Trade Liberalization and Its Impact in Albania’s Sustainable Growth

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Abstract: Albania is currently very focused on growth and promotion of trade liberalization in the context of the ultimate goal which is the full integration into the European family, and within this framework our country has implemented and continues to implement economic policies that promote economic growth in the long term. However, several internal and external factors such as the high level of corruption, low technology, the global financial crisis, the lack of political stability has contributed to the efficiency and success this policy.

This study aims to develop an econometric model for Albania to study the impact of trade openness on the trade balance and on macroeconomic aggregates (country’s economic growth), called endogenous gravity theory (EGT) to develop a simple and flexible simultaneous equation model of openness in Albania with its largest trade partners as Italy.

The study reveals efficient and reliable empirical findings on the link cause-consequence of the elements trade-growth, including the impact of shocks (external crises) and trade policy reform between Albania and its trade partner Italy. The empirical findings suggest that openness between Albania and neighboring partner Italy is positive and statistically significant for economic growth in Albania.

The variable “services liberalization” is small and negative and statistically significant to growth indicators. Moreover, the global financial crisis had a major negative and significant impact on Albania’s growth. On the other hand, FDI, financial system reforms and liberalization of capital flows were positive and important for growth and development.

More specifically, the most important recommendation suggests that trade policymakers in Albania should implement the policy of openness, in accordance with regional agreements and bilateral and multilateral free trade agreements (FTA) to achieve long-term sustainable growth.

Keywords: Trade liberalization, Economic Growth, EGT model, FDI, Financial crisis, Openness

JEL classification: F13
Introduction

There are many studies of many economists in the world that suggest the trade liberalization as a very important phenomenon of globalization has now become an integral part of economic reforms undertaken mainly by developing countries (Grossman dhe Helpman, (1991)).

It is known that Albania is a small developing country (in relative economic size), where economic performance and growth of which are mostly affected by several internal factors. There are other factors that include fiscal, monetary and industrial policies that are necessary to support trade policy to enhance the competitiveness of domestic industries which accelerate long-term growth. In addition, trade and growth are factors can also influence these internal factors.

An open developing economy like Albania is also affected by other factors, such as economies of its major trade partners and the financial crisis that they are experiencing. Since Albania does not produce goods sufficient to meet its consumption and internal production requirements (turning our economy dependent on imports), the crises of the partner countries impact greatly on competitiveness at international level to its industries, economic performance and economic growth. More importantly, the 2008-2009 financial crisis that affected the negatively the world and the economic growth in Albania. This was most obvious in 2008-2009 as a result of the proliferation of regional impact. During the period after the crisis, GDP has steadily declined, reaching a value of 1.4% in 2013. It can be concluded that economic integration (EI) and FTAs directly affect trade liberalization.

In addition, foreign direct investment (FDI) is another external factor that contributes to employment, technology and knowledge transfer, and generates growth, particularly in the manufacturing industry.

Objectives of the study: The main objective of this study is to analyze how trade openness and its deepening in the past 21 years with its trade partner Italy has affected (under the framework of trade liberalization), the performance of Albania’s economic growth; to conclude with recommendations as to whether Albania should deepen trade liberalization with this country trade partner or not. Period from 1993-2014 was chosen as the time when Albania has undertaken the most important economic trading policies. Opening the country through trade liberalization was one of policy choices to achieve sustainable growth for the country. For specific objectives of quantitative analysis, a new and convenient econometric model is built for economic and trade policies in Albania. Suitable econometric approach is used to analyze and interpret the results. Economic policies, trade policies, along with financial crises and shocks are chosen as external or exogenous macroeconomic variables while the dependent variable is economic growth of Albania.

The hypothesis of the study: The hypotheses raised in this study are built to predict calculated results and are formulated in accordance with the aforementioned objectives.

- **Hypothesis 1:** The effect of trade opening to Albania is expected to be positive and significant for its trade and economic growth.

- **Hypothesis 2:** trade policy reforms (economic opening) with trade partner Italy is expected to be positive and important for trade and growth.
• **Hypothesis 3:** Each of the external factors variables (such as FDI, services, financial crisis in 2008-2009, reforms in the financial system) are projected to have different impact and importance on economic growth.

1) FDI and services are expected to be positive and significant for trade and growth.

2) The financial crisis is expected to be negative and significant for trade and growth.

3) Privatization policies are expected to be positive and important for trade and growth.

4) Corruption Index is expected to be positive and important for trade and growth.

It can be said that the empirical findings of possible trade liberalization, particularly the bilateral FTAs should be more effective and accelerate the benefits of the country. FTAs objectives should be extended to the field of investment services and any other economic cooperation at a later stage.


There is evidence that all countries that have opened their markets to international trade and investments have experienced prosperity and economic growth (OECD 2011). Empirical studies addressed to economic growth have not been able to deliver clear results about the impact of trade on indicators of economic growth (Grossman and Helpman, 1991; Rodrík, 1999; Rodriguez and Rodrík, 1999; Sachs and Warner, 1995; among others). Numerous studies claim that there is a strong positive impact of trade liberalization on the growth of imports, and this impact is derived mainly through price sensitivity. On the other hand, theories that emphasize the distribution conflicts arising from trade liberalization are based on the assumption of mobility of production factors; in order to identify winners and losers. For example, long-term Huckster-Ohlin model with fully removable factors, emphasizes that the winners and losers are characterized by the factors they own more (egg, skilled labor vs. unskilled and work towards capital). At the same time, free trade is far from being widely practiced, especially in developing countries. Even countries that implemented important trade reforms in the 1980s and 1990s, such as Colombia, India, and Brazil; still apply higher import tariffs in many industries (Anderson and Martin, 2006).

Trade liberalization in most theories appear to have many advantages such as comparative advantage, economies of scale, increased fair competition, effective use of raw materials, lower living costs, increasing chances of the customer's choice, or and under international framework, good governance and peaceful connection with international partners. Despite these advantages there exists some disadvantages about this phenomenon, egg, economic dependence, political slavery, unbalanced development, domestic products, international monopolies, reduction in wealth for certain groups and difficulties in application since the current conditions in the world do not comply with the conditions predetermined by the implementation of this free trade regime.

Any country in recent decades has not achieved economic success, in terms of substantial growth of living standards for its people without being opened to the rest of the world (OECD 2013). Opening their economies into the global economy has been crucial in enabling many developing countries to develop competitive advantages in the manufacturing of certain products. In these countries, as defined by the World Bank as
"new globalizers" it decreased the number of people in absolute poverty with over 120 million (14 percent) between 1993 and 1998. There is considerable evidence (IMF, 1997; Jeffrey Frankel and David Romer, 1999) that more abroad oriented countries (oriented to exports) tend to consistently grow faster than those that are in oriented (to imports). Indeed, one finding is that the benefits of trade liberalization can exceed costs by a factor of more than 10. (Steven Matusz and David Tarr, 1999).

2. Methodology

There is absolutely no superior methodology to analyze international trade because the world of international trade is infinitely complex, including hundreds of countries with different characteristics (in the possession of factors), with different preferences of customers, thousands types of products, and a great variety of national policy instruments, and that this world is more dynamic in time. But economists around the world are trying to develop models to understand this reality. Trade liberalization models predict that this phenomenon can act positively in world economic development, increasing the welfare of the participating countries and therefore poverty reduction, which are the highest priorities of the international community. This emphasis explains why numerous studies have focused on the assessment of the expected benefits of trade liberalization in the economic development of countries. The main empirical tools for these estimates were the use of partial Partial Equilibrium Model - PEM, the endogenous Gravity Theory - EGT, and the Computable General Equilibrium multicountry-CGEM for a single country/several countries. This paper presents the results of global modelling using a gravity model EGT. Using the model EGT it is found that complete liberalization has made it possible the growth of real GDP in an economy after several years of implementation. This trade reform enhances development, since it involves a greater rate of real income growth in developing countries and particularly for least developed countries. The EGT model is conceived on the principle of Newton's law, which states that the force of attraction of two measures is positively related to the production of two measures and negatively related to their squared distance.

The typical form of the model is as follows:

$$F_{ij} = G\left(M^1_i M^2_j / D^{3}_{ij}\right)$$

Fij interpreted as trade flows, G is a constant, M is the economic measure of each country i and j, and D is the distance between countries that trade with each other. This model is used quite recently in international relations to assess the impact of treaties or alliances in trade, and more specifically is used to test the efficiency of trade agreements such as the Agreement of free trade for the countries of North America (NAFTA) and the WTO.

2.1 Data Processing

The relevant data for the evaluation of the model include: the opening of Albania which is defined as total trade or commercial volume (EX + IM) divided by GDP (economic opening) and other related variables, eg FDI and trade in services divided by GDP. The model is calculated using annual data for the period 1993-2014. Data on GDP and on other macroeconomic variables, including FDIs and services in Albania are taken from official data and various publications INSTAT, World Development Indicators, etc. All variables are transformed in the form of rates of change (%) as required by the model approach EGT (see Tran Van Hoa, 2004a, 2004b and 2008).
3 Trade Liberalization of Albania with Italy

3.1 Operationalization of Concepts in Variables

• Albanian economic growth is the concept due to the phenomenon studied and measured through variable rate of economic growth in Albania. The nature of this data is the percentage and is symbolized by \( g \).

• Causative factors or independent factors are:

1. Openness of the Albanian economy to trading partners. The nature of this data is a percentage and is calculated as the ratio of the amount of import and export to GDP (trading volume/GDP). Considering the above, in this paper Italy is taken into account as a trading partner. The symbol of this variable is \( \text{openness}_{\text{it}} \, \text{gdp} \).

2. The contribution of trade in the Albanian economy. Since trade activity is a separate component of the services sector of a country, then the services sector is an indirect measure of trade. Trade is a factor affecting economic growth and we have tried to represent this effect through controlling the variable of part of services sector in the Albanian GDP, therefore measured as a ratio of services/ GDP and symbolized by \( \text{services} \, \text{gdp} \).

3. FDI. This is a factor that stems from the theory and suitable for this research because foreign direct investment directly affects the number of businesses and production activity in our country. On the other hand, business activity itself affects the activity of the Albanian economy as a whole, as a result foreign direct investment impacts economic growth. The symbol of this variable is \( \text{fdi} \, \text{gdp} \).

4. The emergence of the economic crisis in trade partner countries of Albania. Economic crises situations determine economic growth, ie economic crises are causing growth (as a concept). In fact, the economic crisis also imposes pressure on the openness of the economy. The emergence of crisis is measured through a variable dummy with two attributes: 0 before the onset year of the crisis, 1 after the onset year of the crisis. Here we have a breakdown:

• 2008 - when the crisis began in the European Union. The symbol is \( \text{crisis} \, \text{eu} \).

• 2009 when the crisis began in the Region Countries. The symbol of this variable is \( \text{crisis} \, \text{reg} \).

5. The privatization of the financial system in Albania. In literature is considered one such element and is considered as a concept that puts pressure on economic growth. The year of privatization is fixed 2004 (privatization of The Bank of Savings). Before this year, the variable takes the value 0, then after 2004 the value 1. Its symbol is \( \text{priv} \, \text{sf} \).

6. Corruption. The extent of corruption in the Albanian environment brings effects on economic growth and, by integrating it on econometric modeling, it is expected to trace these effects. It is measured by the index of corruption and its symbol is \( \text{ind} \, \text{corr} \).

Function’s form of linking the dependent variable economic growth (\( g \)) with independent variables, which can also be written like this:

\[ g_i = f(\text{openness}_{\text{it}} \, \text{gdp}, \text{services} \, \text{gdp}, \text{fdi} \, \text{gdp}, \text{crisis} \, \text{eu}, \text{crisis} \, \text{reg}, \text{priv} \, \text{sf}, \text{ind} \, \text{corr}) \]
where indicator t means the period. The reason why the opening of trade variables and crisis are written in the column, is that these variables are not used in the regression at the same time, but each of them superlatively.

### 3.2 Openness and the Application of EGT Model with Italy

Regression deduced from the theory measures the relationship of economic growth-openness with Italy is this:

\[
\Delta g_t = c + \beta_1 \Delta openness_{it\_gdp} + \beta_2 \Delta fdi_{gdp} + \beta_3 \Delta services_{gdp} + \beta_4 crisis_{eu} + \beta_5 crisis_{rajen} + \beta_6 \Delta ind_{corr} + \beta_7 priv_{sf} + \varepsilon
\]

The results of this model are summarized in the table below, along with some key statistics.

Excluded dummy variables (crisis_eu, crisis_reg and priv_sf), all others are differentiated in the first step to return to stationary. Then the regression can be written with the appropriate parameters and statistical probability of each as follows:

\[
\Delta g_t = -0.0332 + 0.3828 \Delta hapja_{it\_gdp} + 0.0499 \Delta fdi_{gdp} - 0.3515 \Delta herbine_{gdp} - 0.0455 \Delta kriza_{eu} + 0.0275 \Delta kriza_{rajen} + 0.0019 \Delta ind_{corr} + 0.035 \Delta priv_{sf} + \varepsilon
\]

\[
\text{Table 1. Model's results of openness}
\]

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c)</td>
<td>-0.033151</td>
<td>0.006204</td>
<td>-5.343409</td>
<td>0.0018</td>
</tr>
<tr>
<td>(d_{openness_it_gdp})</td>
<td>0.382782</td>
<td>0.233072</td>
<td>1.642332</td>
<td>0.1516</td>
</tr>
<tr>
<td>(d_{fdi_gdp})</td>
<td>0.049971</td>
<td>0.227481</td>
<td>0.219671</td>
<td>0.8334</td>
</tr>
<tr>
<td>(d_{services_gdp})</td>
<td>-0.351495</td>
<td>0.079855</td>
<td>-4.401671</td>
<td>0.0046</td>
</tr>
<tr>
<td>(crisis_eu)</td>
<td>-0.045494</td>
<td>0.017040</td>
<td>-2.669782</td>
<td>0.0370</td>
</tr>
<tr>
<td>(crisis_reg)</td>
<td>0.027537</td>
<td>0.015813</td>
<td>1.741430</td>
<td>0.1322</td>
</tr>
<tr>
<td>(d_{ind_corr})</td>
<td>0.001917</td>
<td>0.000361</td>
<td>5.316614</td>
<td>0.0018</td>
</tr>
<tr>
<td>(priv_sf)</td>
<td>0.035217</td>
<td>0.008560</td>
<td>4.114248</td>
<td>0.0063</td>
</tr>
</tbody>
</table>

| R-squared | Mean dependent var | -0.008643 |
| Adjusted R-squared | S.D. dependent var | 0.024056 |
| S.E. of regression | Akaike info criterion | -5.977456 |
| Sum squared resid | Schwarz criterion | -5.612281 |
| Log likelihood | Hannan-Quinn criter. | -6.011260 |
| F-statistic | Durbin-Watson stat | 2.680460 |
| Prob(F-statistic) | 0.008331 |

Dependent Variable: \(d_g\)
Method: Least Squares
Sample (adjusted): 2000 2013
Included observations: 14 after adjustments

The model results indicate that an increase in trade openness of trade with Italy brings economic growth for the country. Fdi_gdp ratio is positively related to economic growth, which means that an increase in fdi_gdp is expected to increase economic growth in
Albania. This parameter is not statistically significant. The same as it was said for fdi\_gdp variable, can be written for link between economic growth and the crisis in the region.

The contribution of services to the Albanian economic growth is negative, which means that the growth of this contribution is expected to shrink then economic growth, as long as the coefficient before the variable services\_gdp has a negative sign. The presence of European Union crisis has reduced economic growth. This is evident by the negative signs before the variable parameter crisis\_eu. Both findings are statistically significant, judging by the rate probability of the parameters.

It is very interesting to note that the index of corruption increases the Albanian economic growth and this statement is 99% statistically reliable as the signs of the coefficient before the variable ind\_corr are positive and the probability of this coefficient is less than 1%. The privatization of the financial system increased pressure on economic growth and we can say this with 99% confidence level (refer to the table for variable data priv\_sf).

Part of the health of a model is also a control associated with "sickness" of heteroscedasticity, serial correlation and autocorrelation. The three statistics that come to the aid to the heteroscedasticity investigation report his absence. So the model does not suffer from the "disease" of heteros. LM test reports that at least 95% level of security, serial correlation is not present in the model. This proves that the model is good. The fact that the autocorrelation coefficients are within the intervals, shows that he is missing. Moreover, statistics-Q probability of greater than 10% shows the lack of autocorrelation in the model.

**Conclusion**

Trade liberalization (Openness) has been hailed for positive effects on productivity, adoption and use of the best technology and the promotion of investments which are channels that stimulate economic growth. Although a considerable number of studies have explored the potential impact of trade openness on economic growth, however, it has not proved easy to try to determine the connection that these two substantial economic indicator.

So as a result of all these problems that presents the study of economic growth in Albania is applied in this paper a combination of gravitational theories model for the impact of trade on growth. The three tests reinforce the idea that the model is good and gives the right to the applicant to interpret the parameters of the variables according to the degree of reliability. According to heteroscedasticity test, serial correlation and autocorrelation we can conclude that the Albanian economic growth seen in the function of economic openness with Italy reveals that:

Openness of the economy with Italy and fdi\_gdp report a positively effect on economic growth. The contribution of the services sector in GDP has negative impact on economic growth and is reliable. It is noted in most of the years in the study while economic growth has shown an upward trend in the services sector reverse this trend has been downward.

The period when the European Union was included in the economic crisis / debt has negatively affected the Albanian economic growth. This is perhaps of the fact that most of our country’s trade is done with the European market (about 65.7%) and it was expected that this crisis could be felt on our macroeconomic indicators. The indexes of corruption together with the privatization of the financial system has a positive impact on economic
growth and are statistically significant. The variable financial institutions reform of 2004 has to do with the privatization of the Savings Bank. This reform was implemented to strengthen the fragile financial institutions in Albania and to protect the country from financial crises. According to empirical findings, the privatization of the financial system in 2004 can be considered as essential and important reform policies of economic growth in Albania, useful in almost all models EGT. So this privatization process has had a positive impact on economic growth as it helps credits and investment in banking markets.

Finally as a recommendation would say that Albania is one of the most advanced in the direction of signing the agreements but still faces a major problem it is the lack of production for export. Currently in our country there is no law or any initiative that stimulates the country's export products. Therefore in these conditions there is a need of promoting strong initiatives and investments in those branches and sectors of the Albanian economy, which have the advantages of growth and development for the regional economy. Therefore attention should focus on intensified investment in branches that favor us in the new regional market dimensions. For this, the major emergency is a new structural orientation of the economy.

References


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