

## Macroeconomics Policy and the European Union Accession: Albanian Case

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**Abstract:** The purpose of this paper is the analyze of the Albanian macroeconomic situation, its developments and policies through the challenging way to the EU accession. Albania was the last of the central and eastern European countries to embark on democratic and free market reforms. Although it might be early to say that everything was done in the proper way to establish the new market economy, Albania is seriously involved in this transformation and has the chances to join Europe, and furthermore the worldwide economic community. Albanian's economic performance shows success story with many ups and downs. Even though Albanian economy has improved substantially over years and outperformed many other countries in the Balkan region, according to major income indicator we still remain the poorest country in Europe. Trying to be part of EU, Albania still has to perform many structural reforms with macroeconomic and fiscal frameworks. A long way in reducing macroeconomic imbalances such as external deficit and the high unemployment rate but also following a prudent monetary policy by reaching and maintain price stability and strengthening the surveillance of financial system. It will be concluded that the developments of Albanian economy to fulfill the EU conditions, even though in difficult situations, will lead on a proper way to the important goal, the EU accession, but would have the positive impact on Albanian growth. This paper is based on real and official data taken from INSTAT and World Bank, which will be theoretically analyzed and it will take place also a regression analyze.

**Key words:** Macroeconomic policy, economic growth, EU accession, GDP.

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### Introduction

The EU accession is one of the most important points of the Albanian government agenda. The relations of Albania with the European Union started from 1991 and it was 2006 when the country was part of the Stabilization and Association Agreement (SAA), which made more serious this relation and motivated the Albanian government to work for more (Hoffman, 2005).

On 1<sup>st</sup> April 2009 Albania joined the NATO (NATO Newsroom, 2009). After this important date for Albania the application for the EU accession was easier and the new status had its advantages.

In this paper are analyzed the macroeconomic indicators of Albania, by offering an overview of the situation and the attitude or trend of these indicators. After the presentation of the criteria of EU, this paper will introduce some of the macroeconomic effects and how is positioned Albania nowadays from the EU.

The regression analyze will be based on official data taken from the World Bank webpage and will analyze the relation of the GDP growth and the foreign liabilities of Albania. How do these indicators have fluctuated and do they have any relation or do their relation indicate something for the economy of Albania.

### Literature Review

In relation with the regression analyses of this paper and its results, the review of the foreign literature shows somehow the same situation of the GDP and the external debt for other countries, of course euro area countries, as the Albanian goal is reaching that position.

According to the study made from Dias (2010) on the external debts of the euro area it was concluded that the last decade was associated with an increase in gross external debt in most of the world's economic areas, including the euro area. This increase was partly driven by higher financing needs of governments in response to the crisis and by heightened global risk aversion on the part of investors. In the years immediately prior to the financial crisis, global financial innovation in debt instruments and the further deepening of global financial integration contributed strongly to the growth of external debt. Although the euro area has a growing gross external debt, it remains, on balance, an economic union with solid fundamentals concerning its net external debt and net interest payments.

Checherita and Rother (2010) studied on the relation and the impact of the government debt on the economic growth and this analysis found evidence for a non-linear impact of public debt on per-capita GDP growth rate across twelve euro area countries over a long period of time starting in 1970. This means that a higher public debt-to-GDP ratio is associated, on average, with lower long-term growth rates at debt levels above the range of 90-100% of GDP.

Empirically, a large part of the debt increases of the past decades are related to higher public consumption and transfers. Yet, government budget deficits are found to be linearly and negatively associated with the growth rate of both real and potential output. The fact that the change in the debt ratio and the budget deficits are linearly and negatively associated with growth (and with the long-term interest rates) may point to a more detrimental impact of the public debt stock even below the threshold. Hence, targeting a higher debt level to support growth is not a policy option.

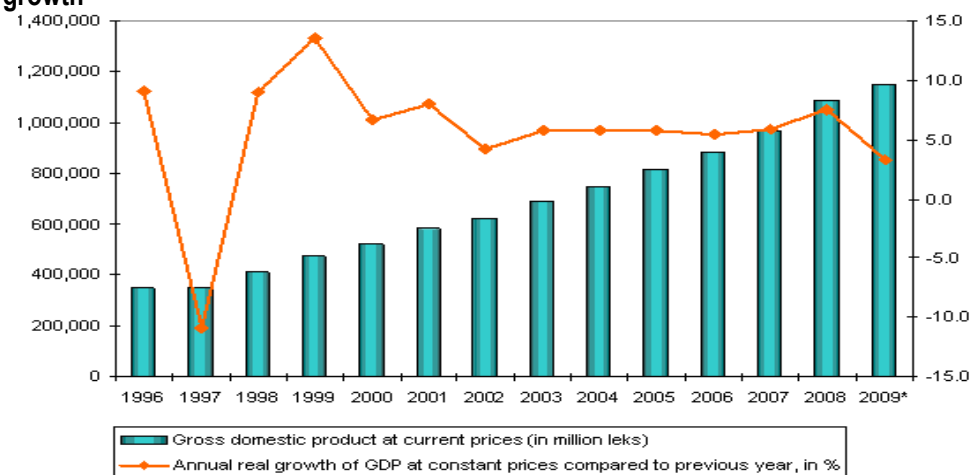
### Macroeconomics Indicators

Based on official data of INSTAT, Bank of Albania and IMF reports below are showed the trends of the 4 most important macroeconomic indicators of the Albanian economy.

#### GDP growth

Gross Domestic Product has an effective growth or increase from year to year. This shows how the macroeconomic policies have been through stabilizing attitudes. The macroeconomic environment seems very favorable for the period 2005 – 2008 as it is shown from a strong GDP growth averaging about 6.3 percent annually (Chart 1). "Albania has seen rapid economic growth over the past decade. Once labeled as the continent's poorest country, Albania has been one of the fastest-growing economies in Europe, enjoying annual real economic growth rates of around 6 percent over the last decade. Today, with a GDP per capita of US\$3,836, Albania is a lower middle-income country." (World Bank)

Chart 1. GDP growth

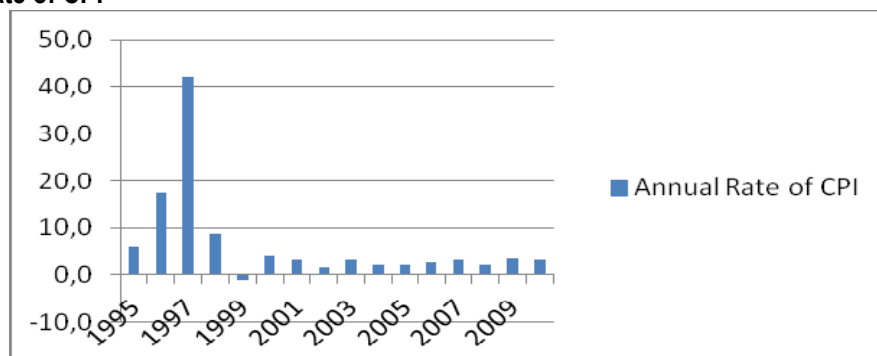


Source: INSTAT, ([www.instat.gov.al](http://www.instat.gov.al), accessed: 12/12/2011).

#### Inflation

According to the last data taken from the INSTAT, the chart below shows the annual rate of the CPI, by which can be understand the fluctuations of the inflation for the period of 1996 to 2010 in Albania (Chart 2).

Chart 2. Annual rate of CPI



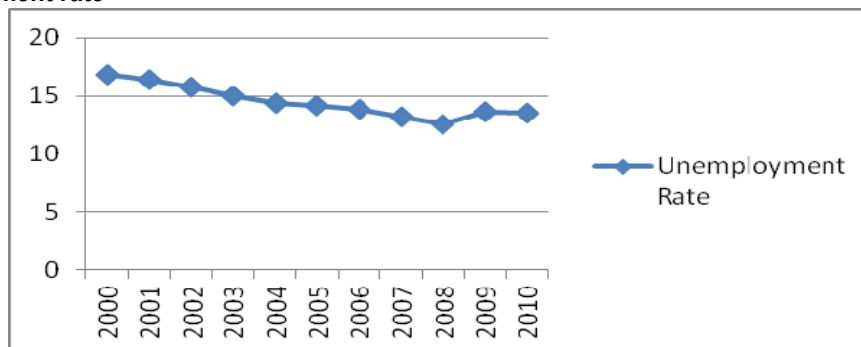
Source: INSTAT, ([www.instat.gov.al](http://www.instat.gov.al), accessed: 12/12/2011).

It can be observed that the CPI annual rate has been in an increasing motion for the first years showed, the highest rate date the 1997 year, and then the rate has been decreased till 1999 having the lowest level. The other years are just under some slight fluctuations. For the last period can be observed the changes of the CPI from the decrease of 2008, it can be observed the increase of 3.7 for the 2009 and a percentage of 3.4 for the 2010 year.

### Unemployment

According to the data taken from INSTAT, the chart below shows the movement of the unemployment rate in years from 2000 to 2010 in Albania (Chart 3).

**Chart3. Unemployment rate**



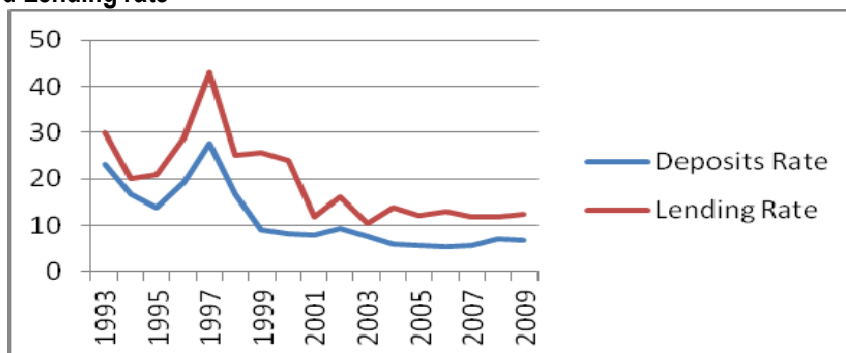
Source: INSTAT, ([www.instat.gov.al](http://www.instat.gov.al), accessed: 12/12/2011).

This graph shows the unemployment rate for Albania. It can be seen the positive decrease of the unemployment rate in Albania from 2000 to 2008, and in this trend of years the decrease is considerable. After 2008 is observed an increase of the unemployment rate approximately with one percent, from 12.5 to 13.6 for 2009 and 13.5 for 2010.

### Interest rates

According to the data taken from INSTAT, the chart below shows the fluctuations of the deposits and lending rates from the 1993 to 2009 in Albania (Chart4). It can be observed the year 1997 where both rates have been in a high increase and after that year the rates have decreased to 16.5 and 25 respectively. In the coming years the changes in rates have been slight till the 2009 where they have been 6.8 and 12.5 respectively.

**Chart 4. Deposit and Lending rate**



Source: INSTAT, ([www.instat.gov.al](http://www.instat.gov.al), accessed: 12/12/2011).

### Macroeconomics Policy

Macroeconomic Policy main indicators are strongly related to the monetary policy, which for Albania is designed, controlled and being implemented and investigated from the BoA. Its main objective or goals will be more detailed explained in the sections below.

### Objectives of macroeconomics policy

According to economic literature, (Mankiw, 2006), the objectives of macroeconomics or also known as categories which measure and estimate macroeconomic performance of a national economy:

1. Stable growth of GDP,
2. Stable level of prices,
3. High employment levels,

For achieving these objectives macroeconomic instruments are used. Same policy works also for Albania, a transition economy, which basically works for stabilization. Albania needs to achieve and maintain the stability of the macroeconomic policies. The targets obviously are the main criteria of the EU accession. Regarding to their economic criteria through targeting the Albanian macroeconomics policies has been in the proper levels, as also mainly observed in the previous section.

### Tools of macroeconomic policy

The most important and functional tools or instruments of the macroeconomic policy in Albania are the fiscal policy and the monetary policy. The report of the World Bank of 2010 year, in regard to Albania, showed that the last decade had a stable growth of the macro-economic frame work. The successful growth of Albanian for the past ten years has been in a linear motion and maintained the 6 percentage of growth, while having a stable inflation, interest and exchange rates. There has been a structural transformation that gave these results; it was the change or movement of the labor from the low productivity agriculture activity to services and construction, to manufacturing. The increase in employment was not matched with the growth of the economy. "The Albanian economy grew by 3.4% in 2011, following the 3.8% growth in 2010. Average inflation was 4.05% for 2011 Q1 period, 0.05 percentage points above the Bank of Albania's upper limit."

"Given the recent fiscal expansion, Albania needs to return to the more prudent fiscal policy that served the economy very well between 2002 and 2007. However, the sharp increase in the overall deficit (and reduction in public saving) in 2009, resulting in a level of debt nearing 60 percent of GDP have raised concerns about the fiscal framework, particularly in the absence of a new IMF program to provide an anchor for fiscal policy since the successful completion of the last program in 2008. Given the uncertainties in Europe and the capital markets, Albania needs to move quickly to withdraw the recent stimulus, consolidate its fiscal position, increase public saving and begin to reverse recent increases in public debt. It should be noted that Albania, with Bank support, has made important strides in strengthening its institutional capacities for debt management, in time for its graduation from International Development Association (IDA) and its entry into the international capital markets. Without the anchor of a credible fiscal policy Albania would be at the risk of higher financing costs and uncertain availability of finance, which may increase macroeconomic volatility." (BoA)

### The EU Accession

The EU accession is the basic goal of the Albania, as other Eastern countries too. As it is mention also above the accession is a long period where each country should work hard in order to meet the criteria asked from the European Union.

### Copenhagen/Madrid criteria for EU accession

Any country seeking membership of the EU must conform to the conditions set out by Article 49 and the principles laid down in Article 6(1) of the Treaty on European Union. Relevant criteria were established by the Copenhagen European Council in 1993 and strengthened by the Madrid European Council in 1995.

To join the EU, a new Member State must meet three criteria:

- political: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- economic: existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union;
- Acceptance of the Community acquires: ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

For the European Council to decide to open negotiations, the political criterion must be satisfied. Any country that wishes to join the Union must meet the accession criteria. The pre-accession strategy and accession negotiations provide the necessary framework and instruments (Summaries of EU legislation).

### Macroeconomic effects

The EU accession is a process that takes a long time to be achieved from the countries and, of course it holds many effects. Expecting positive effects to be immediate, is what any country face, but the fact is that any economic, or macroeconomic effect is observed after some considerable time. The economic growth, the advances in technology or knowledge, the change in foreign trade etc are effects of the EU accession but that takes a long time ahead.

The direct effects are mainly observed in the policy changes a country takes through. For example Slovenia, it did have a direct effect on the changes in the trade regime policies. "Change in the trade regime meant adoption of the EU common trade policy, which for Slovenia implied an elimination of residual customs duties for some sensitive agricultural imports from the EU, a lifting of customs formalities with the EU and a termination of Slovenian free trade arrangements with some former Yugoslav countries." (Lavranc and Majcen, 2006).

There are some macroeconomic effects that can be identified from the EU integration. Firstly is observed the trade effect, due to the removal of the remaining trade barriers between the accessed country and other EU countries. "The trade creation effect can clearly be expected to dominate as empirical evidence of the previous EU enlargement rounds the increase in the international trade brings about a transfer of knowledge in the new accessed country." (Baldwin and Venables, 1995).

Another effect is the increase of the Foreign Direct Investments (FDI), as the trade barriers are removed the foreign trade is freer so the number of foreign investments will be increased.

"Due to increased competition, price mark-ups, difference between production costs and retail prices can be expected to decline. Thus, the inflation rate will be temporarily lower, and the price level will be permanently lower than without EU accession." All countries that enter or access the European Union would be a net-recipient of transfers of from the EU structural funds.

"On the negative side, the wage gap to the incumbent EU Member Countries, at least the EU15, can be expected to lead to net emigration from the new accessed country. To the extent that highly qualified workers leave the country, this "brain drain" exerts adverse effects on the country economy. In part, this effect will probably be mitigated by temporary labor market restrictions of the incumbent EU countries." (Weyerstrass, 2008).

### Economic policy-making in the EU

According to any decision and any rule or regulation of the EU, a state that is being part of the European Union must "obey" the Union rules and its economy must be policed by the EU regulations decided from the Member States and their Councils. Upon EU integration, every country accessed on EU will participate in the European Union fiscal and monetary policy-making framework (European Union).

*Price stability.* The inflation rate of a given member state must not exceed by more than 1½ percentage points that of the three best-performing member states in terms of price stability during the year preceding the examination of the situation in that member state.

*Government finances.* In practice, the European Commission, when drawing up its annual recommendation to the Council of Finance Ministers, examines compliance with budgetary discipline on the basis of the following two criteria:

- Annual government deficit: the ratio of the annual government deficit to GDP must not exceed 3 percent at the end of the preceding financial year.
- Government debt: the ratio of gross government debt to GDP must not exceed 60 percent at the end of the preceding financial year.

*Exchange Rates.* The member state must have participated in the European Exchange-Rate Mechanism (ERM II) without any break during the two years preceding the examination of the situation and without severe tensions. In addition, it must not have devalued its currency on its own initiative during the same period.

*Long-term interest rates.* The nominal long-term interest rate must not exceed by more than 2 percentage points that of, at most, the three best-performing member states in terms of price stability (that is to say, the same member states as those in the case of the price stability criterion). The period taken into consideration is the year preceding the examination of the situation in the Member State concerned.

As the Treaty on European Union laid down only quantitative criteria for the adoption of the single currency, without setting out a budgetary policy to be followed after the change to the euro, the member states judged it necessary to adopt a Stability and Growth Pact (SGP).

### **Recent Albanian position according to EU**

According to the transition report of the European Bank for Reconstruction and Development of 2011, Albania is positioned in as an economy that continues to grow but in a slowed motion. Real GDP is increased to have expanded in 2010 by 3.8 per cent, the highest growth rate in south-eastern Europe for the second consecutive year. The largest contributor to growth was the strong export performance, in particular in the energy sector. The current account deficit narrowed to around 12 per cent of GDP in 2010. More recent macroeconomic figures in the first half of 2011 point to a deceleration in economic activity, in particular in light of a weakening performance in some key EU markets, such as Greece and Italy. Trade activity continues to remain strong but remittances, a vital source of income for many Albanians, have dropped, and this is expected to weaken domestic demand in the coming year. The inflation rate, in line with regional trends, accelerated throughout 2010 and peaked in early 2011, but had fallen by the middle of the year (EBRD)- Fiscal policies have become more prudent in recent years. The 2010 budgetary deficit reached 4.2 per cent of GDP and was partly financed by a debit €300 million Eurobond that the authorities successfully placed in October 2010. The economy is expected to slow further in 2011 and 2012, as the debt crisis in the key European markets unfolds. Negative contagion effects have so far been limited, but Albania's close trading and investment ties to neighboring Greece and Italy may affect the real economy in the short term. The banking sector has so far remained resilient to the crisis and private sector credit growth has resumed in the past year. However, with Greek banks accounting for more than 35 per cent of total banking assets, and a high level of euronisation in the economy, strong policy actions are required to support the banking sector (EBRD, 2011).

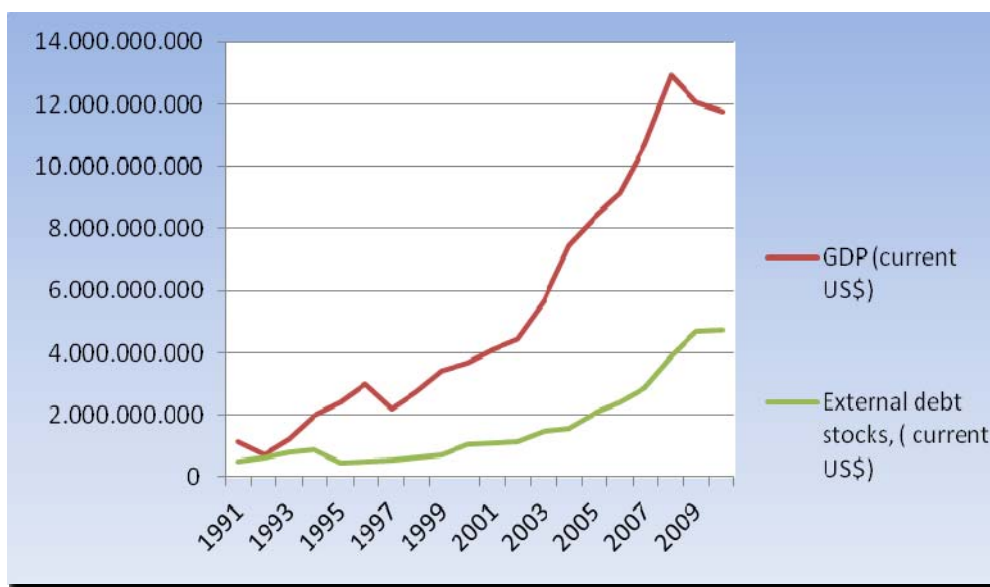
Albania's progress towards integration into the European Union has been halted in the past year. In November 2010 the European Commission published its opinion on Albania's application for membership of the EU. The opinion did not recommend that Albania be granted candidate status. It noted the need for further progress towards meeting the membership criteria and particularly the Copenhagen political criteria concerning governance and the rule of law. The October 2011 report noted the need to make considerable and sustained efforts in all areas identified in last year's Opinion. However, in December 2010 Albania (along with Bosnia and Herzegovina) was granted visa-free access for its citizens to the Schengen Zone (EBRD 2011)

### **Data and Methodology for Regression**

#### **Database for Regression**

The data for the regression analyses is based on the official data published from the BoA reports, and also the database that the World Bank has published for the Albania. The regression analyze will be based on analyze of the relation or correlation of two basic economic indicators for Albania which are the current GDP growth and the total external debt of Albania as a country.

The data are shown in the Chart 5. The data used are from 1991 year to 2010. Methodology used deals with the linear regression, for which it is needed a dependent variable which is the current GDP growth in US\$, and the independent variable which is the total external debt of the Albania (in US\$) for the years mentioned. So the idea of using this methodology consists on the conclusion of which is the relation of these two variables and how much is economic growth depended from the external debt of the country.

**Chart5. Database of the regression analyze**

Source: World Bank, (<http://data.worldbank.org/country/albania>, accessed: 12/12/2011).

The linear regression equation is as follows:

$$Y = \alpha + \beta X + \varepsilon$$

From the summary output of the regression:

X Variable coefficient = 2.726104099

Intercept coefficient = 1009564747

R Square = 0.882896254

Standard Error = 1415534210

t Statistics = 11.64956

So, estimated regression equation is as follows:

$$Y_i = 1009564747 + 2.726104099 \cdot X_i$$

After the analyze of the results of the regression it can be concluded that these two variables have a positive relation with each other so in the Albanian in a long term we have a both growth in economy but also a higher amount of the external debt, these variables do motion in a parallel increasing way.

## Conclusion

To conclude, it can be said that the Albanian economy as a transition economy has been through different and difficult situations but in a long period of time the macroeconomic situation is positive and the following of the EU accession goal has helped the economic policy makers to know right what should be done and how. In general it seems to be in the good position but again a lot has to pass through. After the regression analyze it can be seen that the relation of the current GDP growth and the total external debt of Albania is positive and these two variables go parallel in an increasing motion, even though it has been observed the opposite of this situation in other EU countries, but Albania as mentioned is in transition and has a lot to do before it reaches that situation.

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