

It is important to acknowledge that regardless how well-established this indicator might be, it is still based on respondents’ perceptions, and is as such inherently subjective.

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<thead>
<tr>
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<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
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</thead>
<tbody>
<tr>
<td>Albania</td>
<td>33</td>
<td>31</td>
<td>33</td>
<td>36</td>
</tr>
<tr>
<td>Kosovo</td>
<td>34</td>
<td>33</td>
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Source: Transparency International; 0-highly corrupt, 100-very clean

Therefore, in our efforts towards combating corruption as effectively as possible it is crucial to identify new approaches to measuring this phenomenon, which would enable us to assess the magnitude and trace the channels of corrupt practices.

By obtaining a measure of this phenomenon we are able to carry out a more insightful investigation on how corruption affects growth in transition economies, in order to confirm whether informality is detrimental to economic growth.

The establishment of this relationship would then give us a reason to look into the impact of the governance reforms by means of which a country can reduce or eliminate corruption. It is important to know what works when it comes to reforms governments implement (or plan to implement), so that the often scarce public funds of transition economies are spent effectively.
CURRENT SITUATION AND CHALLENGES

An enterprise survey with more than 200 firms operating in several sectors of industry and mining (in Albania and Kosovo) was conducted in order to examine how informal practices affect growth at the firm level. In addition, data on the important investment licenses (mining and construction permits) distribution time were analyzed to help us understand whether institutional reforms can reduce corruption.

Rent-seeking behaviour as an integral part of business

Respondents in both Albania and Kosovo report high levels of corruption. More than half of the companies surveyed reported that corruption is ‘somewhat’ or ‘extremely widespread’ at different government levels. It is understandable that firms will have less of an interest to invest in skills or technology while their business success is linked with election cycles or political interests rather than long-term entrepreneurial strategy.

Given the political and social organization of transition economies, companies consider it is economically more rational to channel their resources towards becoming parts of networks that will help them gain access to rents and rights. Thus, businesses will rather pay bribes (or carry out any type of lobbying activity) in order to obtain benefits that give them a competitive advantage – also known as rent-seeking. One example of such a benefit is gaining a particular license or permit. Thus, one can look at the distribution of rents over time to investigate the incidence of bribery.

Licenses and Permits as Indicators of Corruption

Having such observable figures allows us to quantify the corruption. Thus we can consider the variation in the distribution of licenses around elections as a proxy for corruption. This is done in the context of electoral competition, since demand for bribes and votes is expected to increase prior to or around elections.

When looking at the flow of mining licenses over time in Albania and Kosovo, an increase is clearly observable in the run-up to elections; the year before elections entails a 55% increase in issued licenses compared to the long-term average number of licenses issued in Albania, and in Kosovo this increase is about 38%.

The intuitive argument behind this behavior is that before elections, the incumbent is busy mobilizing votes and needs money to finance their election campaign. Thus, there is reason to believe the causal relationship between corrupt rent distribution and the pre-election increase in the flow of mining licenses.

Corruption and Firm Growth

The effects of corruption are studied predominantly in regard to losses in efficiency, as corrupt practices are generally considered to reduce productivity of resource allocation (utilization). Having said that, there may be aspects of corrupt practices that lead to positive outcomes: for example, if a company were to receive a technology...
subsidy through corrupt means, one may expect gains in technical efficiency. In this sense, the expenses firms make in order to obtain these advantages are compared to the benefit they derive from them.

Albania and Kosovo exhibit the characteristics of “de-centralized rent-management regimes”: that is, regimes in which corruption extends throughout all levels of the state, including petty bribery at the lowest levels of administration. This makes rent-seeking activities highly unpredictable and much more expensive.

Consequently, in such regimes, rent-seeking costs are likely to exceed the outcomes (that benefiting firms expect in return for their payments), so that, on net value, corruption will actually have a negative effect on firm growth.

This is confirmed by our research, which finds that corruption has a net growth-reducing effect on firms from both countries. It is worth noting however, that this effect is of a mixed nature. Corruption does not seem to reduce investment or artificially inflate the size of the labour force. However, corruption reduces the firm growth rate by 8 percentage points on average, most of which comes from reductions in total-factor productivity (TFP). After establishing that corruption has a (net) negative effect on business growth, the following step is to look into the efforts that governments make to combat it.

Are anti-corruption reforms effective?

A time-series analysis conducted with data on mining licenses suggests that the intensity of corruption (i.e. the intensity of the business cycle) in this sector does not depend significantly on the type of legal regime in place. The same magnitude of corruption recorded while UNMIK 'model' mining law was in force was also recorded under its successor instrument (the post-independence law enacted in 2010). This change in legislation significantly reduced the range of anti-corruption safeguards in the licensing regime and should be expected to have led to a significant increase in corruption. Yet, no such increase was recorded at statistically significant levels.

The comparison between Kosovo and Albania also brings to light an interesting finding; although pre-election licensing is found to be higher in Albania where there has never been any separation of power between the state and the mining licensing authority, pre-election increases in mining licenses remained evident in Kosovo in spite of the existence of a body with full independent authority from the executive branch of the government.

**Neo-patrimonial regimes**

A key underlying lead to understanding the reason as to why corrupt practices are allowed to fester, is to understand the political set-up that makes it possible.

In “neo-patrimonial regimes”, a system is established wherein ‘political power hinges on the creation and distribution of material perks and rewards (rights and rents)” (Kelsall, T. (2011), ‘Rethinking the Relationship between Neo-Patrimonialism and Economic Development in Africa’, IDS Bulletin)

Albania and Kosovo are both low-middle income transition economies in which informality is endemic. Political and administrative life is organized in such a way that politicians create rents and property rights, distributing them to their “political clients” in order to generate, respectively sustain the political support and the financial resources they need to establish and consolidate their rule.

These informal relationships in practice weaken the power of the state, as much as they develop as a result of low levels of state authority and capacity. Thus, from an economic point of view, clients (businessmen, for example) have an incentive to engage in rent-seeking expenditure such as bribes and lobbying costs.
The examples of Albania and Kosovo thus show that large aid flows and investments towards good governance reforms might have done little to combat corruption, at least in the mining sector.

**FDI as a tool of anti-corruption**

A common feature of rents for which the analysis shows an insignificant corruption effect is their association with foreign capital. This leads us to believe that foreign investors do not engage (or engage less often) in informal practices.

The rationale behind FDI-linked licensing exhibiting ‘cleaner’ behavior is that, since most of the corruption in transition economies occurs within already-established locally-based networks of patronage, foreign investors are unlikely to be involved. This makes a rent or right acquired as a result of FDI less likely to have been a product of corrupt practices.

In this regard it is important to acknowledge that foreign investment is not necessarily synonymous to ‘clean’ behaviour – an assumption often made about western investors by political actors in transition economies.

This is not due to foreign investors being necessarily immune to corrupt behaviour, but rather that, as foreigners, they are more likely to be independent of local patronage networks.
POLICY RECOMMENDATIONS

To date formal institutions have been the main focus of anti-corruption efforts. One such example might be the establishment of independent agencies, which would retain the ultimate decision-making power on the distribution of rents and rights, particularly in strategic sectors of the economy such as mining. These may help reduce the incidence of corrupt practices, but they do not seem powerful and efficient enough to eradicate high-level corruption.

In transitional economies, rather than focus on formal institutions, **anti-corruption efforts should target the informal determinants** of this phenomenon. Otherwise, government resources directed towards combating corruption will continue to be inefficient.

The recommendation resulting from the discussion in the previous section of this policy brief seeks to **encourage the FDI**. Nonetheless, a properly monitored, competitive, fair and open process should be maintained. It is important to avoid any biases towards the origin of the applicant since, as explained in the previous section, the origin of the applicant is not always a guarantee of “clean” behaviour.

**Sources:**


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