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The Impact of Corruption, Unemployment, Foreign Direct Investment and Economic Stability in the Country's Economic Development

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Abstract

The main purpose of this paper was to analyze the impact of corruption, unemployment, foreign direct investment and political stability on the level of economic development using data from 1999. Estimated models for correlation and multi factorial regression result that only Foreign Direct Investment as an independent variable is statistically significant. This variable affect positively in economic development, while other variables such as corruption, unemployment and the index of economic stability are not statistically significant and they to have a negative effect on GDP growth of North Macedonia.

Keywords: European Union, Economic Development, Foreign Direct Investment, Unemployment, Corruption and Political Stability

Introduction

The formal process of European integration of the country is now a very old process. One of the main motives of this process are the events of the World War II. There are numerous debates about the economic benefits of the European integration process, debates that include various assessments of benefits regarding economic growth, productivity, direct foreign investments and political stability as well corruption, since the moment of trade liberalization.

Europe was destroyed by the end of World War II and as a result the national economies were inexistent. The exceeded nationalism prevailed and Europe was divided (Nothizile J. Ncube&Wartburg College). Today, the European Union is one of the most important players which influence greatly the economic development of a country and the quality of living regarding European citizens. The European Union includes 28 member countries and it is expected that this number will continue to grow (European Commission, 2014).

This paper examines the influence of the country's membership in EU using the GDP data from 1999, as a measure of the economic development. From previous research on EU and the final analysis, we conclude that there is positive correlation between EU membership and economic development, furthermore, the influence of four other independent variables, including foreign direct investments (FDI), political stability, corruption and unemployment. The first part of this paper focuses on literature review and the theory on which the hypotheses are based. The second part focuses on methodology including hypothesis discussion, variable measurement and the type of statistical analysis used. The third part analyses and clarifies the research findings. The last part of the paper discusses the finding implications and includes suggestions for further research.

Literature Review

Thorhallsso and Kirby (2012) argument that the membership in the economic alliance protects small countries from economic instability. Moravcsik and Vachudova (2003), claim that many Eastern Europe countries join EU to be part of the economic benefits related to the membership. The access to EU implies that FDI attraction becomes more solid and more jobs are created (Lehmann, 2010). The members of the European Monetary Union and EU have experienced great increase of FDI, compared to countries which are only EU members (Lane, 2006). Similarly, Belka (2013) examined the EU influence on Poland's economy by mainly focusing on crucial aspects of the economic development. Belka concluded that EU structural funds have had a positive influence on foreign direct investments, migration etc.
Suliman and Elian (2014), argument is that FDI has a positive influence on economic growth since they provide technology and education in the country. However, the FDI influence in less developed countries is less significant compared to developed countries. For a country that is expecting to get FDI, that country should have developed financial market as well as use properly the FDI opportunities. According to Al Nasser (2010), FDI play a crucial role in the economic growth, but their effect is largely dependent on domestic conditions of the country. FDIs are the main mean of capital transfer to the developing countries which face difficulties with sustainable economic growth (McCloud&Kumbhakar, 2010). According to Habib and Zurawicki (2002), corruption lies mainly in the bureaucratic inefficiency and political institution instability. The effects of corruption vary from a country to another depending on internal conditions of the country.

Henderson also suggested that this form of corruption monopolized markets thereby shifts competition from the public to the political arena. Mauro (1995) and Podubnik, suggested that corruption functions as a tax which decreases the likelihood of FDI and limits the economic development. In fact, the corrupted institutions are perceived as providing nothing than inefficiency. Ake (1975) defines the political stability as a political exchange consistency. Alesina, Ozler, Roubiniand Swagel(1992) also define political stability as the ability of a government to remain unaffected. In their study, they investigated the impact of political instability on economic growth for 113 countries from 1950 to 1982. They found that political instability and economic growth are interrelated. Furthermore, Aisen and Viega (2011) investigate the effect of political instability on the economic growth of 169 countries every five years from 1960 to 2004. They found that political instability is mainly related to lower levels of GDP per capita. Therefore, political instability has a negative impact on economic growth, while political stability leads to high levels of economic growth (Aisen and Viega, 2011; Alesina et al. 1992). Moreover, Aisen and Viega suggest that economic freedom and ethnic homogeneity are essential to economic growth.

Dimitraki (2010) investigated the effect of political instability on economic growth in Western European countries for a period of 55 years and found an inverse relation between political instability and economic growth. In addition, Dimitraki suggested that conflict in neighboring countries could also affect the political stability of a nation, thus leading to low levels of economic growth. Unemployment is defined by the World Bank as "the part of the workforce that is unemployed but available to seek employment" (WorldBank, 2014). According to Berry and Sabot (1984), the extended unemployment decreases the levels of economic growth. Political instability is a quality phenomenon and a complex issue; investors believe that the political risk is an accurate measure of investment restraint. The econometric tests to identify foreign direct investments and political instability risk fail quite often (Junand Singh 1996). As observed by the World Bank, but also by a significant number of studies conclude that FDI promote economic development of the country by promoting productivity, export, technology transfer increases well as creating new employment opportunities for active citizens. Li &Liu (2005) used a database which includes 84 countries. Some of these countries were in a developing stage while others were developed. The analysis was conducted by the authors during the period from 1970 to 1999. They found a positive and significant effect of FDI on developed economies and on growth and employment in the countries in development.

Research Methodology

The correlation analysis – after descriptive analysis, we analyzed the correlation for all variable using Pearson correlation analysis. We came to the conclusion that there is significant positive correlation between GDP and FDI.
There is negative correlation between unemployment and GDP per capita, corruption and GDP, political stability and GDP per capita. The relation between FDI and GDP is considered significant. Moreover, as highlighted in the table below, the data show significant correlation between the independent variables.

Research hypothesis

- Higher levels of foreign investments lead to higher levels of economic development.
- Higher levels of corruption lead to lower levels of economic development.
- Greater political stability leads to higher levels of economic development.
- The higher the unemployment rate, the lower the level of economic development.

From the above hypothesis, we have the predicted model for this research which is as follows:

- Economic development = IV1 + IV2 + IV3 + IV4 + IV5 + E. where:
- IV1 –represents the primary independent variable – economic development
- IV2 = Foreign direct investments,
- IV3 = Corruption index,
- IV4 = Political stability,
- IV5 = Unemployment.

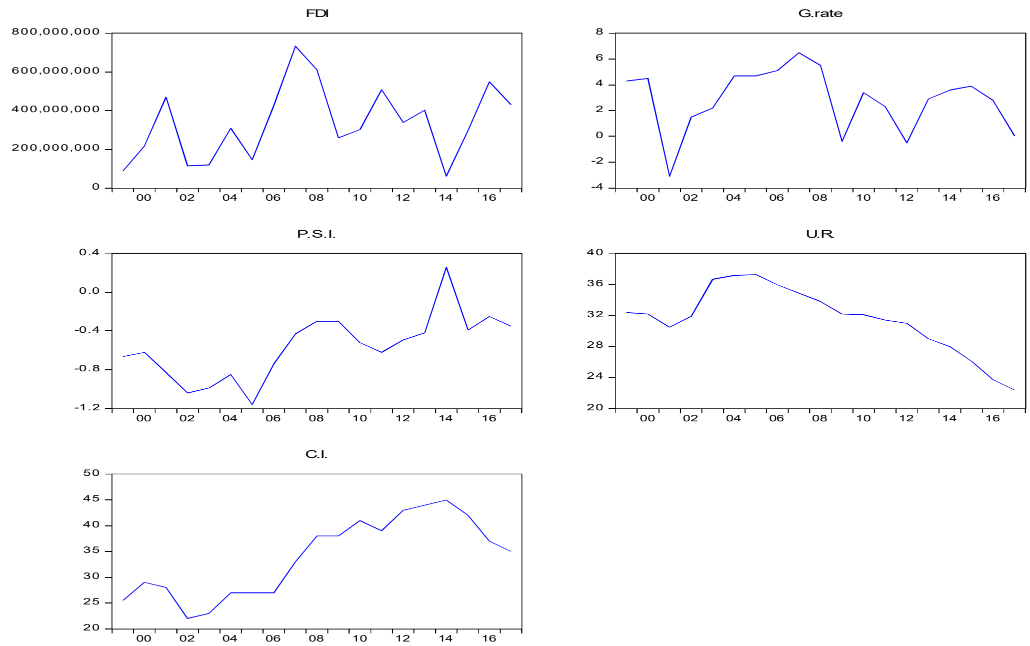

Figure 1. FDI, GDP, PSI, Unemployment, Corruption index for North Macedonia, period 2000-2015

Based on the 1st graph we see that the FDIs are stationary series with an average of 400.000.000. There is a bigger increase in 2007 of about 7 million and in 2014 there is a decrease; 2015 has also an increase but it is followed by a decrease in 2014. The real GDP is a stationary series of a minimal value in 2001 and with a maximum value in 2007.

P.S.I is an instable series with accentuated oscillations. The Unit root test will prove this series is stationary.

Unemployment – has a linear decrease starting from 2007. What is worth mentioning is the Republic of North Macedonia since it has a higher unemployment rate compared to neighboring countries.

Corruption - the initial phase has a decreasing trend, whereas in 2007 we have a trend of increasing corruption.

Table 1. Correlation of the Growth rate, Corruption index, PSI, and FDI of North Macedonia

	G_RATE	C_I_	P_S_I_	U_R_	FDI
G_RATE	1	-0.07284	0.037968	0.385802	0.082377
C_I_	-0.07284	1	0.799213	-0.53678	0.269393
P_S_I_	0.037968	0.799213	1	-0.60685	0.227213
U_R_	0.385802	-0.53678	-0.60685	1	-0.14734
FDI	0.082377	0.269393	0.227213	-0.14734	1

Since this is a multifactorial model, the independent variables should correlate as they would affect multicollinearity. The table shows that the correlation CI-with a coefficient 0.79 and PSI with UR -0.60 which means that it is reasonable to remove the PSI coefficient from the model.

Table 2. Model estimation for the Growth rate as a dependent variable for North Macedonia

Variable	Coefficient	Std. Error	t-Statistic	P value
FDI	6.99E-09	1.95E-09	3.593494	0.0027
D(U_R_,1)	0.349429	0.438283	0.797269	0.4377
D(C_I_,1)	0.208468	0.197845	1.053693	0.3087

According to the results, we can conclude that the determination coefficient is very low R^2 = 0.0027 which indicates that not even 1% of the variability in the economic growth is explained by the independent variables, consequently the investment coefficient statistically indicates that it is significant while the other coefficients are statistically insignificant.

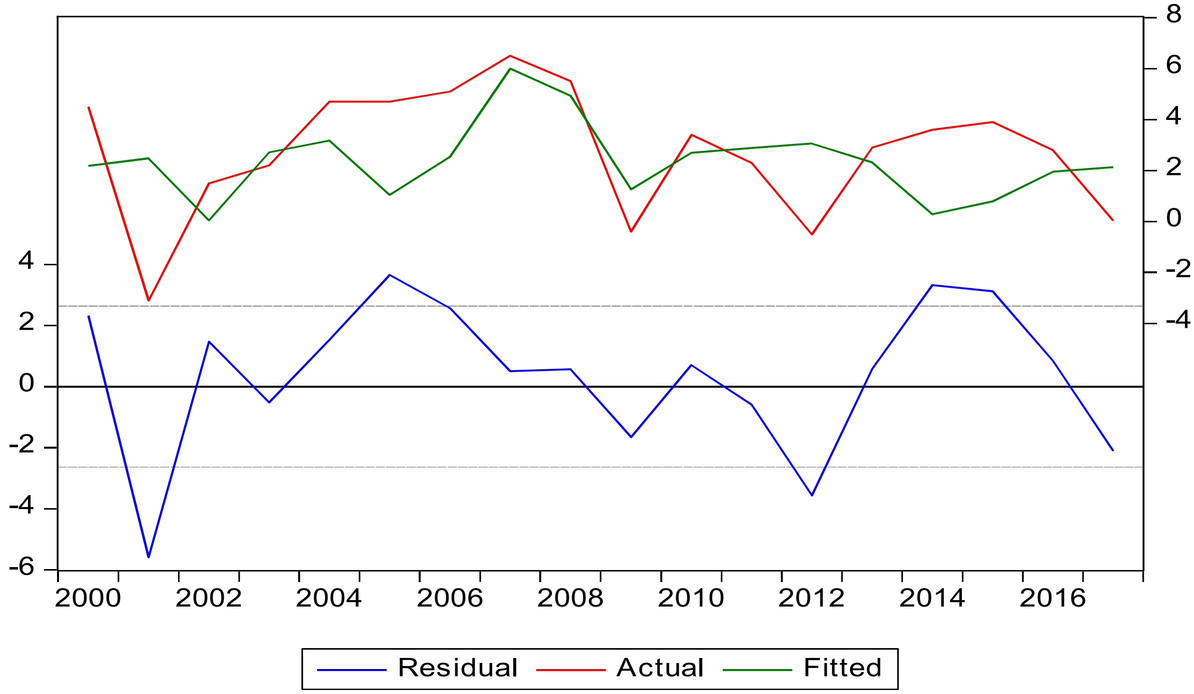

Figure 2. Regression chart for the estimated model in Table 3

-real actual state of the economic growth

- the value of GDP growth from the model

- regression errors

Conclusion

As per the obtained results, we can conclude that FDI is an independent variable which is significant to the economic development.

For a higher economic development for the countries claiming to become part of EU, the governmental institutions should focus on priorities such as transparency, corruption control which would affect the chances for FDI growth.

In the future, this research may focus on a wider comparative analysis between developed countries members of EU and those which are not members, to compare the factors that lead to a higher economic development.

Based on the results, we can give few recommendations starting from that of FDI in the Republic of North Macedonia shouldn't be a goal in itself, but should be seen as a means of support of other developed initiatives such as unemployment and poverty.

In addition, the findings in this paper should serve as a guideline to economists, policymakers who should deal with identifying attractive areas for foreign investors. The government should deal with combating corruption.

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