IMPACT OF THE GOVERNMENT SIZE ON ECONOMIC GROWTH IN THE WESTERN BALKAN COUNTRIES

Roberta Bajrami *, Adelina Gashi **, Kosovare Ukshini *, Donat Rexha *

* AAB College, Pristina, the Republic of Kosovo
** Corresponding author. AAB College, Pristina, the Republic of Kosovo
Contact details: AAB College, St. Elez Berisha, No. 56, Pushe Kosovë Industrial Zone, Prishtina 10000, the Republic of Kosovo

Abstract

The Keynesian theory states that economic growth is positively affected by government spending, while Classical theory states that economic growth is negatively affected by government spending, as is stated by neoclassical public choice theorists (Nyasha & Odhiambo, 2019). Based on these theories, many authors have carried out research on the impact of economic freedom on economic growth by analyzing various empirical cases. Bergh and Karlsson (2010) with the findings from his paper confirmed that the countries with the highest government size have an elevated growth in the globalization index of KOF and the Fraser Institute’s economic freedom index. The main aim of this paper is to analyze the government size impact on the growth of the economy in the Western Balkan in the time period 2000–2017 according to Fraser Institute’s data, incorporating the following econometric models: fixed and random effects, pooled ordinary least squares (OLS), and Hausman-Taylor IV. With these models, this paper analyzes a government size and its components: government enterprises and investment, government consumption, transfers, and subsidies. The results illustrate a relationship between the size of the government and the growth of the economy in the Western Balkans that is positive. 1% increase in government size affects 0.29% gross domestic product (GDP) growth per capita. According to the Hausman-Taylor instrumental variable, 1% growth of government consumption is affected by 0.69% the decline in GDP per capita. The growth rate of transfers and subsidies affects 0.17% of GDP growth per capita and 1% of government enterprises and investment affects 0.54% GDP growth per capita.

Keywords: Government Size, Economic Growth, Fraser Institute, Western Balkan


Declaration of conflicting interests: The Authors declare that there is no conflict of interest.

1. INTRODUCTION

So far there are many researchers who have tried to make the connection and impact between the size of the government and the growth of the economy by explaining the different indicators of measuring government size in relation to gross domestic product (GDP). On one hand, authors such as Kaldor...
In the context of this paper, indicators for measuring the size of government by Fraser Institute were taken. According to this institute, the size of the government is determined by government consumption, transfers and subsidies, government investment, and tax revenue. Government consumption is calculated as general government consumption spending as a percentage of total consumption. Countries with a greater amount of government expenditures had lower ratings and vice versa. Transfers and subsidies are measured as general government transfers and subsidies as a share of GDP. The formula will generate lower ratings for countries with larger transfer sectors. For the purpose of constructing ratings that go from zero to ten, this research used government investment data as a part of total investment. Countries that received lower ratings were those countries with more government enterprises and government investment (Gwartney et al., 2020).

The paper analyzes the size of government from the three indicators of the Fraser Institute and does not analyze tax revenue and its subcomponents. The paper is oriented only towards the Western Balkan countries (Albania, Kosovo, Bosnia and Herzegovina, Croatia, Macedonia (North Macedonia), Montenegro, Serbia) and the time period of the analysis of the results is from 2000 to 2017.

This paper answers the questions:

RQ1: Does government size have a negative impact on economic growth?
RQ1a: Does government consumption have a positive effect on economic growth?
RQ1b: Do transfers and subsidies have a positive effect on economic growth?
RQ1c: Do government enterprises and investments have a negative effect on economic growth?

This paper confirms the following hypotheses:

H1: Government size has a negative and statistically substantial effect on growth.
H1a: Government consumption has a positive effect on economic growth.
H1b: Transfers and subsidies have a positive effect on economic growth.
H1c: Government enterprises and investment have a negative impact on economic growth.

From the review of the literature, we find that in most of the current research works the effects and size of government are positive in the developing country and negative in the developed country, on the other hand, all Western Balkan countries that were a part of this research, are or have been in the transition phase from which investments in the public enterprise were lower. From this, the motivation behind this paper becomes investigating whether there is a positive or negative relationship between government size and economic growth while recognizing the complex nature of economic enterprise in the Western Balkans.

There are two main aspects in which this research differs from other research works. Firstly, there is no research that takes into account the impact of government size on the economic growth in the Western Balkans or research carried out based on m the indicators set by the Fraser Institute for economic freedom, and secondly, the methodology and information used in this research are different from other research. One of the following has been used in every research so far: ordinary least squares (OLS) econometric methods, fixed effect, random effect, etc. In contrast to other research, the method of Hausman-Taylor IV has been used for the current research as well.

Section 1 of this paper presents a detailed description of the research problem, research purpose, research questions, and research hypotheses. In Section 2 of the paper, the literature review on the effect of government size on economic growth is presented, which shows the empirical findings of various authors about the relationship between these two variables and their subcomponents. Section 3 presents the methodology and data description, where the specification of econometric models such as fixed and random effects, OLS, and Hausman-Taylor IV and pre- and post-estimation tests are done. In Section 4 of the paper, the empirical findings and the confirmation of the hypotheses are shown, while the last Section 5 concludes the paper and gives recommendations.

2. LITERATURE REVIEW

The Keynesian theory asserts that government spending positively affects economic growth, whereas classical, neoclassical public choice theorists maintain that government spending negatively affects economic growth due to the blocking effect, which occurs when government spending shifts private sector investment because of resource constraints. As a result, the two have a negative association (Nyasha & Odhiambo, 2019).

The positive effect of government size, according to Kaldor (1966), is greater in “low-income countries” than in “high-income ones”. The positive relationship between economic growth and government size is documented in this research. Because of the high factor of total productivity in the 1960s, the external marginal effect is positive.

A positive and strong association exists between “public spending” and the rate of GDP growth, according to Ram (1986), Kormendi and Meguire (1986). The growth rate of GDP, total government expenditures, investments, imports, and exports are among the factors examined in Ghali’s (1999) paper for OECD nations. The findings reveal positive associations between government size and growth.

For countries of the G-7, Kolluri et al. (2000) investigates the link between government spending and GDP from 1960 to 1993. The empirical findings
in this study reveal that government revenue as well as expenditure have a long-term elastic connection.

Ghose and Das (2013) found that the government size positively and significantly affects economic growth. In order to conduct this study, the researchers measured the total general consumption expenditure of a government as a percentage of GDP, government size, gross capital formation as a percentage of GDP, domestic investment, with GDP per capita as a representative of the growth of the economy. This study was conducted for 19 developing countries during 1970–2006, by employing testing of panel co-integration and estimating the parameters using the method of dynamic ordinary least square. According to Förster and Henrekson (2001), the size of government has a positive effect in developing countries, but a negative impact in developed countries. The results of this study for rich OECD countries demonstrate that the size of the estimated coefficients indicate that increasing the expenditure ratio for 10 percent will reduce the growth rates by 0.7–0.8 percent. Government consumption and taxes were used to calculate the size of the government.

Al-Katout and Bakir (2019) conducted a study in 42 different states and divided these states into two groups. In this study, the first group suggested a positive and statistically significant relationship between government spending and GDP per capita which is in line with the economic theory, i.e., a 1% increase in government spending in the country positively affects GDP per capita for 0–16%, whereas in the second group where income per capita is lower, there is a positive and statistically significant relationship, which is consistent with the economic theory. A 1% increase in government spending has a 0.15% positive effect on the country’s GDP per capita.

Barro (1991), alternatively, looked at 98 countries from 1960 to 1985 in his paper. The results of this research suggest that there are no substantial correlations between government investment and economic growth. The ratio of the consumption expenditure of the government to GDP is adversely connected to the private investment ratio to GDP and the growth of GDP. Government consumption causes distortions, for instance, high tax rates, but it does not offer a compensatory stimulus for investment and growth.

In a study of 23 OECD nations, Gwartney, Lawson, and Holcombe (1998) discovered adverse associations between the size of government and economic development. The variables in this paper were measured using the government ratio consumption to gross domestic product.

Carlsson and Lundström (2002) discovered a substantial influence of government size, with a negative coefficient, showing that the size of government affects economic growth. According to the estimated size, a unit of index growth decreases the typical growth rate by about 0.5 points (percentage). The robust test indicates that the variable is valid. As a result, there is a significant link between the loss of economic freedom and growth of government size. The researchers have identified a positive or insignificant connection, so this conclusion is somewhat surprising.

In their study, Hansson and Henrekson (1994) found that a ten percent increase in total government spending reduces the overall factor productivity growth rate by 0.92 percent each year. A corresponding rise in consumer spending of the government would reduce the annual rate of growth by 1.4 percent. According to Abrams (1999), a 1% rise in government spending (+1, e.g., 20 to 21) would result in a 0.39 percent increase in unemployment (e.g., 7 to 7.39).

Between 1960 and 1985, Guseh (1997) investigated how economic growth can be affected by the size of a government. For 59 developing nations, Guseh employed a fixed-effects model. The model’s findings revealed there is a negative relationship between government size and economic growth. In non-democratic socialist economies, these effects are three times as strong as in democratic market economies. As a result, a 1% increase in government size has a 0.143 percent negative effect on economic growth, whereas a 10% increase has a 0.74 percent negative impact.

Bergh and Karlsson (2010) looked at the relationship between government size and economic development in wealthy OECD nations from 1970 to 2005. In this study, models such as the Bayesian method and the OLS approach were applied. It has been demonstrated through these models that the government size has a detrimental effect on economic growth. The findings show that concentrating on institutional qualities, namely, economic freedom and globalization, can eliminate the detrimental effects of taxation and government spending. Furthermore, the findings in this paper revealed that nations with the largest governments have higher growth rates in the globalization index of KOF and the Fraser Institute’s index for economic freedom.

In their research, Carlsson and Lundström (2002) observed negative and statistically significant correlations between government size and GDP. According to the estimated size, a unit of index growth reduces the average growth rate by about 0.5 points (percentage). The variable passes the robust test, indicating that there is a substantial link between economic freedom and its decline.

In his paper, Ahmed (1986) observed that permanent differences in government spending result in large crowding out of private spending, leading to a negative wealth effect. Like Ahmed (1986), Grier and Tullock (1989) observed that increasing government consumption as a percentage of GDP had a severe negative effect. The coefficient of -0.32 is highly significant, implying that when an increase in government growth of one standard deviation occurs, the average GDP growth is reduced by 0.39 percentage points.

In their study, Ghez and Das (2013) found that a ten percent increase in government spending reduces the overall factor productivity growth rate by 0.92 percent each year. A corresponding rise in consumer spending of the government would reduce the annual rate of growth by 1.4 percent. According to Abrams (1999), a 1% rise in government spending (+1, e.g., 20 to 21) would result in a 0.39 percent increase in unemployment (e.g., 7 to 7.39).
from 13.7 to 22.1 percent of gross national product (GNP) (as they have done for the last forty years) resulted in a 2.1 percent long-term reduction in output. This figure represents a standard estimate of the effect of permanently increasing government consumption on output. Bajrami, Tafa, and Hoxha (2020) discovered that government spending is positively signed, meaning that an elevation in government spending leads to a statistically insignificant increase in GDP. Investment expenditures increase the private sector’s future output. As a result, expenditures are divided into two categories: investment expenditures and consumption expenditures. The investment expenditures used in this study are economics, education and social security expenditures that are classified as investment expenditures, while culture, environment, general public services, and health expenditures are classified as consumption expenditures (Lee, Won, & Jei, 2019).

Many studies have found positive and negative effects between government investment and developing government enterprises. The effects of these depend on the study of various indicators of public investment and political circumstances in the country.

Castelnovo, Del Bo, and Florio (2019), Shaheer, Yi, Li, and Chen (2019), Huat (2016), Bartel and Harrison (2005), Bozec, Breton, and Côté (2002), and Bozec, Dia, and Breton (2006) do not conclude that public enterprises positively or negatively affect economic growth. They list the advantages and disadvantages in their performance which then have a negative effect on economic growth. Among the most noted disadvantages is the low financial performance. Furthermore, Plane (1992), and Gyftason, Herbertsson, and Zoega (2001) confirm that the relationship between economic growth and investment in public enterprises is negative, while Fowler and Richards (1995) and Doamekpor (2003) conclude that public enterprises do not have any significant impact on economic growth. Contrary to the aforementioned studies, Fournier (2016) found positive long-term links between economic growth, public investment, and labor productivity. The research was done for OECD countries where the findings show that elevating the public investment share in total government spending generates substantial growth gains.

Figure 1. Government size and GDP: Non-linear relationship

On average, poor countries are smaller. As a result, there is a positive relationship between the size of the government and economic growth. On the other hand, public sectors of rich countries are larger on average. Hence, the relationship between the size of the government and economic growth is not as positive as it is in poor countries and can even turn negative.

3. METHODOLOGY

This section offers a detailed outline of the methodology employed during the process of designing and carrying out the research under three main headings: data issues, choice of variables and statistical techniques.

This research was done by relying on data from various sources. A panel data set from seven Western Balkan countries for the 2000 to 2017 period was used in this study. Data set also included government consumption, transfers and subsidies, government investment, size of government and gross domestic product per capita. Macroeconomic variables were collected from the World Bank, International Monetary Fund (IMF) and Fraser Institute.

Inference of model parameters with greater precision implies more degrees of freedom that are frequently seen in panel data and more varieties of samples than cross-sectional data which may be perceived as a panel with \( T = 1 \), or time series data which is a panel with \( N = 1 \). As a result, the efficiency of econometric model estimations is improved.

3.1. Statistical techniques

Longitudinal or panel data sets are pieces of data that include both time series and cross sections. Panel data sets are better for cross-sectional analysis and are often wide but short (in terms of the number of observations made throughout time) (Hamaker & Wichers, 2017). The challenge of assessing panel data is centred on unit heterogeneity (Bilgili, Koçak, Bulut, & Kuluğlu, 2017). The fundamental framework is a form regression:

\[
Y_{it} = X_{it}\beta + Z_{it}\gamma + \varepsilon_{it} \tag{1}
\]

where \( X_{it} \beta \) is the \( k \) vector of strictly exogenous time-varying regressors, but there is no constant term. The individual effect or heterogeneity is \( Z_{it}\gamma \) which comprises a constant term and a set of individual or group-specific variables (Chudik, Pesaran, & Yang, 2018). Two cases are considered. For fixed effects, \( Z_{it} \) is unobserved, but correlated with \( X_{it} \) and estimators of \( \beta \) are biased (Brüderl & Ludwig, 2015). For random effects, there
is unobserved heterogeneity which is assumed to be uncorrelated with \( X_{it} \), then:

\[
Y_{it} = X_{it}\beta + E[Z_{it}] + \left( Z_{it} - E[Z_{it}] \right) + \varepsilon_{it} \tag{2}
\]

\[
Y_{it} = X_{it}\beta + \alpha + u_i + \varepsilon_{it} \tag{3}
\]

This random effect method states that \( u_i \) is a random element unique to a group that, despite being random, stays constant for that group through time (Greene, 2005).

Fixed effects posits that changes in the constant term can represent differences across units of observation (Leszczensky & Wolbring, 2019). Each \( \alpha \) is estimated:

\[
Y_{it} = X_{it}\beta + \alpha_i + \varepsilon_{it} \tag{4}
\]

The least square dummy variable (LSDV) model (Zulfikar, 2018) can be obtained by:

\[
Y = X\beta + D\alpha + \varepsilon \tag{5}
\]

This is a classic regression model that does not require any new methodology or tests to analyse. In effect, for each group, simply put, we regress \( Y \) on \( X \) and a dummy variable. Naturally, if there are too many groups, it will cause computing difficulties.

An unbalanced panel is created when data is missing (Baltagi & Liu, 2020). The required adjustments are straightforward. The sample size for a balanced panel is \( n = mT \sum T_i \) with an uneven panel. As a result, rather than calculating group averages based on a sample size of \( n \), each group must have its own sample size \( T_i \).

Individual effects that are unobserved may be associated with the included variables using the fixed effects model. The unit differences are afterward represented as changes in the constant term (Giesselmann & Schmidt-Catran, 2020). This is appropriate when the individual effects are not related to the regressors. The advantage of this method is that it significantly decreases the parameters’ numbers that must be estimated. The cost is the risk of inconsistency in estimations if the estimation is incorrect (Kutlu, Tran, & Tsionas, 2019). We reformulate the fundamental model to account for random effects:

\[
Y_{it} = X_{it}\beta + u_i + \varepsilon_{it} \tag{6}
\]

The mean of the unobserved heterogeneity, \( E(Z_{it}) \), has now become a single constant term. \( u_i \) is the heterogeneity of chance that is unique to the observation of \( t \) (\( t \) means “time”) and remains constant across time. For instance, in a firm study, it is the elements that we cannot measure that remain unique to that firm.

To determine whether the random effects are unaffected by the right-hand side variables, Hausman and Taylor (1981) invented the specification test. This is a broad test that can be used to compare any two estimators. The test is based on the idea that if the right-hand side variables and the random effects have no association, both fixed and random effects are consistent estimators, but fixed effects are inefficient (this is the assumption with random effects).

### 3.2. Model specification

Stata 13 software was utilized for statistical analysis. On a panel data set of seven Western Balkan countries from 2000 to 2017, pooled OLS, fixed effect, and random effect regression analyses were used. The base model used for the current study was as follows:

\[
Y_{it} = f (X_{1it}, X_{2it}, X_{3it}, X_{4it}) \tag{7}
\]

Here, \( Y_{it} = j^{th} \) GDP per capita in period \( t \); \( X_{1it} = j^{th} \) government consumption in period \( t \); \( X_{2it} = j^{th} \) transfers and subsidies in period \( t \); \( X_{3it} = j^{th} \) government investment in period \( t \); \( X_{4it} = j^{th} \) size of government in period \( t \).

The model’s exact specifications were as follows:

\[
Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \varepsilon_{it} \tag{8}
\]

Hausman and Taylor (1981) presented a two-step instrumental variable approach that is 1) faster than the within estimator and 2) captures the effects of time-invariant variables that are lost in the within the transformation.

### 4. EMPIRICAL RESULTS AND ANALYSIS

In this research, pooled OLS, fixed effect and random effect panel model were used to determine the determinants of economic growth. Table 1 below reviews the regression results of the model that were assessed by using pooled least squares with a fixed and random effect estimator.

<table>
<thead>
<tr>
<th>GDP per capita</th>
<th>Pooled OLS Model 1</th>
<th>Fixed effect Model 2</th>
<th>Random effects Model 3</th>
<th>Hausman-Taylor instrumental variable Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>X</td>
<td>-0.3240453 (0.177)</td>
<td>-0.32403 (0.174)</td>
<td>-0.2324053 (0.174)</td>
<td>-0.6920887 (0.026)</td>
</tr>
<tr>
<td>X</td>
<td>0.330242 (0.013)</td>
<td>0.3201967 (0.131)</td>
<td>0.3302424 (0.012)</td>
<td>0.1741237 (0.053)</td>
</tr>
<tr>
<td>X</td>
<td>-0.170961 (0.321)</td>
<td>-0.106722 (0.383)</td>
<td>-0.1170961 (0.319)</td>
<td>0.543821 (0.094)</td>
</tr>
<tr>
<td>X</td>
<td>0.2324053 (0.177)</td>
<td>0.2324053 (0.177)</td>
<td>0.2324053 (0.177)</td>
<td>0.2324053 (0.177)</td>
</tr>
<tr>
<td>Observation</td>
<td>124</td>
<td>124</td>
<td>124</td>
<td>124</td>
</tr>
<tr>
<td>Model</td>
<td>Pooled OLS RE</td>
<td>FE</td>
<td>RE</td>
<td>Hausman-Taylor IV</td>
</tr>
<tr>
<td>Hausman test</td>
<td>4.91 (0.2969)</td>
<td>0.0627</td>
<td>0.0627</td>
<td>0.0864</td>
</tr>
<tr>
<td>R²</td>
<td>0.0627</td>
<td>0.0627</td>
<td>0.0864</td>
<td></td>
</tr>
</tbody>
</table>
From Table 1, Model 1 implies that the size of government is statistically insignificant at a 5% significance level, but the government size positively affects the economic growth. Model 2 also indicates that the government size is statistically insignificant at a 5% significance level, but x4 negatively affects economic growth. Model 3 indicates that the size of the government is statistically insignificant at a 5% level of significance, but the size of the government positively affects the economic growth. According to the Hausman test, the random effect is preferable because the p-value of 0.2561 is larger than 0.05. According to Hausman-Taylor instrumental variable model, a 1% of increase of government size impacts with 0.21% growth of GDP per capita. The results are in accordance with Kaldor (1966), Ram (1986), Kormendi and Meguire (1985), Ghali (1998), Kolluri et al. (2000), Karagianni and Pempetzoglou (2009), Herath (2010), Facchini and Melki (2011), Ghose and Das (2013).

Also, from Table 1, Model 1 indicates that in terms of statistics, government consumption is not significant at a 5% level of significance, but significant at a 10% level. Government consumption has a negative impact on economic growth. Model 2 also indicates that government consumption is statistically insignificant at a 5% level of significance, but government consumption has a negative impact on economic growth. Model 3 indicates that government consumption is statistically insignificant at a 5% level of significance, but government consumption has a positive impact on economic growth. The Hausman test indicates that the fixed effect is better since the p-value of 0.0428 is less than 0.05.

From Table 1, Model 1 indicates that transfers and subsidies are statistically insignificant at a 5% level of significance but transfers and subsidies positively affect economic growth. Model 2 also indicates that transfers and subsidies are statistically insignificant at a 5% level of significance, but transfers and subsidies positively affect economic growth. Model 3 indicates that transfers and subsidies are statistically insignificant at a 5% level of significance, but transfers and subsidies positively affect economic growth. According to the Hausman test, the random effect is better since the p-value of 0.20 is bigger than 0.05. The results are in line with Ram (1986) and Ghali (1998).

The R-square values of 0.0627 and 0.0084 indicate that about 6.27% and 0.84% of the overall variation in economic growth is explained by a combination of factors such as government consumption, transfers and subsidies, government investment as well as the size of government.

Lastly, from Table 1, Model 1 indicates that government investment is statistically insignificant at a 5% level of significance, but government investment negatively affects economic growth. Model 2 similarly indicates that government investment is statistically insignificant at a 5% level of significance, but government investment negatively affects economic growth. The random effect is preferable according to the Hausman test as the p-value of 1.41 is larger than 0.05. The results are in line with Barro (1991).

The matrix correlation indicates that there is a weak link between economic growth, government consumption, transfer and subsidies and size of government. Also, there is a negative relationship between economic growth and government investment. There is a strong relationship between government consumption and transfer and subsidies, government investment and size of government. In the same vein, there is a fairly strong link between transfer and subsidies, government investment and size of government. Finally, a relatively strong link between government investment and government size can be observed.

5. CONCLUSION

This study proves that government size affects economic growth in the Western Balkans for the period 2000-2017 according to the Fraser Institute’s data, incorporating the following econometric models: pooled OLS, fixed and random effects and Hausman-Taylor IV.

The Western Balkan countries analyzed in this paper are developing countries where most of them have not yet passed the transition phase and many of them have a high impact on the size of government by public enterprises, government consumption, and subsidies, as a consequence, the result of this paper becomes positive when it comes to the relationship between these variables. This result is important for future research in finding a level at which the government size will have a positive effect and after that level, the impact will be negative.

The analysis of the results in this paper has two main limitations. Initially, not all indicators that determine the size of government were taken into measurement, hence, the analysis includes variables like government consumption, transfers and subsidies, government enterprises, and investment and does not analyze the last component of government size which deals with taxes, and secondly, the paper is mainly focused on the variables defined by Fraser Institute for economic freedom and factors according to other institutions have not been analyzed.

According to the results of Hausman-Taylor instrumental variable, pooled OLS, fixed and random effects, it is confirmed that the government size positively and significantly increases the relation to GDP per capita. The Hausman test suggests that the random effect is preferable as the p-value of 0.2561 is bigger than 0.05. According to Hausman-Taylor instrumental variable model, a 1% of increase of government size impacts growth of GDP per capita with 0.21%. The results are consistent with Kaldor (1966), Ram (1986), Kormendi and Meguire (1985), Ghali (1999), Kolluri et al. (2000), Karagianni and Pempetzoglou (2009), Herath (2010), Facchini and Melki (2011).

At a 5% level of significance, government consumption is statistically insignificant, but at a 10% level of significance, it is significant. Consumption by the government has a detrimental influence on economic growth. The results are in line with Hansson and Henrekson (1994) who found that a ten percent rise in overall government
spending would reduce total factor productivity growth by 0.92 percent per year, and other authors as well (Abrams, 1999; Ahmed, 1986; Grier & Tullock, 1989; Landau, 1983; Barro, 1991; Devarajan et al., 1996; Nurudeen & Usman, 2010; Ndambiri et al., 2012; Fölster & Henrekson, 1999, 2001).

According to the pooled OLS model, fixed and random indicates that government investment negatively affect economic growth but the results are insignificant. The impact is positive and the results are statistically significant at 10% according to the Hausman-Taylor instrumental variable model. Transfers and subsidies are statistically insignificant at a 5% significance level but transfers and subsidies positively affect economic growth. The results are in line Ram (1986) and Ghali (1998).

The majority of recent scientific studies published in peer-reviewed journals have demonstrated that there is a positive relationship between overall government size and economic growth in developing counties. This agrees sharply with experts like Lindert (2004) and Madrick (2009), who have claimed that there is no compromise between economic progress and government expansion in book-length assessments. When economic growth is the policy goal there are two types of outcomes that are usually observed: 1) directly taxing incomes is worse than indirectly doing so, and 2) social transfers which include human capital are worse than public investment and, if anything, encourages growth. As a result, the findings in this study imply that government needs to decrease in order for growth to expand. By reorganizing taxes and spending, it is possible to boost growth while for a particular government size, lowering the negative outcomes on growth. Moreover, countries gravitate toward institutions that complement one another. Many analysts have stressed that the Balkan welfare state can be viewed as an economic model characterized by a distinctive combination of institutions.

The unique combination of institutions, as well as the resulting distinctive relations between them are significant economic performance determinants. For various levels of government sizes, Balkan welfare states appear to be able to deliver strong growth rates. This is not to suggest that low-tax nations cannot raise taxes without damaging growth, or that Kosovo is immune to the many techniques used by high taxes to interfere with the economy. A more insightful reading is that the analysis is missing something that explains how Kosovo mix high taxation with great economic development. This study proposed two justifications: compensation through policies that are growth-friendly and advantages from historically high levels of trust (lack of anxiety), but both are at best theoretical, with dubious policy consequences. Even while the issue over whether there is a link between growth and total government size in developing nations is established to a degree, research on policy changes, institutions, and growth is moving at a breakneck pace.

REFERENCES


doi=10.1783/1086.3987


