

Albania: Trade Impact of CEFTA

IN FOCUS



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Abstract

Regional free trade agreements (FTAs) have a sizable effect on exports and foster economic growth. While reducing tariffs in member countries, regional FTAs harmonize trade policy across regions and reduce regulation uncertainty for exporters. They are particularly important for supporting trade in isolated countries such as Albania, a transition economy in the Western Balkans. This policy note looks at the impact of membership in the Central European Free Trade Agreement (CEFTA) on Albania's export growth. It finds that Albanian exports to CEFTA members have grown much faster than its exports to other countries. A large share of this growth is contributed by firms that did not export to CEFTA countries previously and via new exports that were among the least traded to CEFTA countries. We also measure the impact of CEFTA on Albanian exports using a gravity equation, which finds that CEFTA increased Albanian exports to member countries between 34 percent and 144 percent.





Evolution of Albanian Exports to CEFTA Countries

CEFTA, founded by Hungary, Poland, and former Czechoslovakia in 1992 in an effort to liberalize their economies, designates a free trade area in the Central European region. It is considered a preparatory tool for signatory countries' EU accession (Dangerfield, 2006). At present, CEFTA is composed of seven countries: Albania, Bosnia and Herzegovina, FYR Macedonia, Kosovo, Moldova, Montenegro, and Serbia. Prior to joining CEFTA in 2006, Albania had ratified bilateral agreements with CEFTA member countries that covered agricultural and manufactured goods tariff reduction and other essential WTO norms. The 2006 CEFTA provided additional coverage in areas like trade in services and investment law. Because its policy coverage is more uniform than that of bilateral FTAs, CEFTA is considered a more efficient tool to promote trade in the region (Adam et al., 2003).

Figure 1 shows the growth of Albanian merchandise exports to CEFTA and other countries in the period 2006–2016.¹ Albanian exports to CEFTA countries (solid blue line) have increased more than fourfold, despite a sharp drop in 2009 due to the global financial crisis. CEFTA countries' share in Albania's export portfolio grew from 7 percent in 2006 to 14 percent in 2016. Albanian exports to non-CEFTA countries (black dash line) grew to only twice their initial value.

The growth of Albanian exports to CEFTA countries may be driven by two factors: an increase in the number of Albanian firms exporting to CEFTA countries or an increase in the value existing exporters' trade, including cases wherein existing exporters export new products to CEFTA member countries, export to a new CEFTA country², or increase the value of products that they were already exporting to a CEFTA country.

Table 1 shows the breakdown of Albania's export growth to CEFTA countries. Exports to CEFTA countries grew every year except 2009,³ and increased by a total of \$369 million from 2004 to 2012. Year to year, higher volumes in existing operations contributed more to export growth than the entry of new firms and new products onto export markets. The median year-to-year contribution of existing operations is 70 percent. Median year-

Additional clauses covered by CEFTA:

- Liberalization of trade in services (GATS)
- Competition policy consistent with the Treaty on the Functioning of the European Union (Treaty of Rome) and related Regulations and Directives
- Investment policies
- Required ratification of a series of intellectual property-related agreements.

¹ To facilitate comparison across group of countries, we compute exports as an index, setting a 100 value for 2006.

² For example, when an Albanian firm that previously exported only to FYR Macedonia begins to export to Serbia.

³ Amounts are in US dollars.

Figure 1. Albanian Exports to CEFTA vs Rest of World

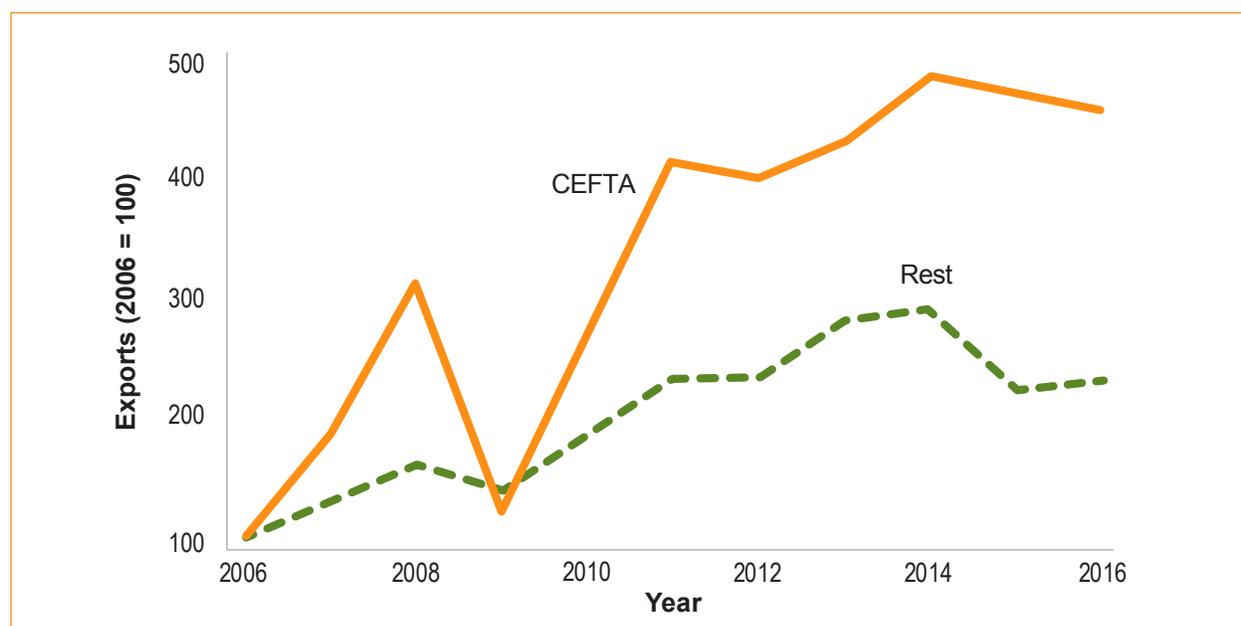


Table 1. Breakdown of Albania's Export Growth to CEFTA Countries, 2004–2012

Period	Total Change in Export Value (USD)	Change in Value Due to New Exporters (USD)	Change in Value Due to New Export Operations (USD)	Change in Value Due to Growth in Existing Operations (USD)	New Exporters' Contribution to Total Value Change (%)	New Export Operations' Contribution to Total Value Change (%)	New Products and Firms Contribution to Total Value Change (%)	New Products and Firms Contribution to Total Value Change (%)
2004–2005	4,879,049	2,081,984	-2,565,379	5,362,444	42.67	-52.58	-9.91	109.91
2005–2006	2,584,708	3,598,527	-5,229,200	4,215,381	139.22	-202.31	-63.09	163.09
2006–2007	36,754,689	9,446,817	4,531,372	22,776,500	25.70	12.33	38.03	61.97
2007–2008	65,995,483	12,018,411	5,638,092	48,338,980	18.21	8.54	26.75	73.25
2008–2009	-6,295,336	12,406,677	1,584,409	-20,286,422	-197.08	-25.17	-222.25	322.25
2009–2010	64,685,754	7,891,745	14,102,387	42,691,622	12.20	21.80	34.00	66.00
2010–2011	152,064,239	32,015,053	21,770,562	98,278,624	21.05	14.32	35.37	64.63
2011–2012	48,264,336	-1,785,840	37,277,603	12,772,573	-3.70	77.24	73.54	26.46
2004–2008	110,213,929	2,933,8407	5,462,101	75,413,421	26.62	4.96	31.58	68.42
2008–2012	258,718,993	96,638,752	88,937,385	73,142,856	37.35	34.38	71.73	28.27
2004–2012	368,932,922	239,618,160	21,178,191	108,136,571	64.95	5.74	70.69	29.31

to-year contribution for new products and new exporting firms is 30 percent, of which the median contribution of new exporters is 20 percent and of new export operations, 10 percent.

We broke the period 2004-2012 down into two components, 2004-2008 and 2008-2012, in order to compare Albania's export performance pre and post CEFTA. In the 2004-2008 period, growth in existing operations contributed more than diversification into new products and markets. With CEFTA in force, the contribution of new products and firms was much larger than the contribution of existing operations, with new exporters' contributions slightly larger than the contribution of new products. CEFTA appears to have encouraged more firms to become exporters; some of these new firms increased the value of their exports very quickly. New exporters' contribution to Albanian export growth over the eight years in which CEFTA has been in force is remarkably larger than is the case in other CEFTA member countries.

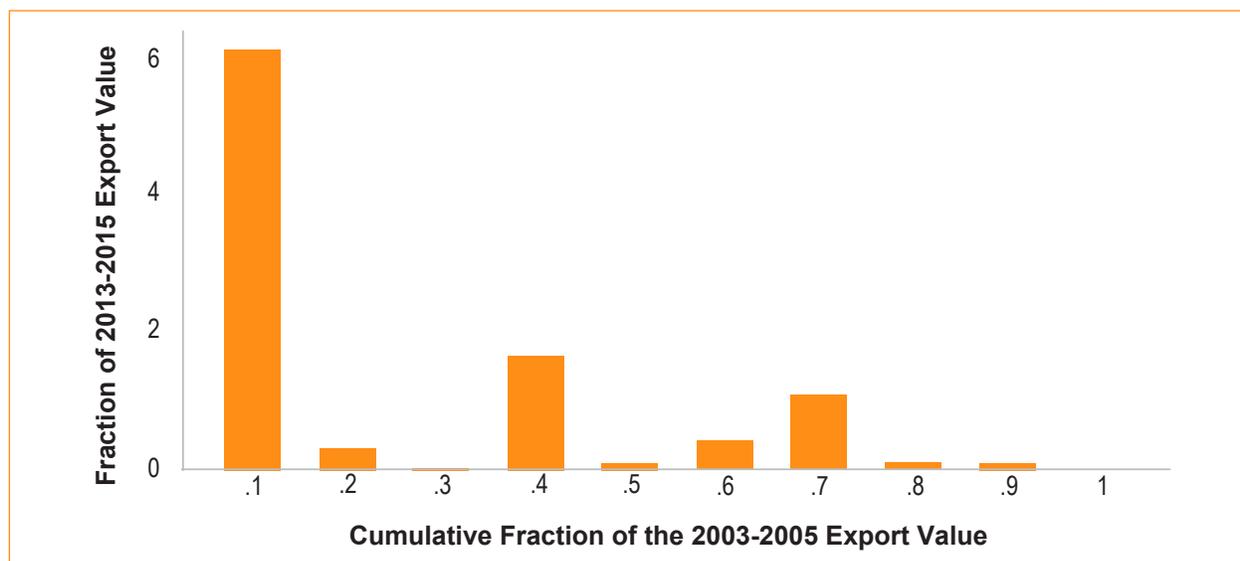
To discover which export products experienced the greatest growth, we sorted Albania's export products into deciles and compared each set's share

of value before and after ratifying the agreement (Figure 2). The bottom decile of traded products, pre-CEFTA, came to represent 62 percent of exports to CEFTA countries post CEFTA. Most of these products (5,081 out of 5,114) originated in the least-traded products category.⁴ These results confirm the finding by Kehoe and Ruhl (2013) that regional trade agreements open the way for trade in previously untraded goods.

Effect of CEFTA Membership on Albanian Exports

Using 1996-2016 COMTRADE data, we estimated a gravity equation for two scenarios, the first of which estimates the impact of CEFTA over and above that of the bilateral FTAs it replaced, and the second of which captures the full effect of free trade agreements in the region by treating CEFTA as an extension of the bilateral FTAs. We find that signing CEFTA had a positive effect on Albania's exports, even when controlling for the effect of the bilateral FTAs it replaced. Notably, joining CEFTA increased Albania's exports to these countries by 34 percent. Signing the CEFTA increased Albania's export to Bosnia and Herzegovina by a factor

Figure 2. Export share of product sets pre and post-CEFTA signing.



⁴ 4,845 products had a zero-export value before the CEFTA agreement was signed.

six and more than doubled the value of Albanian exports to Serbia and Montenegro, but had no effect on Albania’s exports to Macedonia and Moldova.

According to the second estimation, in the absence of previous bilateral FTAs, CEFTA would have multiplied Albania’s exports to member countries by 2.4 (144 percent). This coefficient is larger than the mean 0.59 coefficient reported by Head and Mayer (2014) for regional trade agreements, which suggests the importance of trade agreements for historically isolated economies like Albania. Whilst the bilateral FTAs helped grow Albania’s exports, CEFTA had an additional positive effect, suggesting that a uniform trade agreement across the region encourages even stronger export growth.

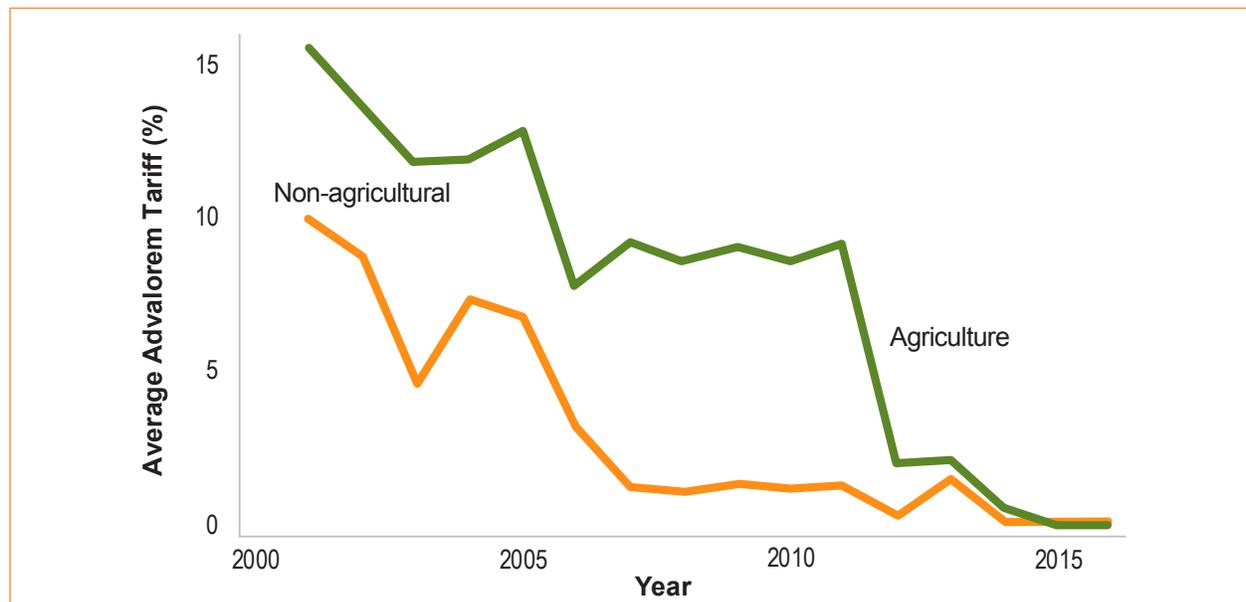
Tariff Reduction as a Driver of Export Growth

Figure 3 shows the evolution of the average tariff imposed on Albanian imports by CEFTA member states. In the early 2000s, Albanian imports were subjected to tariffs of around 15 percent in FYR Macedonia, 14 percent in Serbia and Montenegro,

6 percent in Bosnia and Herzegovina and 5 percent in Moldova. These tariffs then declined in all CEFTA countries, especially from 2007 onwards. By 2016, tariffs on Albanian imports were zero or nearly zero in all CEFTA countries. Until 2015, tariffs on Albanian agricultural products were higher than on non-agricultural products; agricultural tariffs also persisted longer than tariffs for other goods (Figure 4).⁵

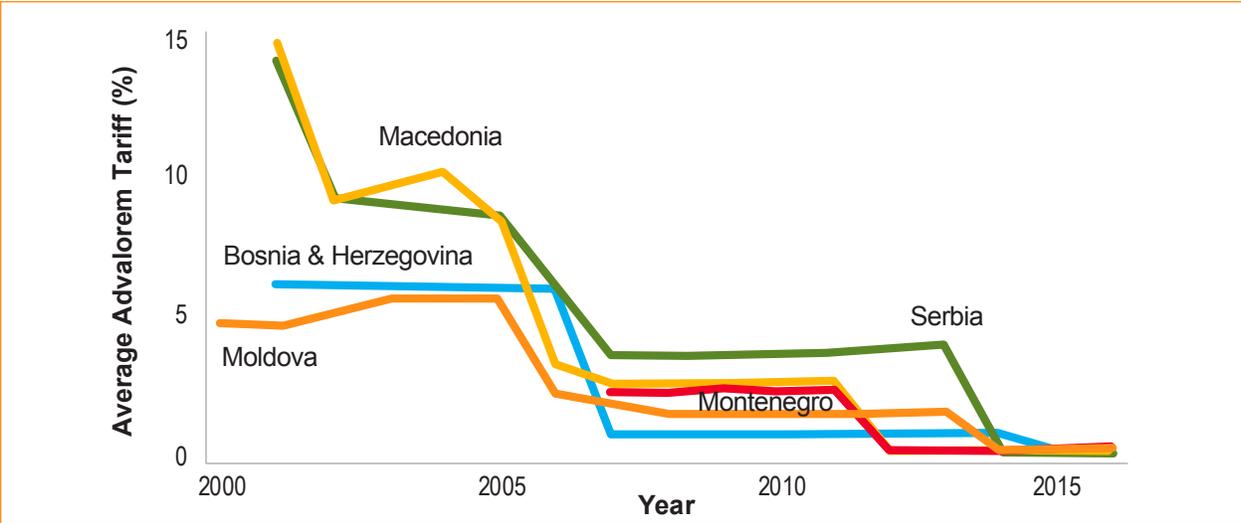
We assess whether the change in tariffs led to a change in the value of imports from Albania in the years 2001 to 2016, controlling for import destination, industry, and year effects. Regression results indicate that the reduction in tariffs led to a significant 525 percent increase in Albanian imports to CEFTA countries over the entire period of analysis. The average tariff imposed by CEFTA countries on Albanian imports fell from 10.49 percent in 2001 to 3.76 percent in 2006, the year before the CEFTA went into force. We estimate that CEFTA countries increased their imports from Albania by 188 percent after 2006, suggesting that the harmonized CEFTA policies further increased trade between CEFTA member countries.

Figure 3. Evolution of Tariffs on Albanian Goods



⁵ We define agricultural products as goods listed in the Harmonized System classification 2-digit chapters 1 to 15.

Figure 4. Tariffs on Agricultural vs Non-agricultural Products



Policy Implications

The results of this study show that regional trade agreements can be an effective tool for promoting trade between member countries, in terms both of absolute value and of attracting new export products and exporter firms. Albania’s exports to CEFTA countries have increased more than fourfold since the agreement was signed in 2006; a large share of this growth was attributed to Albanian firms that did not previously export to CEFTA countries and to products that were among the least traded before the regional trade agreement came into force. A diversified export base, such as that developing in Albania, provides stable export revenues that can weather price fluctuations (IMF, 2014) and increases export growth (Bernard et al, 2009).

Our gravity model showed that CEFTA increased the value of Albanian exports by 34 percent if we codify the FTAs that preceded the CEFTA as active, and by 144 percent if we codify them as extinct, suggesting that upgrading to a regional agreement gave Albania’s export performance an additional push.

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