TRADE INTEGRATION BETWEEN ALBANIA AND EUROPEAN UNION A GRAVITY MODEL BASED ANALYSIS

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Abstract

International trade integration of an economy is a stone for a successful economic development of a country. In the context of European Union enlargement there is a specific interest in exploring the regional trade integration of the countries inspiring the involvement in the EU. As a rather successful econometric approach the gravity model has been widely used to infer and predict substantial foreign trade flows between countries more empirically than theoretically.

The aim of this study is to examine the potential trade volume between European Union and Albania which is trying to join it in the near future. The focus of Albania is how Albania can integrate to the EU market and gather benefits from this international trade possibility to foster its economic development. Considering the previous agreements bilateral, or involving reciprocity between Albania and EU, as well as the recent status of Albania as the country favored in the international reciprocal economic exchanges, where it is verified a not very happy situation for Albania, the analyze of the situation through the gravity model, gives us some conclusions on how Albania should move in the future in this international trade process to increase its benefits. The new situation coming in the near future, in case Albania gets the status of the candidate country (acceding country), this model can help us find the most weighting variables in the increase of the benefits from the Albania-EU international trade in our favor, in favor of Albania

Keywords: International trade, Common currency, Gravity model, Trade integration

Introduction

According to Akyuz et, al (2010), the European union (EU), is the world's second largest economy; only slightly smaller than the US in purchasing power parity terms but slightly larger at the official exchange

rates. Moreover, EU is the world's largest merchandise exporter accounting for about one – fifth of the world trade as well as the largest services exporter that accounts for over a quarter of the world trade. The EU's economic importance has increased substantially since the early 1980s by increasing its number of members. Albania wanting to be economically and politically strong in the region has always aspired to enter the EU for a long time. By acting like this, Albania is aware of the fact that its benefits will be huge as EU is the most important trading partner and source for direct foreign investments. Aspiring to liberalize toward EU mean also trade liberalization with EU member states which will yield greater benefits and open the possibility of internationalization of the domestic economy and business. To this goal Albania have to get use of all its means and channels in order to enter EU market, and in the same time to get use of its neighborhood, countries already members of EU, as well as the countries in the way to EU being steps forward compared to Albania.

1.1 Albania and EU economic framework

Having a look at the history of Albania with EU we notice a very tough relationship between us and EU making the membership very challenging to us because of many reasons.

June 2006, was very significant for Albania when we signed the Stabilization and Association Agreement with the EU, an initiative taken since long time ago from EU, May 1999 for five Balkan countries – Albania, the former Yugoslav Republic of Macedonia, Croatia, Bosnia – Herzegovina and the Federal Republic of Yugoslavia. The SAA was ratified on January 2009 by the 25 EU member states of the time and entered in force on April 1, 2009.

On April 28, 2009 Albania has applied to become EU candidate country which has resulted in a very tough duty for all of us. On November 8, 2010 the Ministers of Interior of the Member States of the European Union approved the lifting of the visa regime with Albania while on November 9, 2010 in the Annual Report the Commission stated that Albania was not ready to become an EU candidate country.

| June 2014: Expected the status of Candidate Country to EU |
| 15 December 2010: Visa Liberalization with Albania enters into force |
| 28 April 2009: Albania submits its application for EU membership |
| 1 April 2009: Entry into force of the Stabilization and Association Agreement (SAA) |
| March 2008: Visa liberalization dialogue lounched |
| January 2008: The visa facilitation agreement between Albania and the EU enters into force |
| January 2007: Entry into force of the new instrument for Pre-Accession Assistance (IPA) |
| December 2006: Entry into force of the Interim Agreement |
| January 2006: Council decision on a revised European Partnership for Albania |
| June 2004: Council decision on a first European Partnership for Albania |
| June 2003: The EU perspective for WB countries is confirmed. |
| November 2000: Zagreb Summit launches SAP for 5 countries of SEE, including Albania |
| 1991: Establishment of diplomatic relations between Albania and the European Economic Community |

2. Gravity Model - theoretical perception - Common currency

Literature has discussed a lot the relationship between monetary unions and bilateral trade. This is conditioned by the situation of common currencies which other European countries have experienced well in advance compared to Albania. Studies show that monetary unions have lower inflation; promote trade and double bilateral trade.

According to Rose and Stanley the conventional gravity model can be used to account factors that drive trade and assess trade effects as below;

$$T_{ijt} = ß_1 D_{ij} + ß_2 (Y_i Y_j)_t + \Sigma_k ß_k Z_{ijt} + \Sigma_t d_t T_t + \gamma CU_{ijt} + u_{ijt},$$

Where:

Tij denotes the natural logarithm of trade between countries i and j at time t,

{ß} is a set of nuisance coefficients,

Dij denotes the log of distance between i and j

Y is the log of real GDP,

Z represents other controls for bilateral trade,

CUijt is a dummy variable that is one of countries i and j are in a currency union at t, zero otherwise,

u is a well behaved disturbance term

γ is the coefficient of interest which represents the partial effect of currency union on trade, ceteris paribus.

One of the most known and accepted effects of substituting a single currency for several national currencies is trade stemming. This results from the reduction of transaction costs because it is clearly cheaper to trade between countries that use the same currency. According to Rose (1999), currency unions do have effects on trade and this effect is big or bigger than the effect of joining a free trade area. In his study about 9 European countries having the same currency, he tried to give an answer to the following question; Do countries inside currency unions tend to trade more holding other factors constant? The estimate Rose found out is that countries with the same currency trade over three times as much with each other as countries with different currencies. So as we can conclude, engaging in a common currency stimulates the trade relationship between countries holding other thing equal. Taking this statement in mind we can suggest that Albania has one other reason of interest to join the common currency union as this will contribute in the increase of trade. This is very substantial for our economy taking into consideration the fact that we are a small economy and in need of international foreign markets.

There is also a clear and logical background of explanation about why the engagement in a common currency encourages trade. According to Rose (1999), a common currency represents a serious government commitment to long term integration which in turn can induce the private sector to engage in much more international trade. Moreover, this facilitates financial integration and foregoing the cost of hedging exchange rate risk.

Meanwhile, we can still use the same model in order to find out the increased interest of exchanging abroad, especially with EU countries, considering other factors deducting for each one of those mentioned in the gravity model of Stanley and Rose, using an approximate logics. We can deduct for distance and bilateral trade as we are at the doors of EU bordering with Italy and Greece, as well as having already signed free trade agreement with EU, both sides, export and import. Increased exchanges with EU countries can foster further the idea of applying a common currency in our

monetary system with EU area either virtual or Euro currency directly, facing the costs of application making first a comparison to the costs of application of Euro in our country, except for the fulfilment of the Maastricht Treaty on this regard. The cases of Monte Negro and Kosovo could be a useful mean to understand better the process, as well as to measure the costs.

2.1 An econometric approach – Gravity Model
    The gravity model has its origin on the Newton's Law of gravity. The bilateral trade flow between two countries i and j is proportional to the mass of labour or goods y_i, produced by the i country, attracted by a mass of demand y_j by j country, but it is inversely proportional to the distance between the two countries;

$$x_{ij} = G \frac{y_i * y_j}{d_{ij}}$$

    Where x_{ij} is the movement of goods and d_{ij} is the distance between country i and j and G is a constant. If we make an econometric estimation of the equation it comes:

$$x_{ij} = G \left(\frac{y_i{}^{\alpha_2} y_j{}^{\alpha_3}}{d_{ij}{}^{\alpha_4}} \right) \eta_{ij}$$

    Where x_{ij} represents the volume of trade between two countries i and j, y_i and y_j are the gross domestic products (GDPs) of i and j, d_{ij} is the distance between country i and j, and η represents an error term with expectation equal to 1.
    According to Anderson (2011), to estimate the equation we take the logarithms of both parts:

$$\ln x_{ij} = \alpha_1 + \alpha_2 \ln y_i + \alpha_3 \ln y_j - \alpha_4 \ln d_{ij} + \varepsilon_{ij}$$

    Here the constant G becomes part of α_1.
    The logic brings us to the fact that to sell a good there are many other possible markets, and to buy a good there are many other possible origins. So, the trade between two countries is influenced also by other alternatives they have to collaborate. Another variable is important to the equation. According to McCollum (1995), it is named Remoteness Variable (REM). The variable expresses the average distance of region i from all other partners not including j. So

$$REM_i = \sum_{m \neq j} y_m / d_{im}$$

where d_{im} is the distance between i region and m region, y_m is the gross domestic production of m region.

The first applications of the gravity model to explain trade flows are made by Tinbergen (1962) and Pöyhönen (1963), where the volume of trade between two countries is equal to the ratio of national incomes to the distance between the two countries. (Howard J. Wall Federal Reserve Bank of St. Louis July 2000)

Anderson's first researches for the gravity model (1979) tell that a country is more likely to trade with a bilateral partner, than with the ones who are more resistant to trade. He bases his theory on the term CES (Constant Elasticity of Substitution) and that the demand for the goods depend on their place of origin. Among others, a big development to the models gave Bergstrand (1985) and Deardorff (1998), who added a Hecker-Ohlin structure. McCallum (1988) treated the gravity model empirically. He proposed the following equation:

$$\ln x_{ij} = \alpha_1 + \alpha_2 \ln y_i + \alpha_3 \ln y_j + \alpha_4 \ln d_{ij} + \alpha_5 \delta_{ij} + \varepsilon_{ij}$$

Here x_{ij} is the exports from region i to region j, y_i and y_j are the gross domestic production in regions i and j, d_{ij} is the distance between regions i and j, and the dummy variable

$$\delta_{ij} = \begin{cases} 1 & \text{international} - \text{provincial trade} \\ 0 & \text{state} - \text{province trade} \end{cases}$$

Considering the remoteness variables the regression comes to:

$$ln_{ij} = \alpha_1 + \alpha_2 \ln y_i + \alpha_3 \ln y_j + \alpha_4 \ln d_{ij} + \alpha_5 \ln REM_i \\ + \alpha_6 \ln REM_j + \alpha_7 \delta_{ij} + \varepsilon_{ij}$$

Another gravity model is used by Rose (2000), which expresses the empirical form of the model. Further versions are the ones from Anderson and Wincoop (2003), who include multilateral trade resistance (MTR).

Nowadays, the gravity model trade flows between two countries is not only based on the distance and economic mass, but to estimate gravity model we should analyze bilateral trade resistance (BTR), which is the size of the barriers between two countries and also multilateral trade resistance (MTR), which are the barriers that both of the countries face in the trade with all the trading partners.

Rose (1999) used an augmented gravity model instead of the standard one in order to count for as many other factors as possible. The equation he used in his methodology is as follows;

$$ln\, x_{ijt} = \alpha_0 + \alpha_1 \ln(Y_i Y_j)_t + \alpha_2 (Y_i Y_j / Pop_i Pop_j)_t + \alpha_3 \ln D_{ij} + \alpha_4 Cont_{ij} \\ + \alpha_5 Lang_{ij} + \alpha_6 FTA_{ijt} + \alpha_7 ComNat_{ij} + \alpha_8 ComCol_{ij} \\ + \alpha_9 Colon\, y_{ij} + \gamma CU_{ijt} + \delta V(e_{ij})_t + \varepsilon_{ijt}$$

where i and j denotes countries, t denotes time, and the variables are defined as:

- Xij denotes the value of bilateral trade between i and j,
- Y is real GDP,

- Pop is population,
- Dij is the distance between i and j,
- Contij is a binary variable which is unity if i and j share a land border,
- Langij is a binary variable which is unity if i and j have a common official language,
- FTAij is a binary variable which is unity if i and j belong to the same regional trade agreement,
- ComNatij is a binary variable which is unity if i and j are part of the same nation (e.g., France and its overseas departments),
- ComColij is a binary variable which is unity if i and j were colonies after 1945 with the same colonizer,
- Colonyij is a binary variable which is unity if i colonized j or *vice versa*,
- CUijt is a binary variable which is unity if i and j use the same currency at time t,
- V(eij)t is the volatility of the bilateral (between i and j) nominal exchange rate in the period before t,
- α is a vector of nuisance coefficients, and
- ij represents the myriad other influences on bilateral exports, assumed to be well behaved.

3. Transnational bridging through immigrant entrepreneurship

The ties connecting immigrants with their countries of origin and their long distance economic relations with them have been subject of many intensive researches in immigrant entrepreneurship. One interesting but not very successful approach to look at this connection is the monetary remittances to fully measure the multiple macroeconomic effect of immigrant economic and noneconomic activity. Immigrants' social, cultural, political and economic relationship with their homeland is implicated theoretically and practically by their multiple economic effects. According to Guarnizo 2003, their activity has multiple effects not only on the global macroeconomic processes such as international trade and consumption of culture but also on the localities and countries of origin. According to Guarnizo 2003, literature review suggests four types of relations and themes studied until now related to the field of transnational living; monetary remittances, business investments, collectives support for local development and transfer into local economies of any type of knowledge that they have gained abroad.

Moreover, living a transnational life endangers two main sets of processes. The first is related to the immigrants desire to reproduce a piece of

their cultural practices and customs in order to maintain and preserve their local and national identities in the host country. This means that most prefer to live as in their country of origin by generating so demand for goods and services in the country of origin. Eating and drinking national food, trading national food and specialties, listening and dancing to the national music becomes the thing to do for many immigrant and ethnic enclaves they are part of. This demand is spread to businesses back home for which the IE is an extension of the native market with a higher purchasing power than that of conational at the origin country. This demand is a bridge for internationalization of national producers to internationalize their operation, production and quality.

This demand for products often is accompanied with demand for supportive services which also internationalize with the products, too. So, this implies that without goods internationalization ours also the transnationalisation of some services which would never have the possibility to expand with this demand generated by the immigrants. The second, is related to the maintenance of more of less stable the relations from the economic, social and political point of view. Consequently to maintain this transnational relationship alive is required a demand for transportation and communication services. For this reason, many advertising campaigns for international companies that provide this king of services, such as "AT&T, MCI, American Airlines and United Airlines have been designed to appeal to ethnic diversity and the interest in ancestral ties" (Guarnizo, 2003)

At this point we can easily see that the last version of the model[51] fits considerably enough with the case of Albania and its possibilities to internationalize towards EU countries using all the channels and counting for the factors closely linking it with EU countries to which we share borders, or other factors, here in the model considered as dummy variables. This adoption is based on the same philosophy of trade resistance. We can still rewrite the model as follow:

$$ln\ x_{ijt} = \alpha_0 + \alpha_1 \ln(Y_i Y_j)_t + \alpha_2 (Y_i Y_j / Pop_i Pop_j)_t + \alpha_3 \ln D_{ij} + \alpha_4 Cont_{ij} + \alpha_5 Lang_{ij} + \alpha_6 FTA_{ijt} + \alpha_7 Eth.Encl_{ij} + \alpha_8 Eth.Immig_{ij} + \delta V(e_{ij})_t + \varepsilon_{ijt}$$

Where:
i denotes Albania and j denotes EU countries, t denotes time, and the variables are defined as:

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[51] $ln\ x_{ijt} = \alpha_0 + \alpha_1 \ln(Y_i Y_j)_t + \alpha_2 (Y_i Y_j / Pop_i Pop_j)_t + \alpha_3 \ln D_{ij} + \alpha_4 Cont_{ij} + \alpha_5 Lang_{ij} + \alpha_6 FTA_{ijt} + \alpha_7 ComNat_{ij} + \alpha_8 ComCol_{ij} + \alpha_9 Colon\ y_{ij} + \gamma CU_{ijt} + \delta V(e_{ij})_t + \varepsilon_{ijt}$
(Rose 1999)

- Xij denotes the value of bilateral trade between i and j, Albania and EU
- Y is real GDP,
- Pop is population, (this variable fits to the quotas' model used within EU in trade exchange planning)
- Dij is the distance between i and j, which is not a very dynamic variable related to the term of trade resistance, and tents to be reduced in effect considering the progress of Albania toward EU, not basing our international trade only with the two bordering countries, Italy and Greece
- Contij is a binary variable which is unity if i and j share a land border, we share borders with Italy and Greece
- FTAij is a binary variable which is unity if i and j belong to the same regional trade agreement, which is already active between EU and Albania (Euro One and CEFTA)
- $V(eij)t$ is the volatility of the bilateral (between i and j) nominal exchange rate in the period before t,
- $Eth.Encl_{ij}$ is a binary variable which is unity if i and j have ethnic minorities (we have 'arbereshe' in the south regions of Adriatic coast Italy, and 'arvanitas' in the bordering territories in Greece)
- Eth.Immig is a binary variable which is unity if i and j have immigrant minorities
- α is a vector of nuisance coefficients, and
- ij represents the myriad other influences on bilateral exports, assumed to be well behaved

While, the other variables used in the model of Rose, are useful to calculate our possible results from the regional internationalization with the Balkan countries and Turkey, not considering the same binary variables, or calculating other ones in the case of China or other countries members of TO, which are listed below:

- Langij is a binary variable which is unity if i and j have a common official language,
- ComNatij is a binary variable which is unity if i and j are part of the same nation (e.g., France and its overseas departments),
- ComColij is a binary variable which is unity if i and j were colonies after 1945 with the same colonizer, (Albania and Turkey, or Albania and Italy on the Second World War)
- CUijt is a binary variable which is unity if i and j use the same currency at time t.

4. Findings

Diminishing production and marketing costs in order to increase our competitive advantage in the international market, has already shown to be a weakly yielding approach to the Albanian economic growth, as we have not the most attractive cost oriented products to the international market, as well as for the FDI oriented to better production conditions costs. As the table 1 shows[52], we find weak possibilities relying on cost approach.

	Labor cost per production unit KPNj [53]	RUEC (%) [54]	Inflation of Import Prices (%)	Index of Prod. Prices / Costs [55] (%)	Average structure of capital Ind/Agr [56]	Public Debt cost (%)	Inflation Rate [57] (%)	Interest Rate of credit (ALL) (%) [58]	Education Cost per hour of teaching (Euro) [59]
Score	-3.9%	-4.7	> 5 [60]	2.2 / 3.3	5 < / 2.3	4.3	3.0-4.5%	10-15	26-65

The weak weight of export in the trade balance, which is still strongly in favour of import on 2011, 2012 and even more increased on 2013, even why an elections' year, show for a low competitive power of Albanian economy in the international market and a strongly negative trade balance of payments.

As for the Albanian immigrants to be considered another possibility to internationalization of the Albanian economy regionally and in EU market we can notice, that they are mostly involved in sectors widely not preferred by locals, both socially and due to low profits, not based in their competitiveness or attractiveness to the international market. Their support to sustain and foster internationalization is still latent.

They have matured a long experience in the foreign market due to their living and working, increasing their human capital working, learning by

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[52] Ilir Bejtja, *Regional and international market - adventure or possibility to develop faster*, 2012

[53] Report of monetary policy on the first trimester 2012, Bank of Albania, pp. 51. Graf. 41

[54] Rate of Use of Economic Capacities, Report of monetary policy on the first trimester 2012, Bank of Albania, pp. 55, Graf. 46

[55] Report of monetary policy on the first trimester 2012, Bank of Albania, pp. 52, Graf. 42

[56] Averaged figures using two samples of businesses in industry production (137 firms) and agriculture production (50 agr. and 50 livestock farmers) at the Region of Elbasan

[57] Report of monetary policy on the first trimester 2012, Bank of Albania, pp. 23, Graf. 10.

[58] Data averaged by different interest rates used by the second tier banks in Albania on 2011

[59] Higher Education in Albania, Wages Categorization System in Albania, public sector (averaged)

[60] January - February, Report of monetary policy on the first trimester 2012, Bank of Albania, pp. 53

doing, as well as through education, mostly professional in several training courses and other educational programs.

Also, improving their standards of living and endowing EU standards related to social life, they have increased their social capital and then, were addicted to their entrepreneurial capacity and capital, more skilled especially managerial.

A considerable number of immigrants recently have started their own businesses, using their own financial capital and only (33%)[61] have taken use of the financial system (banks and credit institutions). They also confirm that most of their employees are relatives or co-nationals.

It is important to consider the fact that more than (90%) of the Albanian immigrant entrepreneurs working in Italy sell their products and services in the local market, Milan or Italy, and only (8.3%) sell in the international market, mostly EU. This is a good promise they can serve to this market Albanian products too. But it is important to know in the case of the Albanian immigrants in Italy that they are inbound oriented and it is still early to consider they can establish an international Albanian immigrant network, regionally or in EU. They are not organized or institutionalized as an immigrant community within EU. But, the fact that almost (90%) of their principal customers are Italians, and (8%) are other immigrant groups than Albanians shows for an important role they can play internationalizing Albanian genuine products and services to this customers.

Almost (82%) base their success in the quality of their products and services, (73%) count for the good image gained among the customers, (54%) have established intimate relations with their customers and are flexible to their needs and wants, and only (27%) see their success based on the competitive low prices. Meanwhile, they do not widely suffer competition by the Italian competitors which still tells that the Albanian immigrant entrepreneurs operate in sectors or industries not too much preferred by the locals, not enjoying the same prestige in the market. This certifies for a still low social inclusion and integration of the Albanian immigrants in Italy and EU[62].

Almost (80%) of them ask for important information on new partners for their business to their co nationals (not parents) and (60%) of them ask to the Italian resources of information.

More than (80%) of them have relations with other co national entrepreneurs, and (89%) of them are collaborative and cooperative relations.

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[61] Elvira Fetahu and Ilir Bejtja, *The involvement of Albanian immigrants in entrepreneurship as new possibility on the integration in the international labour market - their role in transnational bridging for home made products*, 2013
[62] The same resource with 'footnote 11'

While (90%) of them have business relations with Italians and almost all of them partnership relations.

Only (19%) of them have business relations with their home country entrepreneurs and all of them to intermediate for their entry and vending in Italy.

(37.5%) of them are members of Albanian cultural associations, (62.5%) are members of Italian associations of category, and (25%) participate in Italian cultural associations.

Albanian immigrant entrepreneurs are still far of thinking to bridge transnational and to benefit from this, even they claim for shorter international marketing channels, operating with lower tariffs for intermediation and for lower costs of operation.

Albanian immigrants in Italy and other EU countries strongly emphasize that their involvement in entrepreneurship can improve their social inclusion and status among local community.

We find that Albanian immigrants have strongly influenced in the national orientation of our economy toward EU, as well as our life style and consumption is impacted by the European environment. It shows for strong gravity relations Albanian people have toward EU community.

5. Conclusion

The economic patterns installed in Albania have been strongly influenced and still are oriented to the foreign request coming from abroad, especially and notably addicted to the EU community, represented in Albania, both in production and trade, by the Italians and Greeks.

Increasing trust at meso- and macro-level, increasing ties with alters (Italians, Greeks or other partner groups in business) and reinforcing ties with egos, Albanians abroad and in their home country, can strongly impact on their success in business and economic development too. This is a good promise for internationalization of the Albanian economy.

As we find that not just cost control can be our key for the success in international entrepreneurship initiatives, increasing skills and quality, as well as being informed and updated to the new initiatives and generally to innovation are strong points of force in our international marketing perspective success.

Political regulations to be submitted and completed in Albania fostering immigrant transnational bridging can enhance foreign interests in Albanian products and can foster their introduction in the international market, creating whereas the Albanian Trade brand of entrepreneurship. An increasing number of Albanian immigrant entrepreneurs have already registered their subsidiaries in Albania showing for their increased interest in their new role of ethnic transnational marketing channels.

There are also three main directions, other than cost options, we can rely in order to gather competitive advantage; product leader, operational excellent firm and customer intimate firm. Maximizing performance through good combinations of this means, we can be secure in a future positive result related to internationalization of our economy abroad, especially in the region and in EU.

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