The Effects of the Albania-EU Stabilization and Association Agreement: Economic Impact and Social Implications

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Contents

Tables

Figures

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Yiannis Zahariadis

Acronyms

APEC	Asia Pacific Economic Community
ACIT	Albanian Centre for International Trade
BoP	Balance of payments
BUL	Bulgaria
CAP	Common Agricultural Policy (EU)
CEECs	Central and Eastern European Countries
CEFTA	Central European Free Trade Area
CET	Common external Tariff
CGE	Computable General Equilibrium Modelling
CRO	Croatia
CRTS	Constant returns to scale
CU	Customs Union
EBRD	European Bank for Reconstruction and Development
EFTA	European Free Trade Area
EU	European Union
EC	European Commission
FIAS	Foreign Investment Advisory Service (World Bank)
FORSU	Former Soviet Union and Baltic States
FTA	Free Trade Area (or Free Trade Agreement)
GATT	General Agreement on Trade and Tariffs
GDS	General Directorate for Standardization (Albania)
GDC	General Directorate of Customs (Albania)
GoA	Government of Albania

GTAP	Global Trade Analysis Project
IMF	International Monetary Fund
ISO	International Standards Organization
MENA	Middle Eastern Countries and North African Countries
MFN	Most Favoured Nation
NAFTA	North American Free Trade Area
NTBs	Non-tariff barriers
OECD	Organization for Economic Co-operation and Development
PECA	European Protocols for Conformity Assessment
RIA	Regional Integration Agreement
ROM	Romania
ROO	Rules of Origin
RTA/PTAs	Regional/Preferential Trade Agreements
SAA	Stabilization and Association Agreement (also 'the Agreement')
SAP	Stabilization and Association Process (also 'the Process')
SEE	South Eastern Europe
SPS	Sanitary and phytosanitary measures
TBTs	Technical barriers to trade
TOT	Terms of trade
TUR	Turkey
WTO	World Trade Organization

Executive Summary

This paper explores the economic implications and identifies potential winners and losers from the EU-Albania Stabilization and Association Agreement (SAA). Signed in June 2006, the EU-Albania SAA forms part of a broader regional process (the Stabilization and Association Process) and aims to support Albania's economic transition, as well as to strengthen its integration into the EU Single Market. Albania's reform agenda under the SAA is impressive, covering areas ranging from political dialogue and regional co-operation to Community freedoms in the movement of goods, services, workers and capital, and mutual co-operation in justice and home affairs. It requires extensive trade liberalization vis-à-vis both the EU and other countries in the region and provides for substantial non-tariff liberalization through the gradual harmonization with EU structures and directives in the areas of standards, certification, customs administration, competition, and intellectual property rights.

The paper focuses on the trade–related aspects of the EU-Albania SAA to analyze how bilateral liberalization with the EU, regional co-operation with other countries in the Stabilization and Association Process and harmonization with the relevant EU rules and regulations will affect the country's efforts for pro-poor growth and socio-economic development. It therefore, aims to identify both the overall welfare effects of the EU-Albania SAA on the Albanian economy and its impact on sensitive sectors/industries and the more vulnerable groups in the economy. To address these questions, the study employs a multi-country, multi-sector computable general equilibrium model based on the standard the GTAP v.6 model. The methodological framework of GTAP allows us to perform various trade-policy simulations and analyze their effect throughout the whole of the Albanian economy. A distinguishing feature of the modelling exercise is the incorporation of the unemployment of Albanian unskilled workers. This allows us to go beyond the trade, production and welfare impact of the policy reforms, and explore the impact of liberalization on employment in Albania, both in aggregate and between skilled and unskilled workers. Given that poverty in Albania tends to dominate across the unemployed, and especially the unskilled, the exercise allows us to identify some of the groups that are more vulnerable to liberalization.

Our findings suggest that regional integration under the SAA can bring significant benefits to the Albanian economy. These are not as substantial as what could potentially be achieved through unilateral liberalization, if Albania were to open its markets to all regions. Nevertheless the welfare impact of the EU-Albania Stabilization Agreement and the Albanian FTAs with the rest of SE Europe is notable, achieving a combined 1.5% of GDP. Given Albania's increased trade dependence on the EU, the results also suggest that it is trade with the Community that will drive welfare gains rather than trade with other countries in SE Europe. Non-tariff liberalization under the EU-Albania SAA is also found to bring notable gains, albeit smaller than those of traditional liberalization. If Albania were to modernise its customs administration and harmonize fully with EU legislation on standards and related technical barriers to trade, this could bring an additional gain of

0.46% of GDP. Since harmonization will proceed gradually, these gains will not be realized immediately, but as regulatory integration progresses.

While the impact on overall welfare is found to be positive throughout, we also find that the benefits are not evenly distributed between sectors and workers. There are both winners and losers from regional liberalization. The impact on overall employment is positive, but there are notable variations by sector. Sectors like agriculture, apparel and other manufacturing appear to benefit more, while textiles, metals, chemicals and minerals lose out. In declining sectors it is the unskilled workers rather than the skilled who are more adversely affected and are therefore more vulnerable to liberalization. Our analysis therefore reveals that liberalization can lead to greater unemployment inequality between skilled and unskilled workers in certain sectors. This is particularly evident in textiles, metals, chemicals, minerals and some services like utilities and public services. It is important therefore that liberalization in these sectors should proceed with caution and that the Albanian government with the support of the donor community should identify appropriate support policies. Given that overall demand for unskilled labour is expanding, it is important that the Albanian government should focus mainly on those employed in the vulnerable sectors.

Chapter 1: Introduction

The purpose of this paper is to assess the possible economic implications and identify winners and losers from the European Union-Albania Stabilization and Association Process (SAP). Launched in May 1999, the SAP represents an overarching reform agenda to support Albania's economic transition and to strengthen integration with the EU Single Market. The process will culminate in the so-called Stabilization and Association Agreement (SAA) – a legally binding contract between European Union and Albania, which will guide future bilateral commitments. The EU-Albania SAA was signed in June 2006. It places primary emphasis on economic integration with bilateral trade liberalisation, regional co-operation and harmonization with EU structures being central to the reform agenda.

The Stabilization and Association Process and the imminent Stabilization and Association Agreement are purely regional in character. They aim to anchor Albania's economic and political reform to the EU and align the country's development path with that of European integration. Anchoring one's reform process to an existing regional structure like the European Union has important merits, as the latest EU accession process has demonstrated. It opens up the economy to competition, expands trade and investment opportunities, enhances credibility in the reform processes and brings ready-made and tested institutional structures, rules and regulations to support the functioning of a market economy. A regional approach, however, can also entail serious risks. If economic conditions are not right, then the opening-up of markets on a preferential basis can lead to welfare losses which harm both producers and consumers in the partner countries. Equally, foreign rules and regulations may not necessarily be compatible with domestic capacity or indeed local development needs. Most crucially, however, the objective of a regional approach is fundamentally integration, not development and poverty reduction *per se*. Therefore, while development and poverty reduction are recognized as important, the process essentially rests on the assumption that they will follow as integration proceeds.

It is within this context that this paper aims to assess the economic effects of the future EU-Albania Stabilization and Association Agreement. It will focus on the trade–related aspects of the potential SAA to analyze how bilateral liberalization of relations with the EU, regional co-operation with other countries in the SAP and harmonization with the relevant EU rules and regulations will affect Albania's efforts for pro-poor growth and socio-economic development. Our interest, therefore, lies in identifying both the overall welfare effects of the SAA on the Albanian economy, and also its impact on sensitive sectors/industries and the more vulnerable groups in the economy.

To address these questions, the paper undertakes a quantitative assessment of the EU-Albania SAA. It draws on the recent bilateral Agreement and the available reports of the Albanian and EU authorities to identify the key trade-related provisions and to take account of progress so far. It considers both tariff and non-tariff obligations under the

SAA, focusing on both traditional liberalization and regulatory harmonization. In capturing the impact of these areas it employs a multi-country, multi-sector computable general equilibrium model based on the standard GTAP v.6 model. The data for the analysis are based on the GTAP v.6 database for 2001, as well as additional information from the Albanian Centre for International Trade, the Albania Customs Directorate and other secondary sources. The methodological framework of the GTAP allows us to perform various policy simulations and analyze their effect throughout the whole of the Albanian economy. A distinguishing feature of the modelling exercise is the incorporation of unemployment for Albanian unskilled workers. This allows us to go beyond the trade, production and welfare impact of policy reforms, and explore the impact of liberalization on employment in Albania, both in aggregate and between skilled and unskilled workers. Given that poverty in Albania tends to dominate across the unemployed, and especially the unskilled, the exercise allows us to identify some of the groups that are vulnerable to liberalization.

The paper is organized as follows. Section 2 provides an overview of the literature on regional integration and development. Section 3 outlines a background to the Albanian economy and discusses the EU-Albania Stabilization and Association Process. Section 4 presents the modelling framework, data sources and the experiential design for the policy simulations. Section 5 gives a detailed discussion of the main results, and, Section 6 provides some concluding remarks.

Chapter 2: Regional Integration and Development

2.1 The theory of regional integration

The traditional theory of regional integration emerged in the early 1950s with the pioneering works of Viner (1950), Meade (1955) and Lipsey (1957). Drawing mainly on the theoretical advances in international trade as well as the early experience with regionalism, these studies placed primary emphasis on border controls, and excluded other regulatory and institutional aspects of integration. The traditional theory is static, with the work force, capital stock and technology as given. The environment portrayed is characterized by perfect competition, with no internal or external diseconomies. The setting is largely institutionless with no government interference in the economy, except at the border. Trade impediments are limited to tariffs, with no other distortions considered. Within this context the early literature approached regional integration with scepticism. Viewed against the optimal – and therefore welfare maximizing – solution of completely free trade, regional arrangements are not necessarily regarded as steps in the right direction.

Viner (1950) identified two main effects from a regional trade arrangement, namely *trade creation* and *trade diversion*. Both concepts entail an increase in the volume of trade between the partner countries. However, trade creation is regarded as beneficial (welfare-improving), since it represents the replacement of inefficient domestic production with cheap imports from partners, whereas trade diversion is harmful (welfare-reducing) since it represents the replacement of cheap imports from the rest of the world with more expensive imports from partners. It is the relative weight of these two effects which determines whether or not a regional arrangement should be advocated.

The analysis of trade creation and trade diversion constitutes one of the first formal analyzes of the more general problem of 'second-best welfare economics' (Venables, 2000). Given that complete and undistorted free trade is first-best (satisfying all Paretian optimum conditions), a change which brings about the satisfaction of some of the optimal conditions, like regional integration, will always be second-best and have an ambiguous result. Taking Viner's analysis one step further, Meade (1955) stressed the possibility of another source of welfare improvement, namely, *trade expansion.* This is beneficial, as it represents the additional consumption of the imported good, which in turn is induced by the lower price in the partner country. Finally, Lipsey (1957) stressed that the risk of trade diversion is likely to be minimal when large trade partners integrate. This is because the initial trade links would suggest that the partners already constitute the lowest=cost source of supply. Since the seminal studies of Viner (1950), Meade (1955) and Lipsey (1957), the traditional literature has expanded dramatically. Later studies focused primarily on the

identification of special cases of integration, in order to explore further the relative ambiguity of trade creation and trade diversion.[1]

Although the traditional approach to integration fits well with the early efforts towards regionalism, it does not fully capture the essence of more recent initiatives[2]. Regional arrangements during the past decade aim at integrating the participating economies with the rest of the world. They attempt to enhance, rather than regulate, the market allocation of resources. Most profoundly, new arrangements do not merely focus on border barriers (tariffs and quotas), but increasingly cover regulatory areas going beyond the border controls to reconcile divergent national policies (see Lawrence, 1997a). These new – beyond the border elements were captured by the growing literature on deep integration. The term *deep integration* denotes the explicit actions taken by governments to reduce the market-segmenting effects of domestic policies by means of co-ordination and co-operation, and includes measures dealing with health and safety regulations, technical specifications for products (standards), competition laws, licensing and certification regimes, prudential requirements and administrative procedures (Hoekman and Konan, 1998). Overall, therefore, deep integration acts as an umbrella of non-border policies and regulations that can affect trade between countries.

Lawrence (1996) argues that deep integration alters considerably our perception of economic integration. First, the traditional assumptions about trade creation and trade diversion may not hold, as deep integration can stimulate extra-regional trade thus reducing the possibilities for trade diversion. Secondly, common rules enhance the transparency and predictability of policy, providing a more stable economic environment. As a result, deep integration may well bring additional welfare gains as it facilitates the integration process and enhances the effects of liberalization. It should be stressed, however, that deeper does not necessarily mean better or more efficient. If the new rules are stricter, or do not recognize the existing differences between the members' cultures, needs and objectives, then the effects of deep integration could indeed be negative. Equally, the broad nature of deep integration covering a range of policies and regulations makes it difficult to pin down and measure. Thus it is the choice of policies and the level of centralization that will determine the impact of deep integration rules.

[1] For example, Cooper and Massel (1965) focused on home tariffs and showed that the welfare effect of regional integration can never be better and will never be worse than unilateral liberalization. Kemp and Wan (1976) stressed that if we start from a competitive equilibrium, we can always find a particular common external tariff structure, which will leave no party worse off. Corden (1972) focused on market structure and argued that the enlarged market of a RIA offers opportunities for economies of scale, which may further enhance welfare gains. More recently, Schiff (1996) finds that a small country joining a large RIA is likely to gain in a similar manner to a small country liberalizing its trade on a unilateral MFN basis. Finally, Venables (2002) showed that countries with comparative advantage closer to the world average are more likely to gain from a regional arrangement.

[2] For example, the EU Single Market, the Europe Agreements, the Euro-Mediterranean Agreements, Mercosur, APEC and NAFTA.

2.2 Regional integration, trade and poverty

While the overall effects of regional integration have attracted considerable attention in the literature, its links with development and poverty reduction have only recently drawn interest. This is probably because, although developing countries have established regional arrangements for decades, it is only recently that regionalism has begun to be explicitly employed as a tool for development.

Following te Velde, et al. (2004), we can distinguish between global and regional trade effects. Global trade effects are essentially derived from the classical trade literature, which predicts that trade liberalization should increase a country's income as it leads to the specialization of production and trade according to comparative advantage. This involves a reallocation of resources to a more efficient structure, which increases total welfare. However, trade does not raise all incomes. As the economy opens up, previously protected sectors, which operated inefficiently under the old trade regime, will lose out as increased competition lowers prices and squeezes profit margins. Returns should increase to those factors of production where the economy is more abundant. Thus, for a developing country like Albania where unskilled labour is abundant, liberalization should lead to specialization in unskilled labour-intensive activities, which would normally have a positive impact on the incomes of the poor. This does not necessarily mean, however, that trade will always have a positive effect on poverty reduction. Specialization can make individual producers and households more vulnerable to shocks. This, combined with increased market openness and the absence of appropriate safety nets, increases the risk of falling into poverty. Equally, poor households are generally less integrated in the formal economy. This means that, even if liberalization is beneficial on average, the poor may not be able to take advantage of any of the gains.

Turning to regional integration effects, one can identify four types of linkages with poverty (ibid.). First, the principal effect of regional integration is to lower the prices of goods traded within the region. As protection falls, regional demand increases, leading to a reduction in prices. While this will always be beneficial for consumers, the effect on producers will depend on the initial structure and level of protection. Thus, the poor as consumers will gain if they consume more products that are traded intra-regionally. If, however, poor households' consumption is based on local production (e.g. subsistence agriculture), then such gains may not be realized. Equally, the poor as producers of regionally traded goods may gain or lose depending on the level of protection and the coverage of bilateral liberalization. Secondly, regional integration can have both static and dynamic effects on output. As already argued, economies gain by specialising according to their comparative advantage, but additional gains may accrue through increased competition and productivity spillovers. This is particularly relevant in the case of deep integration. Harmonization of national regulations brings new production processes which, apart from enhancing market access, can also bring further efficiency gains for domestic producers. Thirdly, regional integration will have a bearing on a country's fiscal stance through its impact on tax revenues. Experience suggests that tax revenues tend to

decline following trade liberalization[3]. This, by extension, could lead to either lower domestic spending in social sectors or revenue compensation through uniform domestic taxes (e.g. VAT), both of which can have a negative effect on poverty reduction. Finally, research has shown that income convergence within a regional integration arrangement depends on countries' economic positions relative to the rest of the world. Countries with comparative advantage closer to the world average (e.g. manufacturing) will generally do better than countries at the extreme, as the latter are more likely to face trade-diversion costs (Venables, 2002).

2.3 Empirical evidence

Empirical evidence on the welfare effects of regional integration has been mixed. One can distinguish between econometric studies, which focus on changes in bilateral trade flows to analyze the relative balance of trade creation and trade diversion and forecasting models, which are usually based on Computable General Equilibrium frameworks and aim to predict the potential welfare impact of integration. Starting with econometric studies, Aitken (1973) and Bayoumi and Eichengreen (1974) focused on the European Union and European Free Trade Area and found that integration led to higher intra-bloc trade, which in turn was predominantly trade-creating. By contrast, Frankel, et al's (1997) study of eight RIAs including the European Community, EFTA, NAFTA, MERCOSUR and the Andean Pact found that increases in intra-block trade were generally accompanied by evidence of trade diversion (Schiff and Winters, 2003). Finally, Soloaga and Winters (2001) examined a wider range of RIAs and found little evidence of trade diversion; most trade blocks were found to be trade-creating, with the possible exceptions of the EU and EFTA, which have led to some trade diversion (te Velde et al., 2004.

On the CGE front, the estimated impact of integration depends heavily on the modelling approach and assumptions. In the most comprehensive review of CGE models and regional integration, Robinson and Thierfelder (2002) stress that the vast majority of models find that trade creation exceeds trade diversion and that the estimated gains increase if models incorporate features of new trade theories, domestic policy reforms technology and productivity improvements (see also Evans, 2003). Static CGE models that assume a perfectly competitive environment generally produce small welfare effects. For example, Maskus and Eby Konnan (1997) employed a static perfectly competitive model to analyze the EU-Egypt Free Trade Area and found that Egypt stood to benefit by around 1-2% of GDP. Similarly Alessandri's (2000) assessment of all EU-Mediterranean Free Trade Agreements also found that countries would experience a small welfare improvement. Bussolo and Niimi's (2005) analysis of the Central American Free Trade Area found that Nicaragua would gain less than 1% of GDP from membership.

[3] This does not need to be the case however. The rationalization of protection (abolition of quotas and switch to pure tariff structure) and the generally lower level of tariffs may increase collection and reduce evasion, respectively.

CGE estimates of welfare effects increase slightly in studies that allow for imperfect competition and liberalization of non-tariff barriers. For example, Smith and Venables's (1998) seminal study of the EU Single Market incorporated imperfect competition in certain sectors and suggested that the gains from deeper integration (harmonization of standards and customs) could achieve 2.9% of GDP. Hoekman and Konan's (1998) study of deep integration in Egypt, also found that regulatory liberalization can be beneficial, but that welfare gains will be stronger if liberalization is on a multilateral rather than a preferential basis. Results appear to be significantly stronger, however, when productivity improvements are incorporated. Augier and Gasiorek (2001) assessed the EU–Mediterranean Agreements and assumed that improved market access would also lead to an increase in productivity. They argued that trade liberalization would have a strong pro-competitive effect, which, in turn, would lead to a significant trade-induced enhancement of productivity. They allowed for productivity changes of around 5% and found that welfare gains could reach 10-18% of GDP.

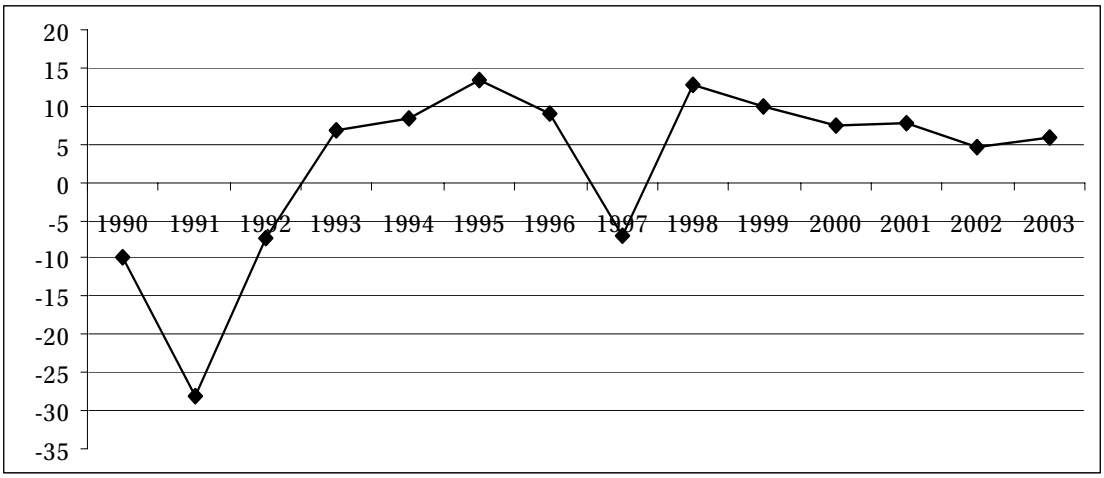
Finally, CGE studies with a clear regional focus on Eastern Europe and EU enlargement find that improved access to EU markets can be welfare-improving, with new member countries gaining more than the EU. The size of the effects will again depend on the model assumptions. Francois (1998) allowed for monopolistic competition to assess the latest EU enlargement and found that welfare gains ranged from 1% for pure tariff liberalization to 10% for non-tariff liberalization. Similarly, Baldwin et al.'s (1997) and Lejour et al.'s (2001) studies of EU accession found that it was more beneficial for the Central and Eastern European countries than for the EU and that regulatory harmonization can bring notable welfare gains. Finally, in the context of the Stabilization and Association Process for Albania studies are very limited. The only available assessment is by the World Bank, which employed a static perfect competition model and found that Albania stands to benefit from free trade with the EU and the rest of South Eastern Europe by 0.3 to 0.5% of GDP, (World Bank, 2004).

Chapter 3: Albania and the Stabilization and Association Process

3.1 Background on the Albanian economy

Like most Central and Eastern European countries, Albania's experience with transition has been a painful one. In the immediate aftermath of the fall of communism, the country faced economic collapse, social disorder and widespread emigration. Between 1990 and 1992 real GDP contracted sharply by a cumulative 38% (World Bank, 2004). This was followed by a relatively short period (1993–6) of stabilization, which brought the economy back to high growth rates and single-digit inflation and reduced external imbalances. In this period the economy grew rapidly at an annual rate of 9.3%, driven primarily by agriculture and services (ibid.). However, in the latter half of the 1990s economic conditions weakened significantly, culminating in the collapse of pyramid schemes in 1997, which plunged the country again into deep economic and social crisis. In that year, real GDP contracted sharply by about 7%. Economic recovery began again in 1998, with a donor-supported stabilization programme aiming to rebuild institutional and administrative capacity and deepen structural reforms. Since the late 1990s, macro-economic conditions have improved significantly, with real GDP growth rates between 7 and 8%, inflation back to single digits, fiscal consolidation and an improvement in the external balance.

Figure 3.1 Albania annual growth rates (constant prices)



Source: Albanian Institute of Statistics

Albania's impressive growth performance can be explained by a number of factors. First, during the past decade or so the economy has experienced a significant transformation

(World Bank, 2004). There has been a steady deindustrialiZation in favour OF services, which in turn account today for about 53% of GDP. Nevertheless, Albania remains A largely agricultural economy. While accounting for around 25% of output, agriculture continues to employ more than half the population. The second important factor driving Albania's growth performance was the Government's commitment to prudent fiscal and monetary policies and a swift transition to market principles from the late 1990s onwards (Treckel, 2002). Structural reforms including price liberalization, privatisation of agriculture and trade liberalization have advanced significantly. This has allowed the reallocation of resources from low-productivity sectors like agriculture to high-productivity sectors (services, construction), which in turn led to a remarkable growth in total factor productivity averaging 6-10% (World Bank, 2004). However, evidence suggests that total factor productivity growth is now slowing down. The final factor behind Albania's growth is remittances. Around 700.000 Albanians work outside the country and it is estimated that remittances represent around 13% of total income among Albanian households[4]. This large injection of resources has strengthened consumption of non-tradeable activities, mainly construction and services.

Table 3.1 Albania – GDP and employment shares by activity 1996–2003 (%)

	1996	1997	1998	1999	2000	2001	2002	2003
GDP								
Agric. Hunting & Forestry	29.2	29.5	27.8	25.2	24.6	23.1	22.1	20.4
Industry	19.8	18.6	16.9	15.1	16.9	15.3	14.7	16.5
Construction	6.2	5.5	5.3	6.6	9.1	11.1	9.7	10
Hospitality Services	20.9	19.4	18.5	20.6	18.2	17	18.6	17
Transport & Communications	8.5	9.1	12.3	12.9	11.8	12.5	12.6	14.4
Other Services	15.4	17.9	19.3	19.5	19.4	21.1	22.2	21.6
Employment								
Agric. Hunting & Forestry	67.2	68.4	70.3	69.6	70.8	72.1	71.8	57.7
Industry	9.5	8.3	7.6	7.9	7.7	7.7	5.4	7.7
Construction	1.6	1.8	2.0	1.4	1.0	1.0	1.2	6.1
Hospitality Services	3.6	5.4	7.0	5.2	3.1	4.0	6.4	9.0
Transport & Communications	2.4	2.6	2.4	2.4	3.0	3.0	2.4	3.5
Other Services	15.8	13.4	10.8	13.4	14.3	12.1	12.7	16.1

Source: Albanian Institute of Statistics

The impressive growth performance of the last decade is also reflected in Albania's external trade record. As illustrated in Table 3.2, exports and imports have grown rapidly

[4] Note that this impressive productivity improvement was not simply trade induced, but a result of general structural reforms. Information on the impact of trade reforms alone is not available. See also World Bank, (2003), *Albania: Poverty Assessment*, Washington, November

in recent years – at an average annual rate of around 18%. Despite this substantial growth, however, their shares in overall national income have remained at relatively low levels. Exports today account for only 7.4% of GDP, while imports' share stands at around 28 percent. Moreover, imports have continued to outpace exports leading to a widening of the trade deficit. This in turn puts significant pressure on the current account, which may be unsustainable in periods of low inflows of capital and remittances.

Table 3.2 Summary of Albanian foreign trade 1993–2004

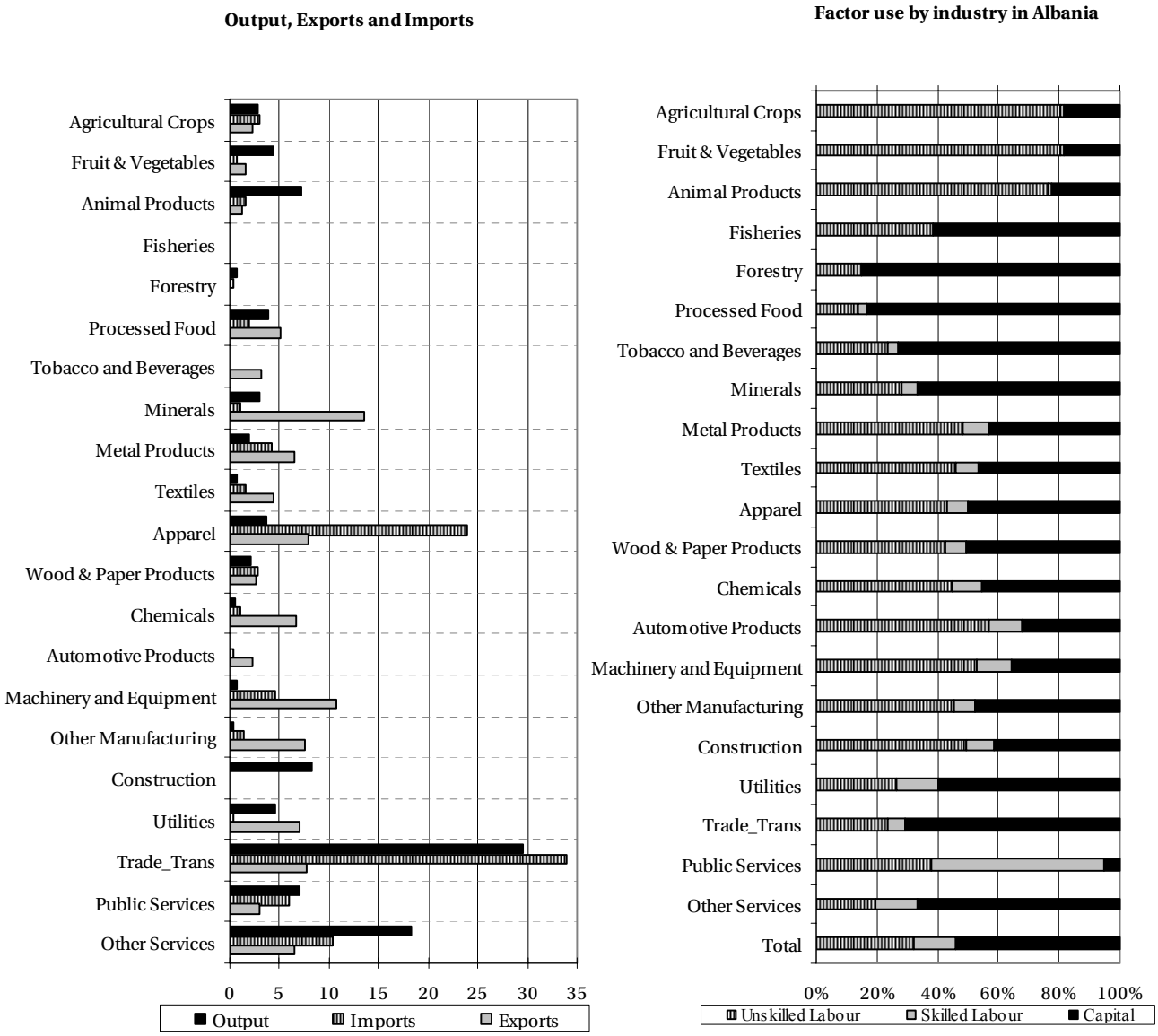
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Exports ($ mil)	123.1	141.8	201.4	224.4	143.6	202.7	275.7	258.9	304.9	330.4	448.1	605.4
Imports ($ mil)	418.4	554.8	648.4	933.1	644.4	823.5	943.0	1089.4	1337.5	1505.8	1859.6	2296.1
Exp. growth (%)	-	13.2	29.6	10.2	-56.3	29.2	26.5	-6.5	15.1	7.7	26.3	26.0
Imp. growth (%)	-	24.6	14.4	30.5	-44.8	21.7	12.7	13.4	18.5	11.2	19.0	19.0
Trade Deficit	-295	-413	-447	-708	-500	-620	-667	-830	-1,032	-1,175	-1,411	-1,690
Exp. % of GDP	10.0	7.3	8.1	7.4	6.6	7.4	8.0	7.0	7.4	7.4	7.3	7.4
Imp. % of GDP	34.1	28.5	26.2	31.0	29.8	30.1	27.4	29.5	32.6	33.5	30.4	28.2
Exp/Imp %	29.4	25.6	31.1	24.0	22.3	24.6	29.2	23.8	22.8	21.9	24.1	26.4
Deficit % of GDP	-24	-21.2	-18	-23.5	-23.1	-22.7	-19.4	-22.5	-25.2	-26.2	-23.1	-20.8

Source: EBRD Transition Report 2005

Figure 3.2 draws on the GTAP database to illustrate Albania's output and exports and imports as a percentage of total output and the percentage shares of capital, and skilled and unskilled labour used in different industries. Overall, it should be noted that the GTAP database understates the contribution of unskilled labour. Nevertheless, the figure suggests that sectorally exports are generally dominated by low skill labour-insensitive manufacturing industries. As can be seen, Albania specializes in the production and export of minerals, chemicals, machinery and equipment and apparel, all of which are characterized by a relatively low skilled to unskilled ratio. At the same time, however, agriculture – traditionally a low skill labour–intensive sector – is characterised by relatively low export shares. This could imply that Albania's farmers still find it difficult to compete in international markets, and domestic agricultural production is primarily consumed locally. The only agricultural sector to reveal some exporting dynamism is processed food, which accounts for around 5% of total exports. With respect to imports, demand is generally dominated by goods and services, the production of which in Albania is more capital-intensive, with a medium to high skilled to unskilled ratio. Trade, transport and other services[5] take the lead, followed by light manufacturing and machinery and equipment. A notable exception is apparel which accounts for nearly 25% of total imports. This would suggest that the Albanian apparel industry depends heavily on intermediate foreign inputs to sustain its substantial domestic and export-oriented production.

[5] Other services include communications, financial, insurance and business services. See Annex II for more details.

Figure 3.2 Albania: Output, exports and imports shares and shares factor use in 2001 by sector (%)

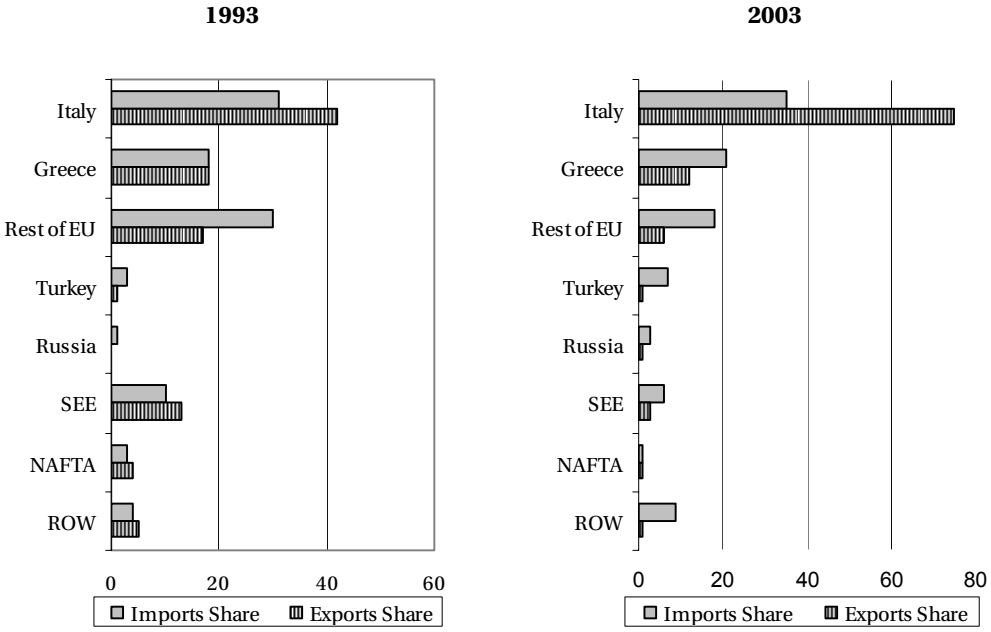


Source: GTAP V.6 Database for 2001

Finally, in terms of regional distribution, Albania's external trade is clearly oriented towards Europe. In 2003, the EU alone accounted for 93% of Albanian exports and 74% of imports, the bulk of the trade being with Italy and Greece. This substantial level of trade implies a significant dependence and a growing vulnerability to any adverse shocks from

the EU. Trade with other countries in South Eastern Europe accounted for 10 and 13% of Albanian imports and exports respectively in 1993 but had fallen to around 6 and 3% by 2003. As regards trade with other regions, recent years have seen a slight increase in commercial links with Turkey and Russia, but a decline in those with North America and the rest of the world.

Figure 3.3 Albanian trade by region (%)



Notes: Rest of EU includes new members for both 2003 and 1993; SEE includes Bulgaria, Romania, Croatia, Macedonia and Serbia Montenegro; NAFTA includes US, Canada and Mexico

Source: Albanian Centre for International Trade

While the growth and trade performance of the Albanian economy is encouraging, substantial challenges continue on the socio-economic front. National per capita income has been rising steadily over the past decade, but it remains at very low levels; in 2003, it stood at around $1900, one of the lowest in the transition economies. Moreover, unemployment remains at a high level and poverty is widespread, with around 25% of the population living at below $2 a day. Poverty in Albania has marked spatial and regional dimensions. The rural areas are consistently poorer than the rest of the country. A recent Living Standards Survey showed that the poverty headcount in rural Albania is around 50% higher than in the urban areas and 66% higher than in the capital Tirana. Moreover, poverty appears to be more prevalent in the mountainous region in the north and northeast of the country, where almost half the residents are poor, with one-fifth living in extreme poverty (World Bank, 2003a).

Analysis further suggests that poverty is clearly correlated with unemployment and underemployment in the labour market. The Living Standards Survey shows that the poverty incidence is 33% higher in unemployed groups (Albanian Government, 2003). This is further illustrated in Table 3.3 showing that the unemployment rate stands at 9.8 and is highest among the poorest segments of the population. The skill levels of the workforce are generally low. While illiteracy rates have continued to fall, (from 7.3% in 1989 to 1.4% in 2001) (EBRD, 2004), around two-thirds of the labour force continue to have less than basic education. It is again these segments of the population that are more vulnerable to unemployment. Indeed, unemployment for workers with less than secondary education reaches 8.6% as compared with 4.9% for those with more than secondary education.

Table 3.3 Unemployment by extent of poverty and by level of education

	Extent of poverty			**Education level**			
	Non-Poor	Poor	Extremely poor	Less than secondary	Secondary	More than secondary	Total
Unemployment rate	8.5	14.2	23.7	8.6	14.2	4.9	9.8
Participation rate	n.a	n.a	n.a	55.7	66.6	73.7	59.7

Source: World Bank, (2003a).

Overall, it is important to emphasize the links between poverty, skills and labour status. The modelling analysis will take account of the high levels of unemployment among unskilled workers and explore the impact of various trade reforms on labour status. In view of the fact that the unemployment rate is highest among workers with less than secondary education and that the poverty incidence is around 33% higher for the unemployed, it is important to bear in mind that these groups will be more vulnerable to poverty than others.

3.2 The EU-Albania Stabilization and Association Process

Diplomatic relations between the European Union and Albania began in 1991 and were formalized the following year with the signing of a Trade and Co-operation Agreement and a joint Declaration on Political Dialogue. For the remainder of the 1990s, relations were generally confined to donor-recipient status, as the EU became the biggest source of external aid for the country. During this period, the EU also extended significant trade preferences to Albania, which facilitated bilateral trade and allowed the creation of stronger commercial links.

It was only in the late 1990s that bilateral relations began to intensify with the opening of the Stabilization and Association Process (SAP). Launched in May 1999, the SAP covers five countries in South-East Europe (Albania, Bosnia and Herzegovina, FR Yugoslavia, Macedonia and Croatia) and represents the EU's renewed long-term commitment to the

region. The Process combines new contractual relationships with trade preferences and financial assistance to support the countries' progress in meeting the requirements for EU membership. In this context, the SAP rests on four building blocks[6]:

i. Stabilization and Association Agreement (SAA), which consists of a legally binding agreement between the EU and each country in the SAP;
ii. bilateral Free Trade Agreements between all countries participating in the SAP;
iii. trade preferences, which unilaterally grant almost totally free access to EU markets for goods from the Balkans; and
iv. financial assistance planned in consultation with the partner countries, EU member States and the international community.

In presenting Albania's participation in the SAP, it is useful to distinguish between those aspects that deal with its relationship with the EU and those that deal with its relationship with the other participating countries.

Starting with EU-Albania relations, formal negotiations for a bilateral Stabilization and Association Agreement began in January 2003 and were completed in June 2006. The SAA foresees the establishment of an Association Agreement, which will be implemented progressively over a maximum transitional period of ten years (Kuko, 2005). The EU-Albania SAA is extensive and like all other SAAs is based largely on the Europe Agreements[7]. It covers a wide range of areas from political dialogue to regional co-operation, and from freedom in the movement of goods, services, workers and capital to mutual co-operation in justice and home affairs. Importantly, the SAA calls for the establishment of a free trade area between the two parties. In 1999, under the Autonomous Trade Preferences regime, the EU liberalized most of its trade. Albania will undertake a more gradual reduction of tariffs over a period of ten years, by the end of which, all bilateral industrial tariffs will be fully liberalized. In agriculture, liberalization will also be substantial but less extensive, covering around 70% of bilateral tariff lines. The free trade area also calls for the elimination of all bilateral export taxes in both industrial and agricultural trade, as well as all remaining quantitative restrictions that have an equivalent effect. It allows, however, for the continuation of anti-dumping measures and safeguards between the two parties.

Finally, the SAA is not confined to border controls, but covers a number of policy and regulatory areas for deeper integration. It recognizes that policy harmonization of policies is a long-term target and places increasing emphasis on its gradual implementation.

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[6] European Commission, *The Stabilization and Association Process for South East Europe*, Brussels (various years)

[7] To date, only Macedonia and Croatia have completed negotiations and adopted Stabilization and Association Agreements with the EU. The term 'Europe Agreements' refers to the bilateral association agreements between the European Union and the Central and Eastern European countries that subsequently became EU candidate countries. Bulgaria and Romania are the last two candidate countries to benefit from this type of agreement, whilst the Europe agreements linking Estonia, Hungary, Latvia, Lithuania, Poland, the Czech Republic, Slovakia and Slovenia to the European Union became redundant at the time of their accession in 2004.

Nevertheless, Albania is required to undertake a gradual harmonization of legislation with that of the EU in the areas of standards, certification and accreditation and customs administration. It is further required to develop a framework for the protection of competition, as well as intellectual, industrial and commercial property rights similar to those of the Community. Finally, Albania will need to seek participation in international and European organizations in all of these areas and to adhere to the relevant international conventions. Based on the EU-Albania SAA, Box 1 gives details of the main economic integration provisions.

Turning to Albania's relations with the other South East European countries in the SAP, these are largely governed by provisions on regional co-operation. The SAP requires that participating countries conclude and implement bilateral free trade agreements between them. In this context, 23 bilateral FTAs are to be established. For the implementation of these agreements, all the countries participating in the Process, together with Bulgaria and Romania, adopted a Memorandum of Understanding in June 2001. The FTAs are to be negotiated autonomously between countries and should comply with the provisions of Article XXIV of the WTO/GATT on regional integration. To date, Albania has completed and signed agreements with all the countries participating in the Process. The agreements are largely based on the SAAs, but are less extensive. Import duties have to be eliminated on 90% of the signatories' mutual trade, with immediate liberalization of most goods and transitional periods for remaining products of between 4 and 6 years. Industrial products are subject to full liberalization, while agricultural products are generally subject to specific concessions. With regard to regulatory and policy harmonization, all FTAs are generally vague, with minimal provisions for mutual co-operation. Finally, it is worth noting that the web of bilateral FTAs under the SAP may be replaced with a full regional agreement in the future. The signatories of the Memorandum of Understanding have recently intensified discussions for a unified Free Trade Area. Although negotiations are still at a relatively early stage, the indications are that this will take the form of an enlarged Central European Free Trade Area[8].

[8] The Central European Free Trade Area (CEFTA) was formed in 1992 and includes the now EU members Poland, Czech Republic, Slovakia, Hungary, Slovenia and Bulgaria and Romania.

Box 1 The main trade-related provisions of EU-Albania Free Trade Area under the SAA

I. Provisions dealing with import and export duties
The EU and Albania are required to eliminate all customs duties and related charges having equivalent effect on industrial products between them. Under the Autonomous Trade Preferences regime the EU already offers completely free entry to Albanian industrial products. In the case of Albania the majority of industrial tariff lines will be liberalizedliberalized in full immediately, while the remaining will be subject to a more gradual liberalization over the next five years.

Bilateral customs duties and related charges will also be eliminated for certain agricultural products. For the EU this will cover virtually all Albanian agricultural exports. In the case of Albania, around 40% of agricultural tariff lines will be liberalizedliberalized in full immediately, 30% will be liberalizedliberalized over a period of five years, while the remainder will retain their MFN tariff.

All bilateral export taxes and related changes having equivalent effect will be liberalized in full immediately after the adoption of the Agreement

II. Provisions dealing with laws, rules and regulations
Albania is required to undertake a gradual harmonization of laws and regulations to those of the *EU Acquis communautaire** for the internal market. This will involve:

- the gradual harmonisation to all Community instruments dealing with technical barriers to trade, sanitary and phytosanitary standards, accreditation and conformity assessment procedures. It also involves participation in European organizations in the areas of standards, conformity assessment, metrology and similar functions;**
- the adoption and implementation of a competition law and policy in line with the relevant EU regulations and the exchange of information on individual cases of public aid;
- the adequate and effective protection of intellectual, industrial and commercial property rights, the effective enforcement of such rights and accession to the relevant multilateral conventions.***

III. Other trade-related provisions
Albania and the EU will co-operate in the area of customs to promote the approximation of the Albanian customs system to that of the Community and achieve the gradual harmonization of the relevant Albanian legislation to that of the *EU acquis*.

Notes: * *EU Acquis communautaire* refers to the body of EU regulations, directives and laws
** Some of these organizations include the European bodies for electrical and electrotechnical standardization (namely, CEN [European Committee for Standardisation]- and CENELEC [Comitee for Electrotechnical Standardisation] and for conformity assessment, namely EOTC (European Organisation for Conformity Assessment)
*** Conventions on intellectual property rights will include the WTO TRIPs agreement and related Conventions such as the Paris Act (1971) on library and artistic works, and the Rome

Table 3.4 Tariff and regulatory provisions in Albania's FTAs with SE European countries

Free Trade Area (Year of entry into force)		Share of HS lines subject to liberaliz-ation (%)	Share of mutual trade subject to liberalizati on (%)	Transiti-onal period	Regulatory and policy provisions		
					Standards & technical barriers to trade	*Competition*	*Intellectual property rights*
ALB-B&H (2003)	**Albania**	91.0	91.7	5 years	Minimal: Co-operation & exchange of information	Minimal: General rules on undertakings and abuse of dominant position	Minimal: Co-operation and effective protection.
	Bosnia & Herzegovina	93.0	88.6				
ALB-BUL (2003)	**Albania**	86.2	70.0	4 years	As above	As above	As above
	Bulgaria	87.0	83.8				
ALB-CRO (2003)	**Albania**	85.7	95.8	5 years	As above	As above	As above
	Croatia	87.4	53.2				
ALB-MAC (2003)	**Albania**	91.6	79.5	5 years	As above	As above	As above
	Macedonia	93.1	89.6				
ALB-ROM (2003)	**Albania**	85.8	99.6	4 years	As above	As above	As above
	Romania	86.5	82.0				
ALB-S&M (2003)	**Albania**	89.7	37.5	4 years	As above	As above	As above
	Serbia	89.3	89.1				

Sources: Messerlin and Miroudot (2003), Free Trade Agreements between Albania and Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Romania, Serbia and Montenegro.

3.3 Albania and the SAP: Progress to date

Before we identify the key trade-related policy measures for our modelling exercise, it is important to consider briefly Albania's reform progress to date. It is recognized that with the EU-Albania SAA in the early stages of implementation and the regional FTAs only three years since this adoption, it is still relatively early to undertake a formal assessment

of Albania's progress in the SAP. However, for the purposes of our analysis it is worth considering briefly some of the recent policy and regulatory reforms that are directly related to the country's efforts towards liberalization and regional integration.

Since the abolition of the state monopoly on foreign trade, Albania has consistently pursued a policy of multilateral liberalization. In 2000, it became a full member of the WTO and accepted an ambitious trade liberalization schedule up to 2007. While liberalization has progressed significantly, there are various delays in the implementation of the WTO commitments. The maximum MFN tariff remains at 15% and, although most industrial products have been liberalized, agriculture is still characterized by significant protection. According to the European Commission this is due to considerations about the impact on the budget and fears about the impact on new companies (European Commission, 2005). With regard to bilateral liberalization, efforts have been concentrated primarily on the implementation of bilateral FTAs with other South East European countries. Since 2002/3, when the majority of Albania's FTAs were adopted, liberalization has progressed rapidly. Today most agreements are close to full implementation with around 80-90% of negotiated HS lines[9] completely liberalized (Messerlin amd Miroudot, 2003). Bilateral liberalization with the EU began with the signing of the SAA in June 2006.

With regard to regulatory and non-tariff barriers, the picture is relatively mixed. Albania maintains a licensing regime for the importation of goods that are important to its national stability (arms, ammunition, explosives, non-hazardous waste, drugs and used tyres) and for goods where statistical information is needed (medicines, seeds, pesticides, live animals, fish and seafood products and products of animal origin). Overall, the system is in line with the WTO Agreement on Technical Barriers to Trade and does not appear to raise any particular problems. It is worth noting that the average number of licences per business is 0.9, which is much lower than that in many other countries in the region (Dhmiri, 2004).

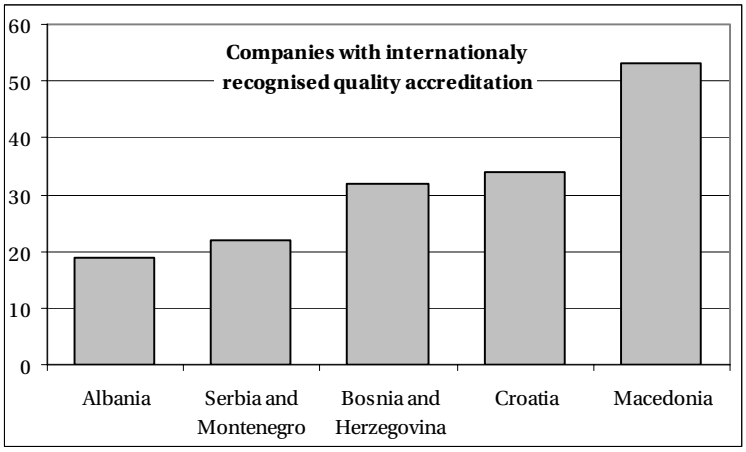
In the area of standards and technical barriers to trade, a new law was adopted in March 1999, replacing the old system of compulsory product requirements. The new law distinguishes between optional and mandatory standards and sets out rules for conformity-assessment procedures and accreditation. Administratively, the full responsibility for both standardization and conformity assessment rests with the General Directorate of Standardization (GDS). As of 2004, Albania had translated and adopted 42% of European standards, while a new law on conformity assessment was ratified that is in line with the relevant European legislation.

On the institutional front, Albania has developed an active profile with affiliate memberships in the European bodies for electrical and electrotechnical standardization (CEN and CENELEC) and correspondent membership in the International Standards Organization (ISO) (Albanian General Directorate of Standardization, 2005). These are all

[9] HS lines HS lines refer to tariff lines under the Harmonized Commodity Description and Coding System (HS), administered by the World Customs Organization

positive developments, as they gradually bring Albania's system closer to that of the EU. However, there are still many problems on the implementation side, due to the lack of infrastructure and capacity in the areas of accreditation and certification. The lack of infrastructure, in turn, translates into a lack of confidence on Albanian processes and procedures. Accreditation of Albanian products continues to be poorly recognized in international markets. As illustrated in Figure 3.4, Albanian companies rank lowest of all any other SAP countries in the recognition of quality accreditation. This, in turn, acts as an important trade barrier for Albanian exporters, as they need to recertify their products with foreign laboratories and institutes. Development of confidence and recognition are crucial in this area. Infrastructure is key; confidence could be developed further through the establishment of European Protocols for Conformity Assessment (PECAs), which aim to identify problem areas for specific products and provide remedies for their resolution. Such agreements are, of course, a long-term goal, but they are provided for in the EU-Albania SAA.

Figure 3.4 Companies in SEE countries with internationally recognized quality accreditation (share of total)

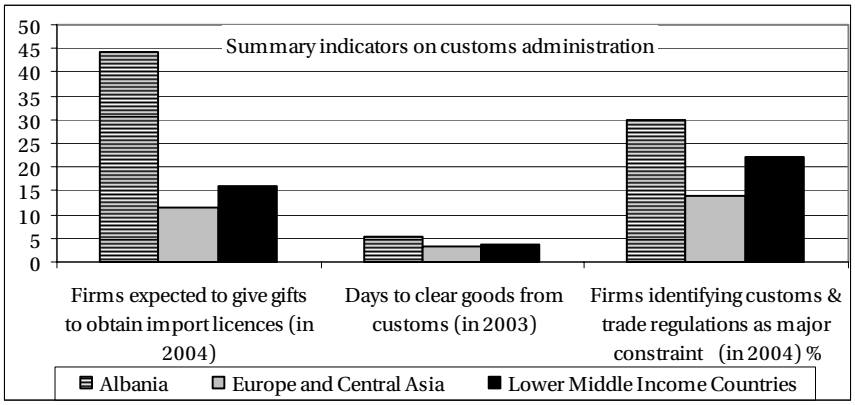


Source: Frohlich (2005).

Turning to customs administration, procedures here remain cumbersome. Customs clearance is still slow, inefficient and imposes high compliance costs on the private sector. As illustrated in Figure 3.5, around 30% of firms trading in Albania identify customs and trade regulations as a major constraint, compared with 14% in other European countries and 22% in other lower- middle-income countries. According to the Albanian Centre for International Trade's Annual Foreign trade Report (2004), the average customs clearance time in 2003 stood at 5.3 days. With the encouragement of the EU Customs Assistance Mission in Albania a number of reforms have been carried out in recent years, which have reduced the average customs clearance time to 1.9 days. These include the strengthening of regional port management, the amendment of the Albanian customs code and the introduction of new information-processing technologies. According to ACIT, however, there is further room for improvement through the simplification of documentation

requirements and the improvement of information systems. Dhimiri (2004) notes that 20 supporting documents are required at the goods declaration for a commercial consignment. Moreover, corruption in customs administration remains a serious problem for firms. It is estimated that corruption alone increases firms' operating costs by around

Figure 3.5 Summary Indicators on Administration of Customs



Source: FIAS, (2005); ACIT (2003–5)

Finally, in the areas of competition law and intellectual property rights, Albania has made encouraging progress. A new competition law was adopted in 2003, which is in line with the relevant EU legislation. The law also foresees the establishment of an independent competition authority[10]. There are, however, delays in its implementation largely due to lack of political agreement over the organization and staffing of the competition authority. In the area of intellectual property rights, Albania has ratified a number of international agreements and has pushed forward the alignment of national legislation to the EU Acquis. There have been a number of initiatives to increase public awareness and to strengthen official capacity in the area. The Commission notes, however, that implementation and enforcement of the overall legislative framework remain a challenge.

[10] European Commission, *Albania: Stabilization and Association Report* (2004)

Chapter 4: Modelling Framework, Data Sources and Experimental Design

In this section our analysis moves to a formal quantitative assessment of the EU-Albania Stabilization and Association Process. We draw on our previous discussion of the Stabilization and Association Agreement and Albania's Free Trade Areas with South-East. Europe to identify the key trade-related provisions for our modelling exercise. We begin with a discussion of the modelling framework and base data followed by a detailed discussion of the experimental design for the simulations.

4.1 The Model: Main features and closure rules

The standard GTAP v.6 model, a multi-country, multi-sector computable general equilibrium model, is employed[11]. The GTAP is based on a standard neo-classical hypothesis, with perfect competition and constant returns to scale assumed throughout. Trade between the different regions in the model is incorporated through an Armington specification. This represents the only important departure from the standard neo-classical framework and allows for product differentiation according to geographical origin. The Armington specification introduces imperfect substitution between domestic and imported sources of supply. More specifically, firms first decide on the optimal mix of domestic and imported goods and then determine the sourcing of the imports. In this way, products are differentiated according to their origin of production, which, in turn, allows the tracking down of bilateral trade flows. A more detailed description of the GTAP model is presented in Annex 1.

Under the standard GTAP closure, the prices of goods, factors and services adjust until all markets clear, that is, until they are simultaneously in general equilibrium. At a macroeconomic level, the standard model requires that the difference between national savings and national investment is exactly equal to the current account surplus. The GTAP, however, does not include observations on net transfers. The macroeconomic closure therefore collapses to its simplest form, whereby net national savings are equal to the trade balance.[12] The principal implication of this specification is that any change in trade flows following a policy shift will require the trade balance to adjust in maintaining the simplified macro identity. In this study we introduce a fundamental departure from the standard closure. Following McDonald and Walmsley (2003), Elbehri and Hertel (2004) and others we allow for the incorporation of unemployment in our experiments (see also Evans, 2001; Keck and Piermartini, 2005). As we have already noted, Albania is

[11] The Global Trade Analysis Project (GTAP) was developed at Purdue University Illinois to facilitate research on trade and trade-related issues. The project consists of a fully documented global database, a standard modelling framework, and software for the manipulation of data and the implementation of the standard model.

[12] S-I = X-M + R collapses to its simplest form S-I = X-M, where S is national savings, I national investment, X-M the trade balance and R net transfers.

characterized by high levels of unskilled labour unemployment. Hence, the standard GTAP assumption of full employment is inappropriate. To take account of this, the real wage for unskilled labour in Albania was fixed, while the supply of labour was endogenized, the critical assumption being that the base data reflect employment, not endowment, so that there exists an unobserved pool of unemployed labour in our benchmark. In effect, an expansion in output is fuelled by the pool of unemployed, while a contraction leads to further losses in employment. The employment of unskilled labour will tend to rise or fall according to the skilled intensity of exports compared with import-competing sectors. For comparative purposes some of our key experiments were also analyzed under the standard GTAP closure of full employment (see Annex 8).

The choice of our closure rules allows us to consider some of the socio-economic impacts of liberalization. While other studies would look at the impact on wages in order to identify the socio-economic effects of reforms, this study focuses on changes in employment patterns. Given the specifications of the GTAP model, which does not distinguish between household types, it is not possible to model the impact on poverty directly. It is, however, possible through our closure rule to explore the impact on employment both in aggregate and between skilled and unskilled workers. Given that poverty in Albania tends to dominate across the unemployed, and especially the unskilled, our closure rule will allow us to identify some of the groups that are vulnerable to liberalization. It is recognized that unemployment will not necessarily result in poverty,[13] and that, while some sectors may decline, others will expand, creating positive employment effects. Our discussion of various trade-policy reforms, will therefore look closely at changes in the returns and employment of low-skill workers across industries to identify, where possible, 'winners and losers' from policy shocks.

4.2 Data sources

The base environment is based on the GTAP v.6 database for 2001. The complete database consists of 87 regions/countries, 57 commodities and 5 primary factors. For the purposes of our analysis, the data were aggregated into 10 regions and 21 sectors, including, 7 primary (6 of them agricultural), 9 manufacturing and 5 service sectors. No aggregation was applied to the factors of production, which include land, skilled and unskilled labour, capital and natural resources. The regions and commodities used for our modelling exercise are shown in Table 4.1, while details of the aggregation mapping are reported in Annex 2.

[13] Poverty is, of course, determined by the multiplication of wages and employment, not just unemployment.

Table 4.1 Aggregation of base data

	Sectors			Regions	
1.	Crops	Agricultural Crops	1.	NAFTA	North American FTA
2.	Fruit_Veg	Fruit &Vegetables	2.	EU	European Union (25)
3.	Animal_Prods	Animal Products	3.	EFTA	European Free Trade Area
4.	Forestry	Forestry	4.	ALB	Albania
5.	Fisheries	Fisheries	5.	BUL	Bulgaria
6.	ProcFood	Processed Food	6.	CRO	Croatia
7.	Tob_Bev	Tobacco & Beverages	7.	ROM	Romania
8.	Textiles	Textiles	8.	ForSU	Former Soviet Union
9.	Apparel	Wearing Apparel &	9.	TUR_MENA	Turkey, M. East & N. Africa
10.	Wd_Pap_Prods	Wood and Paper Products	10.	ROW	Rest of the World
11.	Minerals	Mineral products			
12.	Chemicals	Chemicals			
13.	Metal_Prods	Metals and Metal Products			
14.	Auto_Prods	Automotive & Transport			
15.	OthManuf	Other Manufacturing Prod			
16.	Mach_Eq	Machinery and Equipment			
17.	Utilities	Utilities			
18.	Construction	Construction			
19.	Trade_Trans	Trade and Transport			
20.	Pub_Services	Public Services			
21.	Oth_Services	Other Services			

Source: GTAP v.6 Database

The choice of commodity and regional aggregations reflects Albania's trade and production patterns and aims to maximize flexibility in the modelling of the various trade agreements that Albania has and will complete under the auspices of the Stabilization and Association Agreement. The baseline does not contain regional preferences that Albania may have agreed to in recent years. The tariff structure therefore reflects the policy regime as it stood in 2001, before any liberalization under the Stabilization and Association Process. It does, however, incorporate the EU's Autonomous Trade Preference regime vis-à-vis Albania, as this was specified in 2000. Annex 3 provides a detailed presentation of the base tariff structure.

4.3 Experimental Design

We performed seven core policy experiments that aimed to capture Albania's trade liberalization efforts both unilaterally and regionally in the context of the Stabilization and Association Process[14]. More specifically, we explored the following trade scenarios contained mostly in the SAP:

i. a hypothetical unilateral liberalization;
ii. a free trade area between Albania and the EU(25);

[14] A number of additional experiments were also performed to test the robustness of our results and to explore variations in trade policy liberalization. These are presented in Annex VIII, IX and X.

iii. a hypothetical customs union between Albania and the EU(25);
iv. free trade areas between Albania and Bulgaria, Romania and Croatia;
v. a full SAP combining Albania's free trade areas with the EU and with Bulgaria, Romania and Croatia;
vi. the reduction in trade costs due to Albania's harmonization with EU standards;
vii. the reduction in trade costs due to the modernization of Albania's customs.

E1: Unilateral liberalization
The purpose of this scenario was to establish a benchmark. It explored the full potential effects of trade liberalization, if Albania were to reduce its tariffs in all regions, countries and sectors. It therefore involved the full elimination of all tariffs for agricultural and industrial imports into Albania, irrespective of region of origin.

Given that the experiment models the full liberalization of tariffs in Albania we can expect to find the strongest possible welfare effects. With no distortions remaining, Albania's production and trade will be specialized according to its full comparative advantage and resources will be re-allocated to a more efficient structure.

E2: EU-Albania Free Trade Area
This scenario concentrated on the EU-Albania SAA and explored the effects of the establishment a free trade area between the two parties. As discussed in section 3.2, the EU-Albania FTA involves the gradual elimination of bilateral industrial tariffs, the gradual reduction of some bilateral agricultural tariffs within quotas (as specified by the negotiated concessional schedule), the elimination of all bilateral export taxes and the retention of complete autonomy in the parties' trade policy towards third countries.

This modelling exercise did not address the gradual character of the liberalization and assumed, for the sake of simplicity, that the negotiated agricultural tariffs would be liberalized in full. This assumption was unlikely to have a major impact on the main results. The experiment therefore involved the:

i. elimination of all bilateral tariffs on industrial imports between EU and Albania;
ii. elimination of all remaining tariffs on Albanian agricultural exports to the EU;
iii. reduction of tariffs for certain EU agricultural imports into Albania; and
iv. elimination of all bilateral export taxes.

Information on agricultural tariff concessions was obtained from the Albanian Customs Authority and the Albanian Centre for International Trade. As the schedule of tariff concessions was defined at HS 8-digit level, the information was aggregated to GTAP sectors using import weights and HS8 agreements with the GTAP. More specifically, our calculations used GTAP tariffs for 2001 as a basis and utilized the negotiated tariff concessions to estimate the percentage reductions[15]. The final post-FTA tariffs are presented in Annex 4.

[15] Consistent estimates of pre- and post-FTA tariff data proved difficult to obtain. We employed the WITS Database to map EU-Albanian trade flows at HS 8-digit level to GTAP categories. The share of

Given that this experiment involves preferential liberalization, with Albania maintaining a significantly higher bilateral tariff structure than the EU, we expect an expansion of EU exports to Albania. As the EU accounts for nearly 70% of Albanian imports this will translate into lower import and domestic prices, which in turn will lead to an exchange-rate devaluation driving an expansion of Albanian exports. The overall welfare implications will depend on the interplay of trade creation and trade diversion, the impact of liberalization on Albania's terms of trade and the impact of increased competition from EU imports on allocative efficiency in Albania.

E3: EU–Albania Customs Union
Although a customs union between the EU and Albania is not currently under negotiation, this experiment explored the hypothetical scenario of extending the free trade area through the adoption by Albania of the EU Common External Tariff (CET). This experiment therefore replicates experiment E2 (EU-Albania FTA) and sets Albania's tariffs on imports from all regions equal to those of the EU. The adoption of the EU Common External Tariff by Albania was calculated using GTAP tariff data for 2001. EU tariffs at full GTAP disaggregation were weighted and re-aggregated using Albania's import flows. The final post-customs union tariff schedule is presented in Annex 5.

Under this scenario the possibilities for welfare gains are stronger. EU tariffs vis-à-vis third countries are generally lower than those of Albania. Thus, by adopting the CET, Albania would essentially be liberalising vis-à-vis the rest of the world as well. This should lead to stronger trade-creation effects and therefore stronger welfare gains.

E4: Albania's Free Trade Areas with Bulgaria, Romania and Croatia
This scenario returned to the Albanian SAP and explored the impact of Albania's free trade agreements with other South East European countries. As already argued, the regional FTAs require the elimination of bilateral import tariffs and export taxes for industrial products, and provide a number of tariff concessions for certain agricultural products. While Albania has concluded agreements with all eight South East European countries, the GTAP provides a disaggregation for only three: Bulgaria, Romania and Croatia. Our experiment therefore concentrated on Albania's FTAs with these three countries and consisted of:

i. the elimination of bilateral import tariffs for industrial products between Albania and Bulgaria, Romania and Croatia;
ii. the reduction of bilateral agricultural tariffs as specified by the negotiated tariff concessions between Albania and Bulgaria, Romania and Croatia.

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each HS 8-digit line to GTAP category was in turn calculated. By identifying the specific HS lines that were subject to liberalization, we calculated the proportional reductions to GTAP 2001 base tariffs. This approach was necessary because of the limited trade and tariff information available, but it is recognized that it carries a possible aggregation bias, as it does not capture the different elasticities of demand between liberalized and non-liberalized imports.

Information on the bilateral agricultural tariff concessions was obtained from the official agreements. As in the case of the EU-Albania FTA, tariff concessions were aggregated to GTAP sectors using import weights and HS8 agreements with the GTAP. The percentage tariff reductions were calculated using GTAP tariffs for 2001 as a basis. The final post-FTA tariff schedule is presented in Annex 4.

This experiment is likely to have relatively small welfare effects. Although Bulgaria, Romania and Croatia are Albania's strongest trading partners in the South East European region, the levels of bilateral trade are still small relative to those with the EU. Thus, even if tariffs are completely eliminated, the aggregate impact on trade, prices and production is likely to be much smaller in magnitude.

E5: Albania's Free Trade Areas with the EU and Bulgaria, Romania and Croatia
This scenario explored the full potential of the Albanian SAP. It was essentially the combination of experiments E2 (EU-Albania FTA) and E4 (Albania's FTAs with South East European countries) and aimed to address the impact of Albania's full tariff liberalization under the Stabilization and Association Agreement.

Overall, this experiment is likely to produce a stronger welfare effect for both Albania and its respective partners. However, stronger welfare gains are not guaranteed, as the combination of the remaining trade distortions, primarily in agricultural trade, can lead to stronger trade-diversion effects, thus limiting the beneficial effects of the liberalization.

E6: Albania's Harmonization with EU Standards
With this experiment the analysis moves to the non-tariff aspects of the EU-Albania SAA. As already noted, the Agreement requires Albania to adopt and implement all EU regulations on technical barriers to trade (TBTs), as well as sanitatary and phytosanitary standards (SPS). Harmonization with European TBT and SPS norms and regulations is meant to address any remaining trade costs that accrue to Albanian exporters, due to the heterogeneous systems of standardisation and conformity assessment. Different standards require changes in production to meet EU regulations. They also imply duplicative testing and certification of traded products, as the EU will not accept Albanian conformity assessment systems. These, in turn, impose a real resource cost on Albanian exporters to the EU. If Albania harmonizes its regulations with those of the EU, export costs will fall. This will drive the final price down, increasing demand for Albanian exports.

The GTAP does not explicitly capture the unobserved trade costs arising from heterogeneous standards and conformity assessment procedures. To address these costs, our analysis follows Hertel, et al. (2001). This approach introduces a new variable into the GTAP model, which allows one to lower the average import price, thereby encouraging an expansion of imports (see also Walkenhorst and Yasui, 2003; Fox et al., 2003). Given the values of trade elasticities in the GTAP, a reduction in trade costs should lead to an increase in both observed expenditures on imports and the share of imports from partners to which this reduction in trade costs is applied (Hertel et al., 2001) It should be recognized that our modelling approach focuses only on the benefits of standards

harmonization, that is, enhanced market access.[16] Adopting EU regulations, however, will also impose a cost on Albanian producers, as production processes will have to be changed to ensure compliance and more expensive intermediate products and parts will possibly be needed to meet new requirements. These one-off and recurring costs are not taken into account in this exercise.

Available data on the magnitude of TBT and SPS restrictions on trade are generally limited. With the exception of a few larger studies that combine econometric estimates with in-house surveys, most researchers rely on secondary estimates and even guesstimates. At a European level, the most comprehensive analysis of barriers comes from the European Commissioner's (1988) study of the EC Single Market. It estimated that the harmonization of European standardization and certification regimes would reduce trading costs by up to 2% of the value of trade. Similarly, CGE studies of the EC single market, assumed that heterogeneous standards and border formalities implied a tariff equivalent of 2.5% across the board (Smith and Venables, 1998; Harrison et al., 1996). Later studies on EU enlargement to Central and Eastern Europe have employed slightly stronger estimates. For example, Baldwin, et al. (1997) assume a tariff equivalent of 5-10 percent, while Lejour et al. (2001) estimate barriers of between 5 and 18%. At a global level, UNCTAD (1994) also estimates that straightforward trade facilitation measures could reduce these costs by 2% of the value of the trade, while the Australian Industry Commission (1995) found potentially higher savings in the context of APEC, of between 5 and 10% of the value of the trade. Finally, Francois, van Meijl and van Tongeren (2003) CGE study on trade facilitation assumes that full liberalization of trade costs would amount to 3% of the value of the trade, while partial liberalization would amount to 1.5%. Annex 6 provides a summary of the estimates and guesstimates of other studies.

For the purposes of our analysis, we used a conservative middle way to other estimates available in the literature. This corresponds well with Francois et al.'s (2003) estimates of the full trade costs. We therefore assumed that Albania's harmonization with EU standards and certification procedures would amount to a reduction in trade costs of 3% of the value of trade. This cost reduction is not applied uniformly across the board, but was weighted by Albanian exports to the EU. The final set of weighted guesstimates is presented in Annex 7. For comparative purposes, this scenario was also run on alternative sets of estimates from the literature. The results of this exercise are presented in Annex 9.

[16] There are additional benefits, which are not taken into account in this exercise. These consist of efficiency gains to Albanian producers stemming from the realization of internal and external economies of scale. Harmonisation with common standards will lead to greater compatibility between intermediate products and parts, as well as necessitating the adoption of more efficient production processes. These could bring improvements in total factor productivity, as indicated by the EC (1988) study of the EC Single Market. Moreover, standards harmonization reduces the heterogeneity between Albanian and EU products, and thus increases the elasticity of substitution between domestic goods and imports in both regions (Armington elasticity in GTAP) which Ganslandt and Markusen (2000) have shown can lead to a further improvement in welfare.

E7: Modernization of customs - reduction in delays for foreigners into Albania
Our final experiment modelled the impact of customs modernization in Albania. As already noted, Albania is required under the SAA to harmonize its customs legislation with that of the EU. While customs modernization, as such, is not strictly within the provisions of the Agreement, the EU, in co-operation with the World Bank, has been supporting Albanian efforts in this area in recent years. The 2004 Report of the Albanian Centre for International Trade (ACIT) argues that, while considerable challenges remain in Albanian customs administration, substantial efforts have been made towards facilitation and simplification. Recall from section 3.3 that the average customs clearance time in Albania in 2003 was 5.3 days. This had fallen to 1.9 days in 2004. This reduction in customs delays represents a significant reduction in costs for foreign and Albanian companies. Hummels (2001) emphasizes that such time savings can have a profound effect on international trade by reducing both 'spoilage' and inventory holding costs. He finds that the average value of firms' willingness to pay for one day saved in trade is estimated to be 0.5% ad valorem. Assuming that in 2001 the average customs clearance time in Albania was 5.3 days, this would translate into a 2.65% tariff equivalent, which would apply across the board to all Albanian imports.

Customs procedures are frictional in nature, involving clearance, documentation, surveillance and inspection. Given these characteristics, one can think of such costs as the additional purchases of transportation services required in shipping a good from one region to another (Harrison et al., 1996). Indeed, an extra hour of delay at the border, due to non-automation of procedures or detailed inspection by customs officials, is equivalent to an extra hour of transportation of the commodity from the producer to the end user. To take account of this, our exercise modelled improvements in customs administration as a reduction in transport costs.

The deeper integration scenarios captured by experiments E6 and E7 do not take account of the impact on trade elasticities of trade facilitation and regulatory harmonization, both of which will reduce the heterogeneity between Albanian and EU products, which in turn will increase the elasticity of substitution between domestic goods and bilateral imports in both regions. Unfortunately these effects are assumed away in the GTAP, as on the export supply side the model specifies a perfect elasticity of transformation of domestic goods into exports. This, in turn, tends to exaggerate the terms of trade on the standard GTAP model, as will be seen in the next section.

Box 2 Summary of Experiments

E1: Unilateral Liberalization
- Elimination of all import tariffs for industrial and agricultural products into Albania

E2: EU-Albania Free Trade Area
- Elimination of all import tariffs for industrial products between Albania and EU
- Elimination of all import tariffs for agricultural exports from Albania into EU
- Reduction of import tariffs for agricultural exports from the EU into Albania according to negotiated concessions (see Annex 4)

E3: EU-Albania Customs Union
- E2 (EU-Albania FTA) and
- Adoption by Albania of the EU Common External Tariff (see Annex 5)

E4: Albania's Free Trade Areas with Romania, Bulgaria and Croatia
- Elimination of all import tariffs for all industrial products between Albania and Bulgaria, Croatia and Romania
- Reduction of import tariffs for agricultural products between Albania and Bulgaria, Croatia and Romania according to negotiated concessions (see Annex 4)

E5: Albania's Free Trade Areas with the EU, Bulgaria, Romania and Croatia.
- Full SAP liberalization: Combination of experiments E2 and E4

E6: Harmonisation to EU Standards
- Reduction of real trade costs for Albanian exports into the EU.
- Cost reduction based on the guesstimate of Francois et al. (2003) weighted by base trade data (see Annex 7)

E7: Modernization of Albanian customs
- Reduction of transportation cost for all regions' exports to Albania
- Cost reduction based on an estimated tariff equivalent of the delays reported by the Albanian Centre for International Trade (see Annex 7)

Additional Experiments in Annexes 8, 9 and 10

Chapter 5: Discussion of Results

This section discusses the results of our seven simulation scenarios. It is recognized that CGE modelling has both strengths and weaknesses and that results can be misinterpreted, if taken outside the strict assumptions of the model. This does not weaken the powerful insights of general equilibrium modelling, but implies that the results should not be treated as absolute truths, but rather as strong indicators of the possible direction of change.

We begin with an overview of the summary findings focusing on Albania's welfare, trade and sectoral production. This is followed by a more detailed analysis of specific experiments, starting with unilateral liberalization, followed by regional integration under the SAP and ending with non-tariff liberalization under standards harmonization and customs administration.

5.1 Summary findings

Starting with a summary of welfare effects, Table 5.1 illustrates the impact of individual experiments, by region. In the GTAP, welfare is measured as a change in equivalent variation[17] and is presented below both in its money metric absolute levels (million US$) and as a percentage of GDP. Both of these measures represent annual changes in welfare and national income.

[17] Equivalent variation provides a monetary measure of the welfare effects of a specified change in the economy. It refers to the amount of money that, paid to a person, group, or the economy as a whole, would make them as well off as would the specified change.

Table 5.1 Summary welfare effects for all regions

	E1 Unilateral		E2 EU-Albania FTA		E3 EU-Albania CU		E4 Albania SEE FTAs		E5 Albania FTA with EU & SEE		E6 Standards		E7 Customs	
	($m)	% GDP	($m)	% GDP	($m)	% GDP	($m)	% GDP	($m)	% GDP	($m)	% GDP	($m)	% GDP
ALB	76.43	1.86	59.12	1.44	73.45	1.79	3.30	0.08	62.42	1.53	12.92	0.31	7.42	0.18
EU	28.56	0.00	43.72	0.00	27.91	0.00	-3.89	0.00	39.84	0.00	0.42	0.00	0.32	0.00
EFTA	2.29	0.00	-0.36	0.00	2.01	0.00	-0.29	0.00	-0.65	0.00	0.07	0.00	0.05	0.00
BUL	0.56	0.00	-1.35	-0.01	0.24	0.00	2.14	0.02	0.79	0.01	0.01	0.00	0.03	0.00
ROM	-0.56	0.00	-3.24	-0.01	-0.70	0.00	3.47	0.01	0.23	0.00	-0.08	0.00	-0.08	0.00
CRO	0.47	0.00	-1.49	-0.01	0.12	0.00	2.25	0.01	0.76	0.00	0.06	0.00	0.13	0.00
ForSU	1.12	0.00	-4.24	0.00	-0.86	0.00	-0.16	0.00	-4.41	0.00	-0.04	0.00	-0.10	0.00
TUR_MENA	3.57	0.00	-6.22	0.00	1.63	0.00	-0.50	0.00	-6.72	0.00	-0.27	0.00	0.04	0.00
NAFTA	4.24	0.00	1.05	0.00	0.73	0.00	-0.38	0.00	0.67	0.00	-1.23	0.00	-0.26	0.00
ROW	8.88	0.00	0.73	0.00	3.97	0.00	0.20	0.00	0.94	0.00	-2.50	0.00	-0.27	0.00

Source: Author's simulations

A first key finding is that the overall welfare effects of unilateral liberalization are stronger than the effects of various regional integration scenarios. This is a standard result (see, for example, Evans, 2003). Indeed, unilateral liberalization (E1) produces the strongest possible gains for Albania, reaching 1.86% of GDP. Despite this, we also find that regional integration under the auspices of the SAP can also have a positive impact on Albania's welfare. More specifically, welfare gains under a free trade area with the EU (E2) and the free trade areas with other SE European countries (E4) are around 1.44 and 0.08% respectively. This suggests that the overall welfare effects of the SAP could be significantly higher, and our combined experiment (E5) confirms this, indicating gains of around 1.53% of GDP. Other SAP partners also gain from liberalization, although the benefits are negligible, ranging between 0.01% and 002% of GDP. A further interesting finding comes from the hypothetical scenario of extending the EU-Albania FTA to a full customs union (E3). This indicates that should Albania adopt the EU Common External Tariff, benefits from regional integration could reach 1.79% of GDP. Turning finally to the non-tariff aspects of the SAA, our analysis suggests that Albania stands to benefit from both the harmonization with EU standards and certification regimes and the modernization of customs procedures. Although gains are not as strong as under traditional tariff-related liberalizations, our simulations show welfare gains of 0.31 and 0.18% of GDP respectively from standards harmonization and customs administration.

The fact that regional integration under the auspices of the SAP does not outweigh the effects of unilateral liberalization is not surprising. Regional integration is preferential by design and covers only a specific number of trade partners (EU and SE Europe), while unilateral liberalization introduces an across-the-board opening-up of the Albanian economy and thus maximizes potential benefits from the reallocation of resources. It is interesting to note, however, that the difference between the welfare effects of unilateral (E1) and full SAA liberalizations (E5) is relatively small, namely 1.86% and 1.53% respectively. This finding is mainly driven by the fact that the EU and South Eastern Europe are Albania's strongest trading partners, and suggests that regional integration under the SAA will be trade-creating. In fact, if one were to add to the full SAA (E5) the benefits from standards harmonization and customs modernization (E6 & E7), the overall gains could reach 2% of GDP. This result is in line with that of similar studies on other countries, which find gains of between 1% and 6% from tariff and non-tariff liberalization with the EU[18].

The previous discussion is further emphasized by Table 5.2, which illustrates changes in aggregate consumption, investment, trade and factor income under the alternative scenarios. The results are presented as a percentage change from base value. As can be seen, the overall trade effects of SAP-based liberalizations are smaller that those under unilateral liberalization. Consumption and investment effects are generally similar across all experiments. It is interesting to note that households' consumption is generally weaker

[18] Piazolo, DS (2000) study of Poland for example finds that tariff and non-tariff liberalization would bring gains of around 0.6% from accession, while Lejour et al. (2001) estimate that CEECs gains from joining the Single Market could reach 5.6%.

under unilateral liberalization and stronger under regional integration, while the inverse holds for private investment.

Table 5.2 Summary Macro Effects for Albania (percentage change from base)

		E1	E2	E3	E4	E5	E6	E7
		Unilateral	EU-Albania FTA	EU-Albania CU	Albania SEE FTAs	Albania FTA with EU & SEE	Standards	Customs
	Base ($m)	Percentage Change from the Base						
Absorption	4672.4	2.42	2.77	1.30	0.20	2.96	0.72	0.25
Consumption	3858.6	0.08	1.12	1.58	0.07	1.19	0.65	0.21
Investment	813.8	12.19	9.90	0.12	0.79	10.54	1.06	0.48
Exports	865.2	8.30	5.08	5.35	0.20	5.26	0.45	-0.13
Imports	1881.3	10.22	7.75	9.30	0.52	8.20	0.86	0.24

Source: Author's simulations.

Turning next to the aggregate trade effects of our experiments. Table 5.3 illustrates the percentage change from the base value in Albania's sectoral exports and imports. Overall, trade expands under all scenarios. A striking feature is the growth in low-skill manufacturing exports, especially metal products, apparel and other manufacturing. As expected unilateral liberalization has the biggest positive impact, followed by full SAP liberalization (E5) and the hypothetical customs union (E4). In the context of the SAP, Albania's free trade areas with the EU and South Eastern Europe appear to favour more strongly the exports of processed food, apparel, metal products and other manufacturing. More mixed results are derived from non-tariff barrier liberalizations. Standards have an overall positive effect on trade, although growth is more pronounced in imports relative to exports. Again, it is apparel, textiles and metals that take the lead in export growth, but we also find that chemicals, machinery and equipment and mineral exports also increase with standards harmonization. Finally, the modernization of customs administration has, as expected, an overall positive effect on imports, but a less favourable impact on Albania's exports.

Table 5.3 Changes in Albania's total trade by activity (% change from base)

	EXPORTS								IMPORTS							
	Base Value ($m)	**E1** UNIL	**E2** EU-ALB FTA	**E3** EU-ALB CU	**E4** ALB SEE FTA	**E5** FTA ALL	**E6** STA	**E7** CUST	**Base Value ($m)**	**E1** UNIL	**E2** EU-ALB FTA	**E3** EU-ALB CU	**E4** ALB SEE FTA	**E5** FTA ALL	**E6** STA	**E7** CUST
Crops	24.1	10.7	-1.4	-4.5	-0.1	-1.5	-0.2	-0.1	44.9	7.7	-4.5	4.2	0.1	3.9	-0.1	0.4
Fru & Veg.	6.4	7.5	0.1	-1.6	0.2	0.3	-1.2	-0.1	37.4	10.1	-1.6	5.9	0.1	5.5	-0.1	0.6
Animal Pro	13.7	15.2	0.0	-3.9	0.0	0.0	1.4	-0.1	26.2	21.0	-3.9	-6.1	0.1	3.2	-0.1	0.5
Fisheries	0.3	7.8	-2.2	-2.5	0.0	-2.2	-0.6	0.0	2.6	9.0	-2.5	2.9	0.1	2.0	0.0	0.4
Forestry	2.6	-3.3	-3.3	-4.6	-0.3	-3.6	-7.4	-0.4	0.5	7.3	-4.6	0.2	0.2	-0.6	-0.4	0.4
Proc Food	13.4	2.5	38.4	36.1	-0.2	38.2	0.0	-0.3	109.3	14.7	36.1	7.4	0.2	7.4	-0.3	0.4
Tob & Bev	0.9	3.1	0.8	0.3	0.1	0.9	-1.8	-0.1	72.2	4.3	0.3	1.6	0.1	1.3	-0.1	0.1
Minerals	7.7	16.0	8.9	11.5	2.2	11.1	4.3	0.0	300.1	12.1	11.5	11.7	1.6	9.7	0.0	0.4
Metal Prod	34.8	28.0	18.2	22.9	1.5	19.6	8.5	0.2	142.5	16.9	22.9	16.0	0.6	13.4	0.2	0.4
Textiles	13.7	17.0	10.0	11.0	0.2	10.2	7.1	-0.2	93.3	12.9	11.0	11.5	0.2	9.5	-0.2	0.2
Apparel	200.0	28.8	19.7	22.0	0.4	20.1	9.5	0.0	168.3	11.6	22.0	11.0	0.1	10.2	0.0	0.2
Wood&Pa	22.9	4.0	1.4	0.8	0.0	1.4	2.2	-0.3	60.3	21.5	0.8	22.3	0.9	19.0	-0.3	0.6
Chemicals	8.4	20.5	13.7	17.4	2.4	16.2	5.3	0.3	140.1	5.5	17.4	5.3	0.2	4.5	0.3	0.2
Autom. Pr	3.2	18.3	11.0	13.0	2.8	13.7	2.6	-0.1	46.0	9.6	13.0	9.4	0.4	7.9	-0.1	0.3
Mach&Eq.	38.5	24.6	14.6	18.2	0.8	15.4	4.3	-0.1	211.9	11.8	18.2	11.4	0.6	9.5	-0.1	0.3
Other Manuf	12.2	26.6	17.1	21.0	0.8	17.9	1.5	0.0	148.8	8.0	21.0	7.9	0.4	6.9	0.0	0.3
Construct.	1.8	14.5	9.3	11.7	1.1	10.3	-3.3	0.2	1.1	9.3	11.7	10.1	0.4	8.3	0.2	0.4
Utilities	2.9	-4.8	-6.6	-8.8	-0.3	-6.9	-8.5	-0.6	129.7	3.6	-8.8	5.0	0.2	4.1	-0.6	0.3
Trade&Tra	297.7	0.3	-1.8	-2.6	0.1	-1.7	-5.2	-0.3	139.2	2.9	-2.6	4.0	0.1	3.2	-0.3	0.3
Pub Service	52.0	-1.1	-3.2	-4.6	-0.2	-3.4	-5.6	-0.4	54.8	0.8	-4.6	2.9	0.1	2.2	-0.4	0.3
Ot Services	90.5	-2.4	-4.6	-6.4	-0.3	-5.0	-5.6	-0.4	116.0	4.1	-6.4	5.3	0.3	4.4	-0.4	0.3
Total	*847.9*	*10.7*	*6.0*	*6.3*	*0.2*	*6.2*	*0.3*	*-0.2*	*2045.4*	*9.8*	*6.3*	*8.8*	*0.5*	*7.6*	*-0.2*	*0.3*

Source: Author's simulations

Finally, it is useful to consider briefly the resulting output effects of our experiments. Table 5.4 illustrates the percentage change in Albania's sectoral production under our seven scenarios. Output expands in all our policy experiments, but there are notable sectoral variations. The biggest growth in production takes places in low-skill manufacturing including apparel, machinery and equipment and other manufactures. This, however, takes place against a contraction in the minerals, textiles and chemicals industries. Agricultural and primary production also reveals a mixed response to liberalization. While fruit and vegetables, animal products and (in most scenarios) processed food respond positively to liberalization, forestry loses out in all scenarios. Services, although not subjected to any tariff reductions, appear to benefit from liberalization – driven primarily by increased demand from other expanding sectors. Overall, the strongest impact is observed under unilateral liberalization, followed by the SAP reforms and non-tariff liberalizations.

Table 5.4 Summary effects on sectoral output (% change from base)

	Base value	**E1** Unilateral	**E2** EU-Albania FTA	**E3** EU-Albania CU	**E4** Albania SEE FTAs	**E5** Albania FTA with EU &SEE	**E6** Standards	**E7** Customs
	($ million)	% change from base value						
Crops	180.78	-0.06	0.33	0.42	0.04	0.37	-0.25	-0.07
Fruit & Veg.	284.76	0.00	0.57	0.90	0.09	0.66	0.38	0.01
Animal Prods	469.70	0.84	1.90	3.18	0.10	2.00	0.88	0.10
Fisheries	5.10	-1.29	0.82	0.90	0.08	0.90	0.27	0.00
Forestry	45.47	-2.38	-2.61	-3.20	-0.07	-2.68	0.14	-0.10
Proc Food	255.15	-4.65	0.77	1.26	0.03	0.80	-0.06	-0.04
Tob & Bev	9.75	-10.22	1.48	1.47	0.12	1.60	-0.46	-0.03
Minerals	190.42	-10.98	-8.86	-11.79	-1.54	-10.40	-1.15	-0.52
Metal Prods	125.37	0.18	-0.85	-1.32	0.51	-0.34	2.46	0.00
Textiles	43.55	-7.13	-7.17	-10.50	0.15	-7.02	2.23	-0.40
Apparel	241.82	20.31	12.49	14.11	0.31	12.80	7.84	-0.05
Wood&Paper	142.49	-5.83	-5.88	-7.11	-0.18	-6.06	0.17	-0.21
Chemicals	31.09	-4.29	-3.90	-5.90	0.63	-3.27	0.64	-0.03
Autom. Prods	7.72	0.22	-2.22	-2.25	1.41	-0.80	0.49	-0.05
Mach&Equip	45.50	21.29	12.48	15.35	0.68	13.16	3.44	-0.06
Oth Manuf	17.81	16.27	8.95	11.52	0.67	9.62	0.37	-0.06
Construction	540.58	16.40	12.52	15.93	0.93	13.45	2.74	0.56
Utilities	296.55	0.79	0.29	0.25	0.01	0.30	-0.11	0.02
Trade&Trans	1923.71	2.93	1.88	2.33	0.17	2.05	0.06	0.10
Pub. Services	461.02	0.15	0.08	0.09	-0.01	0.07	0.05	0.06
Oth Services	1191.44	2.25	1.31	1.57	0.09	1.40	0.30	0.11
Total	6509.76	2.97	2.14	2.66	0.14	2.28	0.72	0.08

Source: Author's simulations

5.2 Effects of unilateral liberalization

Unilateral liberalization was included in our experimental design to establish a benchmark across all our policy scenarios. As our previous discussion has demonstrated it is, indeed, under this scenario that Albania can achieve the strongest possible welfare, trade and production effects. In this section we look more closely at the channels through which these gains are realized.

We begin by looking at the sources of welfare change. These include allocative efficiency (allocative effects), endowment (employment) gains, technical change, terms of trade and investment effects[19].

Table 5.5 Welfare Decomposition under (E1) Unilateral Liberalization

	Allocative Effects	Endowment Effects	Technical Change	Terms of Trade	Investment Effects	Total	
	($ million)					($ million)	*% of GDP*
ALB	73.5	57.5	0.0	-12.5	-42.1	76.4	1.858
EU	-1.8	0.0	0.0	20.7	9.6	28.6	0.000
EFTA	0.3	0.0	0.0	1.4	0.6	2.3	0.001
BUL	0.1	0.0	0.0	0.5	0.0	0.6	0.004
ROM	-0.1	0.0	0.0	-0.4	-0.1	-0.6	-0.001
CRO	0.2	0.0	0.0	0.3	0.0	0.5	0.002
ForSU	0.0	0.0	0.0	0.3	0.8	1.1	0.000
TUR_MENA	0.3	0.0	0.0	1.9	1.4	3.6	0.000
NAFTA	-0.8	0.0	0.0	-4.7	9.7	4.2	0.000
ROW	-3.7	0.0	0.0	-7.5	20.0	8.9	0.000

Source: Author's simulations

As illustrated in Table 5.5, Albania's gains from unilateral liberalization stem mainly from allocative efficiency and endowment effects. This is not surprising. With complete liberalization, resources are free to move according to full comparative advantage, thus maximizing efficiency gains from reallocation. Moreover, as production shifts to activities intensive in factors abundant in the economy, output expands in labour intensive sectors. This leads to an increased demand for unskilled labour, which improves aggregate employment in the economy. Against these positive effects, however, Albania also experiences a significant deterioration in its terms of trade. Recall from our earlier discussion that the standard GTAP assumes a perfect elasticity of transformation between domestic goods and exports. As a result, export prices tend to fall significantly faster than import prices following the liberalization of tariffs, which in turn leads to a strong deterioration in Albania's terms of trade.

[19] The GTAP also allows for two additional welfare channels: population effects and adjustment for non-homothetic preferences. These produce zero results across all our experiments and are therefore omitted from the discussion.

Turning to trade effects, our summary discussion illustrated that unilateral liberalization produces the strongest possible trade expansion. Both exports and imports grow across all sectors, with more pronounced increases in metals, wearing apparel, machinery and equipment and other manufacturing. Here we focus more on changes in the regional direction of trade. Overall, Albania's trade expands with all regions under unilateral liberalization. The EU remains the strongest trading partner, with exports and imports growing by 14.8% and 11.2% respectively. Interestingly, however, shifts in trade with other regions are not necessarily reflected by the regional base shares. The rest of Western and Eastern Europe (EFTA, Bulgaria, Romania and Croatia) may not account for particularly large proportions of base trade, but they reveal a strong increase for both exports and imports. This is particularly true for exports to Croatia and imports from Bulgaria which grow by 11.9% and 3.8% respectively.

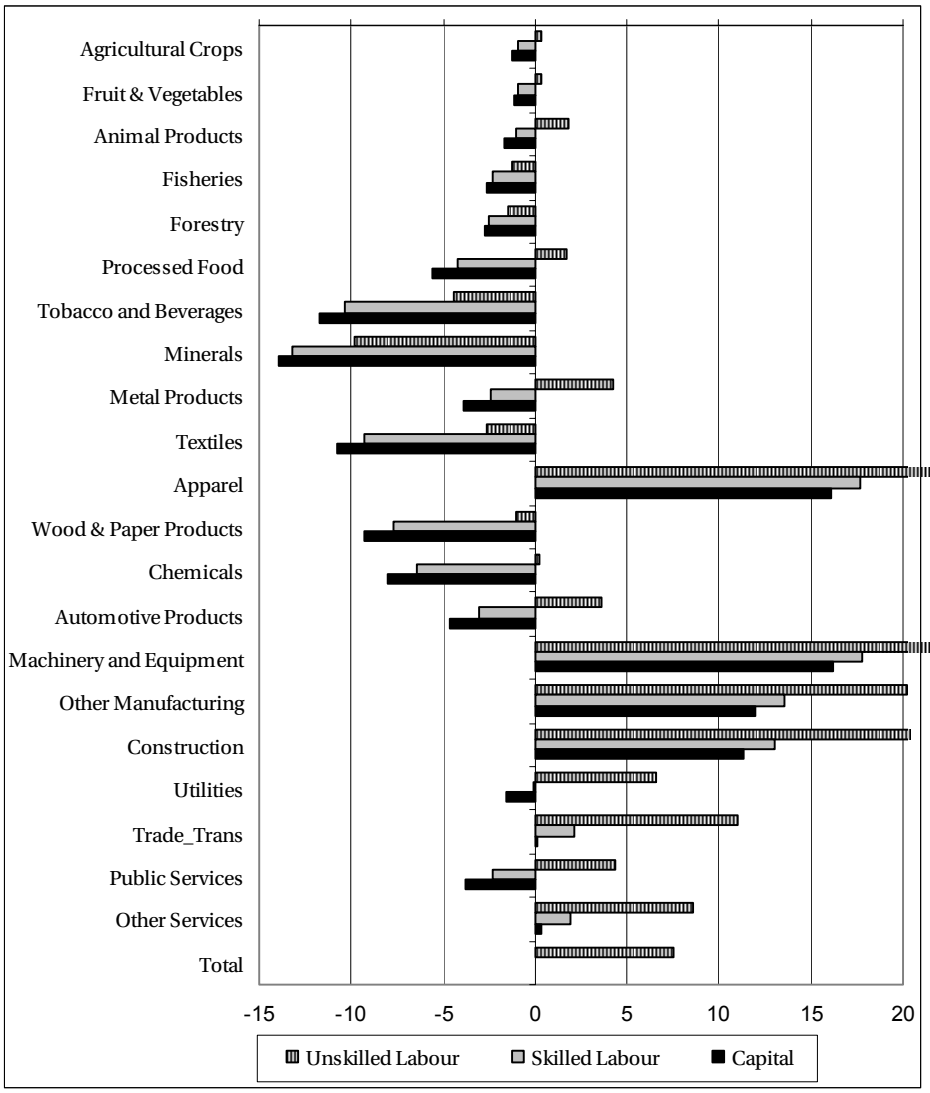
Table 5.6 Albania's exports and imports (by region)

	EU	**EFTA**	**BUL**	**ROM**	**CRO**	**ForSU**	**TUR MENA**	**NAFTA**	**ROW**	**Total**
EXPORTS										
Base Value ($ m)	543.2	37.2	0.6	1.7	1.6	14.9	36.1	130.5	110.4	876.3
(% change from base)	*14.8*	*11.1*	*3.8*	*6.1*	*11.9*	*1.7*	*6.1*	*1.4*	*1.2*	*10.3*
IMPORTS										
Base Value ($ m)	1370.7	129.5	31.3	36.3	26.9	74.4	113.4	123.1	139.5	2045.4
(% change from base)	*11.2*	*4.7*	*11.9*	*0.1*	*5.5*	*1.8*	*15.1*	*2.9*	*8.6*	*9.7*

Source: Author's simulations

The final area of interest under unilateral liberalization concerns changes in demand for factor inputs. As Figure 5.1 illustrates, there is a clear specialization in labour-intensive (particularly unskilled labour) activities following liberalization in Albania. Demand for unskilled labour expands both in total and across most sectors of the economy, particularly apparel, machinery and equipment, other manufacturing and construction. Employment also expands for key agricultural and semi-agricultural activities such as fruit and vegetables, animal products and processed food. The only sectors where unskilled labour employment is negatively affected are forestry, minerals, textiles and wood and paper products. Demand for skilled labour also expands, although the aggregate effect is negligible. Sectorally, demand for skilled labour follows a similar pattern to unskilled. Notable exceptions where skilled labour employment contracts relative to unskilled include metal products, automotive and transport products, utilities and public services.

Figure 5.1 Demand for capital, skilled and unskilled labour under unilateral liberalization (% change from base)



Source: Author's simulations

In the light of our previous discussion, we could argue that unilateral liberalization will have a positive effect on growth and overall welfare in Albania. This will arise from increased trading opportunities, stronger competitiveness and a substantial improvement in efficiency due to the reallocation of resources. Gains will generally benefit most workers and production activities, but the picture is slightly uneven. The benefits of growth will be greater in the manufacturing sectors followed by agriculture. Overall,

employment opportunities improve in aggregate, especially for unskilled workers. Aggregate demand for unskilled labour expands, while the most pronounced increase is observed in the apparel and manufacturing sectors. However, employment in textiles, minerals, forestry and wood and paper industries will contract. Workers in these industries could be considered as vulnerable to a unilateral liberalization episode.

5.3 Effects of Albania's free trade areas with the EU and South Eastern Europe

In this section, we return to our discussion of the effects of regional integration under Albania's Stabilization and Association Agreement/Process. We focus on the EU-Albania FTA (E2), the FTAs between Albania and other South East European countries (E4) and the combined effect of all free trade areas under the SAA (E5).

Starting with welfare effects, Table 5.7 illustrates the possible channels of change. As before, we focus on allocative efficiency, endowment, technical change, terms of trade and investment effects, but narrow our regional focus, mainly because the impact on non-SAA partners was found to be negligible. As already argued in our summary discussion, Albania gains across all scenarios. There are important differences, however. While the total possible impact of SAA liberalization (E5) reaches 1.54% of GDP, this is driven primarily by Albania's FTA with the EU. Integration with other SE European countries is found to have a relatively small effect on Albania, reaching only 0.08% of GDP. Overall, gains grow mainly from improvements in allocative efficiency and endowment. Regional liberalization, although not as extensive as unilateral, will increase competition through cheaper imports from the EU and South East Europe and exert greater pressure for a more efficient allocation of resources. Production will shift to reflect Albania's comparative advantage better, and as a result labour-intensive activities will expand, exerting a positive effect on total employment. Effects on other SAA partners are generally small, but their distribution is useful to highlight. The EU gains under bilateral liberalization with Albania primarily because of enhanced efficiency and improved terms of trade, but loses slightly when Albania liberalizes only vis-à-vis other South East European countries. Similarly, all SEEs experience small losses from the EU-Albania FTA, but realize small gains from bilateral FTAs (up to 0.016% of GDP). It is only under the unified SAA scenario (E5) that gains are shared by all partners.

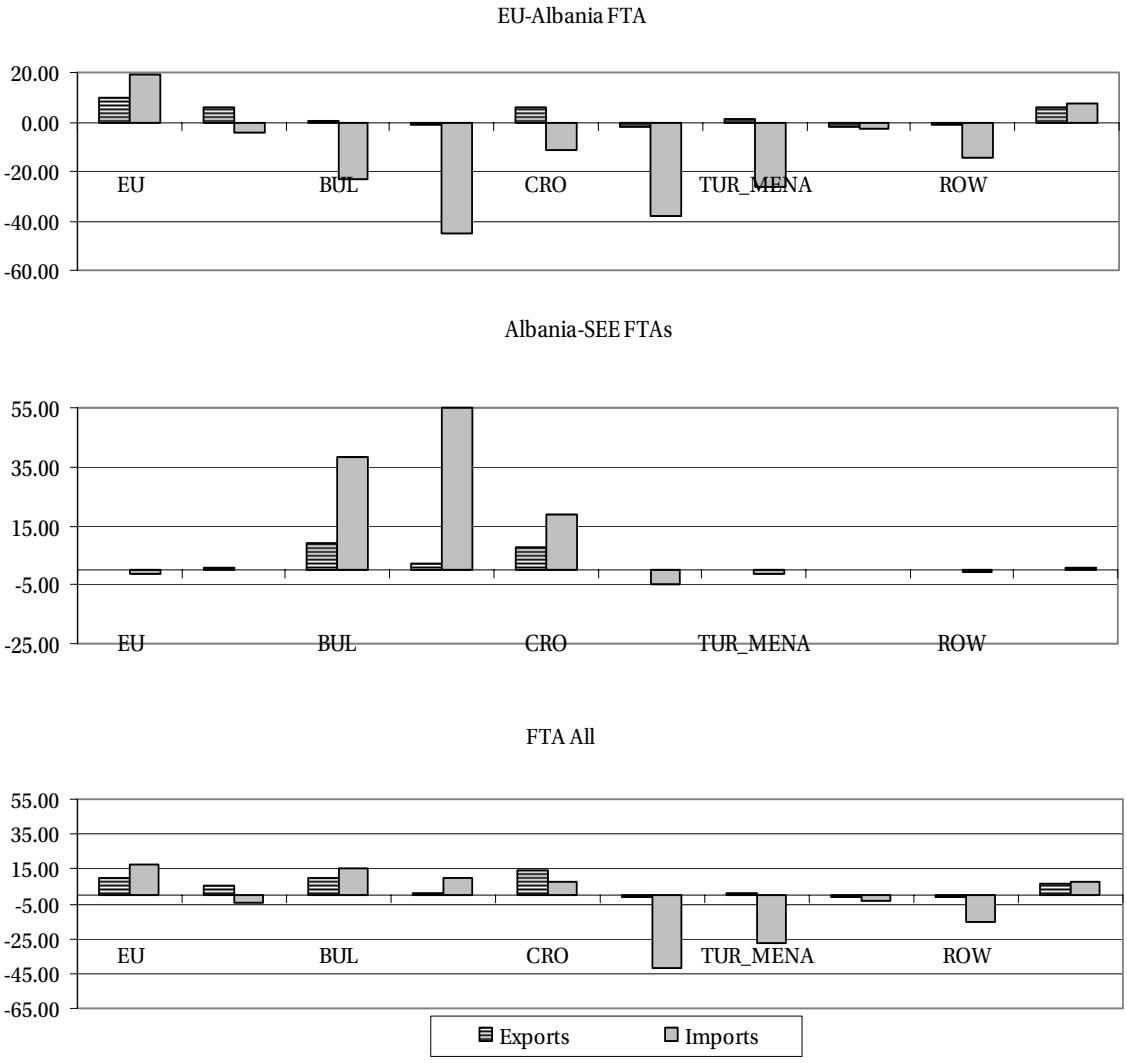
Table 5.7 Welfare decomposition of SAA Liberalization (E2, E4, E5)

	Allocative effects	Endowment effects	Technical change	Terms of trade	Investment effects	Total	
	($ million)					($ m.)	% of GDP
E2: EU-Albania Free Trade Area							
ALB	52.4	39.7	0	-4.5	-28.5	59.1	1.437
EU	3.8	0	0	33.7	6.1	43.7	0.000
BUL	-0.2	0	0	-1.1	0.0	-1.4	-0.010
ROM	0.0	0	0	-2.7	-0.4	-3.2	-0.008
CRO	-0.9	0	0	-0.4	0.0	-1.5	-0.007
E4: Albania-SEE Free Trade Areas							
ALB	3.0	2.8	0.0	-0.2	3.3	3.3	0.080
EU	-0.8	0.0	0.0	-3.5	-3.9	-3.9	-0.000
BUL	0.3	0.0	0.0	1.8	2.1	2.1	0.016
ROM	0.0	0.0	0.0	3.0	3.5	3.5	0.009
CRO	1.4	0.0	0.0	0.8	2.3	2.3	0.011
E5: Albania's Free Trade Areas with the EU and SEE							
ALB	55.4	42.5	0.0	-4.8	-30.7	62.4	1.517
EU	3.0	0.0	0.0	30.3	6.6	39.8	0.000
BUL	0.1	0.0	0.0	0.7	0.0	0.8	0.006
ROM	0.0	0.0	0.0	0.3	0.0	0.2	0.001
CRO	0.4	0.0	0.0	0.3	0.1	0.8	0.004

Source: Author's simulations

Turning to trade effects, Figure 5.2 illustrates changes in Albania's bilateral trade with other regions. As can be seen, EU-Albania trade expands under their bilateral FTA, but at the expense of trade with other countries. Although Albania's exports increase towards certain regions (EFTA, Croatia, Turkey and MENA), imports from all regions other than the EU show a reduction. A similar pattern is obtained from Albania's FTAs with Bulgaria, Romania and Croatia. The regions that experience the most pronounced loss in export shares to Albania include the Former Soviet Union countries, Turkey, the Middle East and North Africa and the rest of the world. This strong shift in the regional sourcing of Albania's imports would have raised concern about the balance in trade creation and trade diversion under the SAA liberalizations. However, as our previous discussion has shown, all FTAs are welfare-improving. While there is some trade diversion, this is outweighed by trade creation.

Figure 5.2 Albania's trade by region under SAA scenarios -E2, E3, E5 (% change from base)



Source: Author's simulations

The previous discussion is further illustrated in Table 5.8, which shows the percentage change in Albania's output, exports and imports under the full SAP scenario. Although the picture is relatively mixed, Albanian domestic production and exports increase across most sectors. The most pronounced expansion is observed in apparel, machinery and equipment and processed food. Export growth is absorbed primarily by the EU, followed by Romania and Croatia. Against this positive picture, however, key Albanian

manufacturing sectors namely, minerals, metals, chemicals, and textiles ,experience a contraction following the full SAP. This is accompanied by an expansion of imports, mainly from the EU and Romania, which implies that historically these sectors were protected from foreign competition against the economy's true comparative advantage. With the opening up of markets, there is increased pressure from abroad and a subsequent replacement of inefficient domestic production with imports. This is another indication that the SAA is trade-creating, but it is clear that the welfare gains are not shared by all. While Albanian consumers will benefit across the board from cheaper products, the effects on Albanians as producers and workers is mixed across industries. Thus, while agriculture, processed food, apparel, machinery and equipment and construction benefit, other industries like minerals, metals, chemicals, and textiles appear to lose out. In general, the severity of these losses will depend on the flexibility of the economy and the ability of workers/producers to shift to more viable activities after the liberalization.

Table 5.8 Albania's output, exports and imports under E5: Full FTA scenario (% change from base)

	DOMESTIC OUTPUT	EXPORTS				IMPORTS			
		EU	BUL	ROM	CRO	EU	BUL	ROM	CRO
Crops	0.3	-1.4	-1.6	-1.7	-1.6	14.8	-0.9	-0.9	-0.9
Fruit & Veg.	0.6	0.1	0.1	29.5	0.1	9.5	-6.0	-3.1	-6.0
Animal Prods	2.0	-0.1	-0.1	-0.1	-0.1	4.4	1.2	1.2	1.2
Fisheries	0.9	-2.1	-2.8	-3.3	-3.3	2.7	2.7	2.7	2.7
Forestry	-2.6	-3.4	-4.1	-4.0	-4.1	-0.6	-0.6	-0.6	-0.6
Proc Food	0.8	60.1	-3.2	33.5	-3.6	15.2	-7.9	-4.1	-6.6
Tob & Bev	1.6	3.8	0.1	0.1	0.1	1.6	1.6	9.8	1.6
Minerals	-10.4	11.1	10.4	12.9	12.9	33.1	-64.4	30.0	11.5
Metal Prods	-0.3	19.5	19.1	47.4	20.5	40.0	-55.3	46.6	45.9
Textiles	-7.0	10.2	9.8	10.2	10.2	35.8	-51.4	24.1	16.7
Apparel	12.8	20.0	19.8	20.8	20.8	21.1	-77.6	49.7	-77.7
Wood&Paper	-6.0	1.6	0.5	31.3	0.5	36.1	-40.2	23.2	17.8
Chemicals	-3.2	15.8	15.8	70.7	16.3	22.0	-42.5	20.3	5.7
Autom. Prods	-0.8	11.4	10.7	11.3	11.3	25.4	-43.8	20.5	10.0
Mach&Equip	13.1	15.3	15.0	67.0	90.9	20.7	-24.0	25.1	15.2
Oth Manuf	9.6	18.4	17.3	17.9	140.3	12.0	-40.3	40.9	-11.0
Construction	13.4	10.3	10.3	10.3	10.3	8.3	8.3	8.3	8.3
Utilities	0.3	-6.8	-6.8	-6.8	-6.8	4.2	4.2	4.1	4.2
Trade&Trans	2.0	-1.7	-1.7	-1.7	-1.7	3.1	3.1	3.1	3.1
Pub. Services	0.1	-3.3	-3.3	-3.3	-3.3	2.1	2.1	2.1	2.1
Oth Services	1.4	-4.9	-4.9	-4.9	-4.9	14.8	-0.9	-0.9	-0.9

Source: Author's simulations

To complete the picture, Table 5.9 illustrates the percentage change in skilled and unskilled labour demanded both in aggregate and by industry. Overall, demand for both skilled and unskilled labour increases in aggregate. Sectorally, demand for both labour types expands across all agricultural activities, and apparel, machinery and equipment

and other manufacturing. Although the difference is small, it is worth noting that growth in these industries is slightly stronger for skilled relative to unskilled labour. In contracting industries, the demand for labour drops for both skilled and unskilled labour. However, as can be seen in textiles, minerals and chemicals, the biggest employment losses are felt by the unskilled. In fact, in the case of metal products, it is only the unskilled that are hit by the contraction in output. Liberalization of trade in goods appears to favour skilled workers in the services sector. Given that services are mostly located in urban areas, this would suggest that unskilled urban workers would be vulnerable to liberalization. As before, the full effect will depend on labour market flexibility in Albania and the ability of expanding sectors to absorb the unemployed from contracting activities.

Table 5.9 Demand for skilled and unskilled labour in Albania under SAA -by activity (% change from base)

	Base Value		**E2** EU-Albania FTA		**E4** Albania SEE FTAs		**E5** Albania FTA with EU and SEE	
	Skilled	Unskilled	Sk	UnS	Sk	UnS	Sk	UnS
	$ million		(% change from base)					
Crops	64.7	0.7	0.9	0.0	0.1	0.0	0.9	0.0
Fruit & Veg.	102.1	1.0	1.1	0.3	0.1	0.1	1.2	0.3
Animal Prods	56.3	1.0	3.2	1.3	0.2	0.1	3.4	1.4
Fisheries	0.7	0.0	1.9	1.2	0.2	0.1	2.1	1.3
Forestry	4.4	0.0	-2.1	-2.9	0.0	-0.1	-2.2	-2.9
Proc Food	11.3	2.2	5.0	1.1	0.3	0.1	5.4	1.1
Tob & Bev	0.6	0.1	5.3	1.3	0.4	0.1	5.6	1.4
Minerals	15.6	2.8	-8.6	-10.8	-1.7	-1.9	-10.3	-12.7
Metal Prods	15.6	2.8	2.0	-2.5	0.7	0.4	2.7	-2.1
Textiles	6.0	1.0	-4.2	-8.7	0.4	0.1	-3.9	-8.6
Apparel	28.9	4.4	15.6	11.1	0.5	0.2	16.1	11.3
Wood&Paper	18.3	3.0	-2.7	-7.2	0.0	-0.3	-2.7	-7.5
Chemicals	3.1	0.7	-0.9	-5.4	0.8	0.5	-0.1	-4.9
Autom. Prods	1.9	0.4	0.1	-4.4	1.6	1.3	1.7	-3.1
Mach&Equip	10.5	2.3	15.0	10.5	0.9	0.6	15.9	11.1
Oth Manuf	3.1	0.5	11.9	7.5	0.9	0.6	12.8	8.0
Construction	75.6	14.1	15.6	10.6	1.1	0.8	16.7	11.4
Utilities	55.8	29.0	4.3	-0.2	0.3	0.0	4.5	-0.2
Trade&Trans	251.0	57.0	7.5	1.5	0.6	0.2	8.1	1.7
Pub. Services	150.0	227.9	2.9	-1.6	0.2	-0.1	3.1	-1.7
Oth Services	141.8	99.2	5.7	1.2	0.4	0.1	6.1	1.3
Total	450.2	1017.3	0.00	5.17	0.00	0.36	0.00	5.53

Source: Author's simulations

Our analysis has shown that the SAP can have a positive effect on Albania's growth and overall welfare. There are, however, both winners and losers from liberalization. We argued that agriculture, apparel and some industrial activities would expand and thus benefit from new trading opportunities. At the other end of the spectrum, however,

workers and producers in textiles, metals, chemicals and minerals will be negatively hit. Services generally gain through an increase in domestic demand, but the benefits are mainly felt by skilled workers. Unskilled workers in these industries are therefore vulnerable, and if markets cannot accommodate their re-employment in other sectors, this may have a negative impact on poverty.

5.4 Effects of Harmonization to EU Standards and Modernization of Customs

Our final section deals with the effects of non-tariff liberalization under the SAA, focusing on the harmonization with EU standards and the modernization of Albanian customs. As can be seen from Table 5.10, non-tariff liberalization can have a notable positive effect on Albanian welfare and growth, albeit of a smaller magnitude than traditional tariff liberalization. Gains are around 0.31% and 0.16% of GDP for standards and customs respectively. Although the modelling approach differed between the two scenarios, the overall impact was the same, namely, to lower the final effective import price. In the case of standards, this affected Albanian exports to the EU, while in the case of customs, it affected all Albanian imports. Thus, in the first case gains are realized primarily through new trading opportunities, in the latter benefits come from increased competition from abroad. Both of these channels result in strong improvements in efficiency, due to a better reallocation of resources and an improvement in Albania's terms of trade. The impact on other regions is negligible. It is, however, worth noting that SAA partners, with the exception of Romania, also gain from non-tariff liberalization.

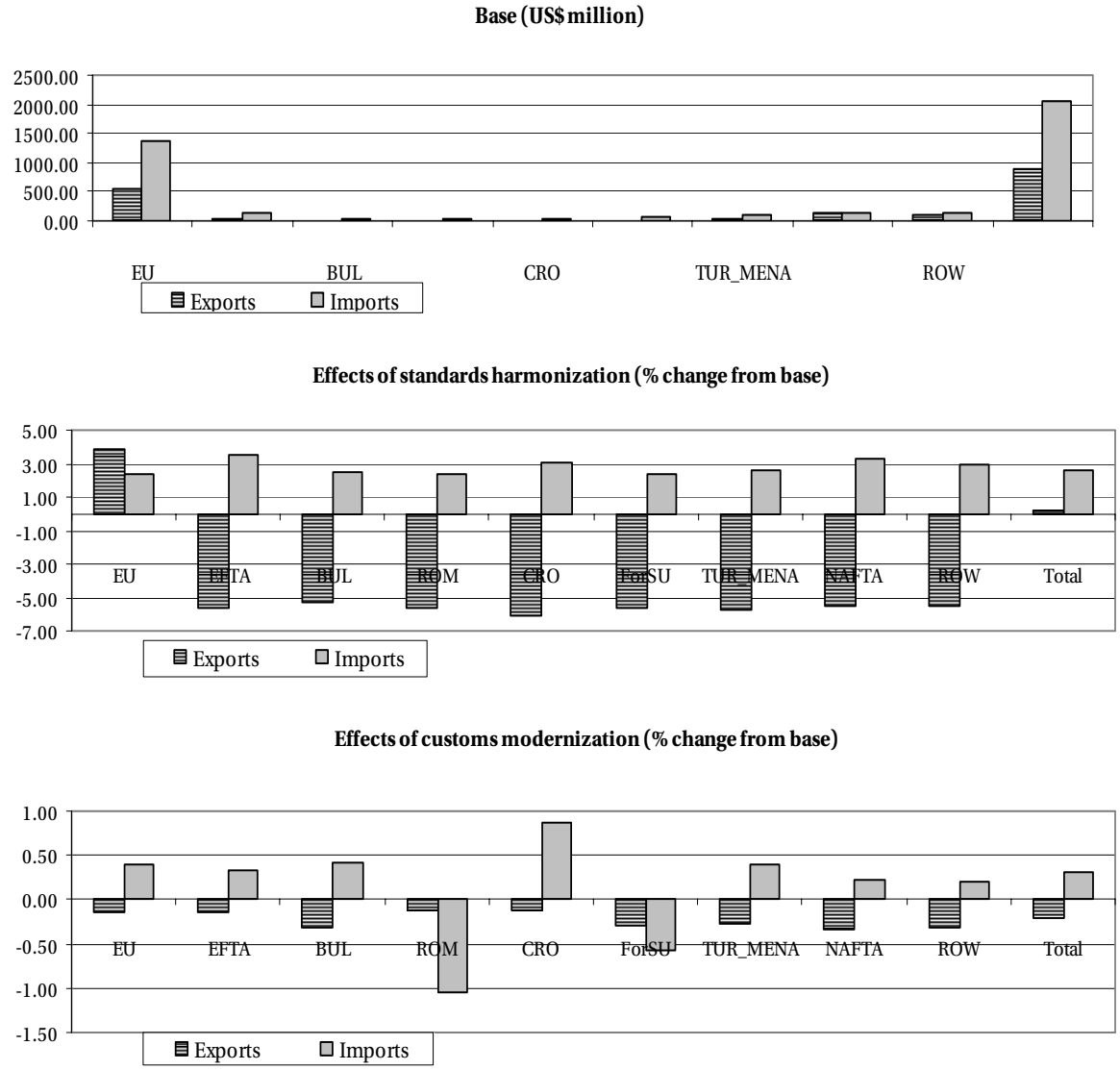
Table 5.10 Welfare decomposition under standards harmonization and customs liberalization (E6 & E7)

	Allocative effects	Endowment effects	Technical change	Terms of trade	Investment effects	Total	
	($ million)					($ million)	*% of GDP*
E6: Standards harmonization							
ALB	4.91	3.08	0.00	2.96	1.97	12.92	*0.31*
EU	-0.36	0.00	2.43	-1.20	-0.44	0.42	*0.00*
EFTA	-0.02	0.00	0.00	0.14	-0.06	0.07	*0.00*
BUL	0.00	0.00	0.00	0.01	0.00	0.01	*0.00*
ROM	-0.02	0.00	0.00	-0.05	-0.01	-0.08	*0.00*
CRO	0.02	0.00	0.00	0.04	0.00	0.06	*0.00*
ForSU	0.01	0.00	0.00	0.00	-0.05	-0.04	*0.00*
TUR_MEN	-0.06	0.00	0.00	-0.14	-0.06	-0.27	*0.00*
NAFTA	-0.05	0.00	0.00	-0.45	-0.73	-1.23	*0.00*
ROW	-0.57	0.00	0.00	-1.30	-0.63	-2.50	*0.00*
E7: Customs Modernization							
ALB	2.46	1.56	2.46	0.39	-0.43	6.43	*0.16*
EU	-0.08	0.00	0.00	0.26	0.10	0.27	*0.00*
EFTA	0.00	0.00	0.00	0.04	0.00	0.04	*0.00*
BUL	0.00	0.00	0.00	0.02	0.00	0.02	*0.00*
ROM	0.00	0.00	0.00	-0.06	-0.01	-0.07	*0.00*
CRO	0.07	0.00	0.00	0.04	0.00	0.12	*0.00*
ForSU	-0.03	0.00	0.00	-0.09	0.03	-0.09	*0.00*
TUR_MEN	0.00	0.00	0.00	0.02	0.02	0.03	*0.00*
NAFTA	-0.03	0.00	0.00	-0.22	0.03	-0.23	*0.00*
ROW	-0.10	0.00	0.00	-0.40	0.27	-0.23	*0.00*

Source: Author's simulations

The trade effects of non-tariff liberalization are mixed. Harmonization with EU standards leads to an expansion of EU-Albania trade, with exports growing by 3.8% and imports by 2.4% of base value. This growth, however, takes place at the expense of trade with other regions. Albanian exports decline throughout all non-EU countries. This is mainly due to our modelling approach, which applied the reduction in standards-related trade costs exclusively to EU-Albania trade. Thus the effects of adopting EU standards on Albania's trade with other regions were intentionally excluded. Given that EU standards are generally recognized globally, we would expect that harmonization would also result in an expansion of Albanian exports to other regions. Thus the benefits of adopting EU norms and regulations could be significantly higher than those reported. In the case of customs, it is primarily imports that benefit from modernization. This is to be expected, as modernization lowers transport costs, which allows for a larger value of goods to be imported at any given time. While this is beneficial for Albanian consumers, it does not appear to feed positively to exporters, who face a small decline from the modernization of customs.

Figure 5.3 Albania's trade under standards harmonization and customs Modernization (% change from base)



Source: Author's simulations

The output and employment effects of non-tariff liberalization are generally small, compared with other experiments. Standards harmonization has a positive overall effect on output, except in agricultural crops, processed food, tobacco and beverages and minerals. Its impact on employment is less clear, however. In many expanding industries

(chemicals, automotives, machinery and equipment and other manufactures) output growth does not increase demand for labour. Employment of both skilled and unskilled labour declines in these industries. The picture is not uniform, however, as employment in key activities like fruit and vegetables, animal products, apparel and construction expands. Overall, however, it is the unskilled who are hit worst[20]. Customs modernization has a less favourable effect on output. Although the resulting lower import prices would mean cheaper intermediate inputs, Albanian producers find it difficult to compete and so output contracts in most sectors. In terms of employment, it is again the unskilled who are more negatively affected by the fall in output. Thus, while Albanian consumers would benefit from lower import prices, they also face more uncertainty in employment.

Table 5.11 Change in output, skilled and unskilled labour under customs modernization (E7) and standards harmonization (E6) (% change from base)

	E6 Standards			E7 Customs		
	Output	**Unskilled Labour**	**Skilled Labour**	**Output**	**Unskilled Labour**	**Skilled Labour**
Crops	-0.25	-0.17	-0.23	-0.07	-0.06	-0.11
Fruit & Veg.	0.38	0.14	0.08	0.01	0.03	-0.02
Animal Prods	0.88	0.34	0.2	0.10	0.15	0.04
Fisheries	0.27	0.13	0.08	0.00	0.03	-0.01
Forestry	0.14	-0.07	-0.13	-0.10	-0.07	-0.12
Proc Food	-0.06	0.22	-0.07	-0.04	0.17	-0.06
Tob & Bev	-0.46	0.14	-0.14	-0.03	0.16	-0.07
Minerals	-1.15	-0.42	-0.59	-0.52	-0.52	-0.65
Metal Prods	2.46	-0.02	-0.34	0.00	0.14	-0.12
Textiles	2.23	0.06	-0.26	-0.40	-0.25	-0.51
Apparel	7.84	4.74	4.42	-0.05	0.11	-0.15
Wood & Paper	0.17	-0.11	-0.44	-0.21	-0.06	-0.31
Chemicals	0.64	-0.32	-0.64	-0.03	0.12	-0.14
Autom. Prods	0.49	-0.74	-1.06	-0.05	0.07	-0.19
Mach & Equip	3.44	-1.1	-1.42	-0.06	0.06	-0.19
Oth Manuf	0.37	-1.38	-1.7	-0.06	0.08	-0.17
Construction	2.74	1.02	0.66	0.56	0.71	0.42
Utilities	-0.11	0.22	-0.11	0.02	0.22	-0.04
Trade&Trans	0.06	0.42	-0.01	0.10	0.38	0.04
Pub. Services	0.05	0.22	-0.1	0.06	0.22	-0.04
Oth Services	0.30	0.40	0.08	0.11	0.33	0.07
Total	0.72	0.20	0.00	0.08	0.20	0.00

Source: Author's simulations

[20] This observation could suggest that EU standards increase the skill intensity of production in Albania and therefore the demand for unskilled workers declines. However, this would be a peripheral conclusion, which cannot be supported fully by our modelling approach or the available model results.

5.5 Summary of modelling results and implications for poverty reduction

Our study employed the standard GTAP model to explore the economic impact of Albania's tariff and non-tariff liberalization efforts under the auspices of the SAP and beyond. Our results suggest the following conclusions:

i. The strongest possible welfare gains in Albania can be achieved through unilateral liberalization, up to 2% of GDP. While this is relatively small compared with other CGE studies assessing unilateral liberalization, it is clear that only by opening up its markets fully to all regions can Albania maximize the benefits of trade liberalization.

ii. Regional integration under the Stabilization and Association Process can also bring significant benefits to the Albanian economy. However, potential welfare gains will be maximized, only if all regional agreements, including those with the EU and the other South East European countries are in force. Not surprisingly, it is free trade with the EU relative to that with the other South East European countries that will drive Albania's gains under the SAP. This is largely because the EU accounts for a much bigger share of Albania's external trade compared with the SEEs.

iii. Both unilateral liberalization and regional integration under the SAP are found to have very small effects on other regions. Overall, the EU will gain from most scenarios, except under Albania's FTAs with other SEEs, but the size of the effects is generally negligible. Other South East European countries appear to lose from a EU-Albania FTA, but benefit from bilateral agreements. Overall, the impact is again relatively small, however, between 0.01% and 0.02% of GDP.

iv. Non-tariff liberalization under the EU-Albania SAA can also bring notable gains to Albania. Although the welfare impact of standards harmonization and customs modernization is found to be smaller than that of traditional tariff liberalization, both areas represent important channels for future growth. It should be noted, however, that both, and especially customs modernization, are costly and lengthy processes. As already argued, these costs are primarily one-off, while the estimated gains will be recurring.

v. Overall, Albania's trade with the EU and other South East European countries expands under all experiments. With the exception of standards harmonization, this bilateral trade expansion does not take place at the expense of trade with other regions. The strongest growth in trade is realized in low-skilled manufacturing, particularly processed food, apparel, metals and other manufactures.

vi. A distinguishing feature of our modelling exercise was the incorporation of unemployment. This allowed our analysis to consider some of the social implications of liberalization, in particular on employment by skill. Both unilateral and regional liberalizations appear to have a positive overall effect on employment. Demand for both

skilled and unskilled labour expands in aggregate, although the impact is much stronger for the latter. Our results, however, indicate that there are notable variations by sector. Unilateral liberalization improves employment opportunities for unskilled workers in apparel and some other manufacturing sectors, but has a negative effect on textiles, minerals and forestry. Under the SAP, it is agriculture, apparel and other manufacturing that benefit more, while textiles, metals, chemicals and minerals lose out. A similar picture is obtained under non-tariff liberalization, which tends, however, to favour the skilled more than the unskilled workers.

vii. Overall, the findings of our modelling exercise are in line with those of other CGE studies in the literature. A detailed overview of these was provided in section 2.3, but it is worthwhile recalling some of the key results for comparative purposes. In the context of pure regional integration, other static CGE models (for example, Alessandri, 2000; Maskus and Eby Konnan, 1997) have produced welfare effects roughly similar to ours ranging between 1% and 3% of GDP. The size of gains depends, of course, on the model's assumptions, with perfectly competitive models standing at the lower end and monopolistic models at the upper, and on initial conditions such as the structure of the economy, exports and the level of tariffs. In the context of non-tariff barriers, standards, customs and trade facilitation, studies reveal that liberalization of these should add another 2-3% of GDP (for example, Smith and Venables, 1998). In the context of European enlargement to Eastern Europe, studies have also found that integration was more beneficial for the new members than for the EU. Finally, in the context of the SAA and Albania studies, the only available study by the World Bank finds very similar results to this study – with gains from the SAA ranging between 0.3% and 0.5% of GDP (World Bank, 2004).

Our modelling conclusions raise, in turn, a number of points with regard to Albania's efforts for socio-economic development and poverty reduction. Regional integration under the Stabilization and Associational Agreement can have a notable effect on Albania's overall welfare and improve prospects for stronger economic growth. Its impact on poverty, however, is less clear. On balance, we could argue that stronger economic growth should lead to a pro-poor outcome. Employment prospects improve in aggregate, but we also find that benefits are not evenly distributed between sectors and workers. There are both winners and losers from liberalization and their prospects should be considered carefully during the reform process. More specifically, our analysis has shown that it is textiles, chemicals, metals and mineral industries that are more vulnerable to external competition and experience a contraction in the face of liberalization. Within these sectors it is the unskilled workers who appear to be hit hardest. The same holds in services, particularly utilities and public services, where liberalization appears to favour skilled workers almost exclusively. Given that services are mostly located in urban areas, this would suggest that unskilled urban workers would be vulnerable to liberalization. Our analysis therefore reveals that, while in aggregate liberalization increases demand for all types of labour, in certain sectors it could lead to greater inequality between skilled and unskilled workers. As our earlier discussion demonstrated, poverty in Albania dominates across low-skill workers, especially those who are unemployed. Although this would not necessarily mean that poverty would rise for affected workers in these sectors, it gives an

indication of the possible groups that are vulnerable to liberalization. Liberalization of these sectors should therefore be accompanied by appropriate support policies to reduce vulnerability and enhance prospects for re-employment in more viable sectors.

Chapter 6: Conclusions

This paper has explored the possible economic impact and some of the social implications of the EU-Albania Stabilization and Association Process. Drawing on the recent EU-Albania Stabilization and Association Agreement and the recently adopted Free Trade Agreements between Albania and other South East European countries, it identified the key trade-related provisions for the country's integration with the region and assessed their potential impact on growth, trade, production and employment.

Economic and policy integration is a lengthy process and should be sensitive to countries' initial conditions, as well as their administrative and physical capacity to undertake reforms. The EU-Albania SAP recognizes this and places increasing emphasis on the gradual character of reforms vis-à-vis both the EU and the SEE region as a whole. Nevertheless, Albania's reform agenda under the SAP is impressive, covering areas ranging from political dialogue and regional co-operation to Community freedoms in the movement of goods, services, workers and capital; and mutual co-operation in justice and home affairs. With regard to trade integration, the SAP requires extensive trade liberalization vis-à-vis both the EU and towards other countries in the region. It further provides for the gradual integration into the EU Single Market through harmonization with Community structures and directives in the areas of standards, certification, customs administration, protection of competition, and intellectual property rights.

We have focused on certain aspects of this extensive reform agenda and assessed the impact of both tariff and non-tariff provisions. For the purposes of our analysis, the standard GTAP model and database were employed, supplemented with additional information from official and secondary sources. Our findings suggest that regional integration under the SAP can bring significant benefits to the Albanian economy. These are not as strong as what could potentially be achieved through unilateral liberalization, if Albania were to open up its markets to all regions. Nevertheless, the welfare impact of the EU-Albania Stabilization Agreement and the Albanian FTAs with the rest of South East Europe is notable, reaching a combined 1.5% of GDP. This is not negligible, given the estimates of other CGE studies on regional integration. In view of Albania's increased trade dependence on the EU, our results also suggest that it is trade with the Community that will drive welfare gains rather than trade with other countries in South East Europe. Non-tariff liberalization under the EU-Albania SAA is also found to bring notable gains, albeit smaller than those of traditional liberalization. If Albania were to modernise its customs administration and harmonize fully with EU legislation on standards and related technical barriers to trade, this could bring an additional gain of 0.46% of GDP. Since harmonization will proceed gradually, these gains will not be realised immediately, but as regulatory integration progresses.

While the impact on overall welfare is found to be positive throughout, we also find that benefits are not evenly distributed between sectors and workers. There are both winners and losers from regional liberalization. The impact on overall employment is positive, but

there are notable variations by sector. Sectors like agriculture, apparel and some other manufacturing sectors appear to benefit more, while textiles, metals, chemicals and minerals lose out. In declining sectors it is the unskilled workers relative to the skilled who are more adversely affected and are therefore more vulnerable to liberalization. Our analysis therefore reveals that liberalization can lead to greater employment inequality between skilled and unskilled workers in certain sectors. This is particularly evident in textiles, metals, chemicals, minerals and some services like utilities and public services. It is important, therefore, that liberalization in these sectors should proceed with caution and that the Albanian government, with the support of the donor community, should identify appropriate support policies. Given that overall demand for unskilled labour expands, it is important that the government should focus mainly on those employed in the vulnerable sectors. The appropriate mix of policies is difficult to identify. Some examples include the development of special social safety-nets for specific industries and programmes of training and re-training for unemployed workers, which would enhance their prospects of re-employment in more viable industries.

Finally, it is important to emphasize some of the major limitations arising from the modelling framework of our analysis. First, the standard GTAP model tends to exaggerate the estimated terms-of trade-effects, as it assumes a perfect elasticity of transformation between exports and domestic goods. This increases the magnitude of our welfare predictions and should be taken into account in interpreting the results of our experiments. Second, as a distinguishing feature of our exercise was the incorporation of unskilled labour unemployment, it is useful to re-emphasize the relative understatement of unskilled labour in the GTAP dataset. This introduces a downward bias to our calculations since the employment effects could, in fact, be significantly greater than those reported. Finally, the modelling framework of the GTAP does not allow us to fully capture the benefits from deep integration. Harmonization of rules and regulations reduces the heterogeneity between domestic and imported products, which in turn would translate into an increase in Armington elasticities. While this was not introduced into our calculations, we could argue that an exogenous increase in Armingtons as a result of harmonization would increase the magnitude of the results.

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Annex 1: The Standard GTAP v.6 Model

The standard GTAP model is based on perfect competition and constant returns to scale. The demand structure of the model is centred on a single, representative, composite regional household. In each region the composite household receives all income generated in the given economy – all payments to factors of production – which in turn is used entirely on three broad types of expenditure: private, government and savings. Demand for all three expenditure areas is modelled by a Cobb-Douglas per capita utility function. This allows for the claims of each of these areas to represent a constant share of total income. On the production side, firms combine primary factors (land, skilled and unskilled labour, capital and natural resources) with intermediate inputs from domestic and foreign sources in producing their total output. Production is modelled through a weakly separable, constant returns to scale function, which in turn implies that the optimal mix of primary inputs is independent of the prices of intermediates.[21]

The GTAP model is typically solved in rates of change. Prices on goods, factors and services adjust until all markets clear, that is, until they are simultaneously in general equilibrium. At a macroeconomic level the standard model requires the difference between national savings and national investment to be exactly equal to the current account surplus. The GTAP, however, does not include observations on net transfers. The macroeconomic closure therefore collapses to its simplest form, whereby net national savings are equal to the trade balance.[22] The principal implication of this specification is that any change in trade flows following a policy shift will require the trade balance to adjust in maintaining the simplified macro identity. Put simply, if imports rise following the liberalization of tariffs, then exports must also rise to maintain stability on the macro closure.

[21] For detailed discussion on the standard GTAP model see Hertel (1997), Itakura (2004) and Hertel (2004).

[22] S-I = X-M + R collapses to its simplest form S-I = X-M, where S is national savings, I national investment, X-M is the trade balance and R is net transfers.

Annex 2: Regional and Sectoral Aggregation for GTAP Modelling Exercise

	Regions	Description	Components
1	**NAFTA**	North American Free Trade Area	Canada, United States, Mexico
2	**EU**	European Union of 25	Austria, Belgium, Denmark, Finland, France, Germany, United Kingdom, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, Cyprus, Czech Republic, Hungary, Malta, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania
3	**EFTA**	European Free Trade Area	Switzerland, rest of EFTA, rest of Europe
4	**ALB**	Albania	Albania
5	**BUL**	Bulgaria	Bulgaria
6	**CRO**	Croatia	Croatia
7	**ROM**	Romania	Romania
8	**ForSU**	Former Soviet Union	Russian Federation, Rest of Former Soviet Union
9	**TUR_MENA**	Turkey, Middle East and N. Africa	Turkey, rest of Middle East, Morocco, Tunisia, rest of North Africa
10.	**ROW**	Rest of the World	Australia, New Zealand, Rest of Oceania, China, Hong Kong, Japan, Korea, Taiwan, Rest of East Asia, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam, Rest of Southeast Asia, Bangladesh, India Sri Lanka, Rest of South Asia, Rest of North America, Colombia, Peru, Venezuela, Rest of Andean Pact, Argentina, Brazil, Chile, Uruguay, Rest of South America, Central America, Rest of FTAA, Rest of the Caribbean, Botswana, South Africa, Rest of South African CU, Malawi, Mozambique, Tanzania, Zambia, Zimbabwe, Rest of SADC, Madagascar, Uganda, Rest of Sub-Saharan Africa

	Sectors	Description	Components
1.	**Crops**	Agricultural Crops	Paddy rice, Wheat, Cereal grains, Oil seeds, Sugar cane, sugar beet, Plant-based fibers, Crops
2.	**Fruit_Veg**	Fruit and Vegetables	Vegetables, fruit, nuts
3.	**Animal_Prods**	Animal Products	Cattle, sheep, goats, horses, Animal products, Raw milk, Wool, silk-worm cocoons, Meat, Meat products
4.	**Forestry**	Forestry	Forestry
5.	**Fisheries**	Fisheries	Fishing
6.	**ProcFood**	Processed Food	Dairy products, Vegetable oils and fats, Processed rice, Sugar, Food products
7.	**Tob_Bev**	Tobacco and Beverages	Beverages and tobacco products
8.	**Textiles**	Textiles	Textiles
9.	**Apparel**	Wearing Apparel and Leather Products	Wearing apparel, Leather products
10.	**Wd_Pap_Prods**	Wood and Paper products	Wood products, Paper products, publishing
11.	**Minerals**	Mineral products	Coal, Oil, Gas, Minerals, Petroleum, coal products
12.	**Chemicals**	Chemicals	Chemical, rubber, plastic prods
13.	**Metal_Prods**	Metals and Metal Products	Ferrous metals, Metals, Metal products
14.	**Auto_Prods**	Automotive Products and Transport Equipment	Motor vehicles and parts, Transport equipment
15.	**OthManuf**	Other Manufacturing Products	Electronic equipment, Manufactures
16.	**Mach_Eq**	Machinery and Equipment	Machinery and equipment
17.	**Utilities**	Utilities	Electricity, Gas manufacture, distribution, Water
18.	**Construction**	Construction	Construction
19.	**Trade_Trans**	Trade and Transport Services	Trade, Transport, Sea transport, Air transport
20.	**Pub_Services**	Public Services	Public Administration, Defence, Health, Education
21.	**Oth_Services**	Other Services	Communication, Financial services, Insurance, Business services, Recreation and other services, Dwellings

Source: GTAP V6 Database

Annex 3: Base GTAP Tariff Data for 2001

Albanian tariffs against all regions for 2001 (BASE)

	EU	EFTA	BUL	ROM	CRO	FOR SU	TUR & MENA	NAFTA	ROW
Agric Crops	5.9	8.7	5.3	5.0	5.0	5.0	5.0	5.0	7.6
Fruit & Veg	10.5	10.8	10.1	0.0	0.0	9.7	10.7	9.6	6.5
Animal Prods	10.1	8.4	9.4	0.0	3.7	8.0	6.5	10.0	7.7
Fisheries	19.3	18.8	0.0	0.0	0.0	0.0	15.2	0.0	8.2
Forestry	6.0	5.0	7.8	0.0	0.0	0.0	0.0	0.0	0.0
Processed Food	11.5	10.8	9.7	6.2	11.9	8.9	10.2	12.2	8.6
Tobacco & Bev	19.8	18.7	19.8	0.0	19.1	14.7	16.7	19.1	3.7
Minerals	11.6	16.5	11.2	8.8	9.9	8.8	11.3	9.3	8.9
Metal Prods	15.1	16.1	16.4	16.2	11.7	12.9	17.4	14.6	12.3
Textiles	13.2	11.9	11.2	10.0	0.0	16.1	11.7	8.9	11.4
Apparel	14.8	16.1	20.0	0.0	19.8	11.8	19.0	2.3	18.0
Wood&Paper	13.8	10.8	11.2	10.1	12.0	8.7	16.0	8.9	11.5
Chemicals	10.8	3.9	10.5	7.9	8.6	5.3	13.3	3.8	11.5
Automotive Prods	12.1	11.0	11.1	9.2	15.3	13.9	10.3	6.3	13.3
Machinery&Equip	5.9	5.5	6.5	5.1	5.2	6.2	6.8	5.7	5.9
Other Manuf	6.5	7.9	10.5	3.6	12.6	15.8	14.5	10.0	10.3
Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Utilities	3.2	5.0	0.0	0.0	5.0	0.0	0.0	0.0	0.0
Trade&Transport	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: GTAP v.6 Database

Tariffs facing Albanian products in each region for 2001 (BASE)

	EU	EFTA	BUL	ROM	CRO	FOR SU	TUR & MENA	NAFTA	ROW
Agric Crops	0.0	7.8	2.5	28.4	4.3	3.1	32.9	4.6	1.6
Fruit & Veg	0.0	80.0	33.4	0.0	14.1	0.0	5.0	0.3	0.0
Animal Prods	0.0	61.5	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Fisheries	0.3	8.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Forestry	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Processed Food	15.1	49.3	28.0	0.0	15.3	0.0	7.7	0.1	0.1
Tobacco & Bev	1.7	24.8	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Minerals	0.0	12.6	0.0	0.0	0.0	0.0	17.0	2.2	2.1
Metal Prods	0.1	6.7	4.1	0.0	4.2	0.0	6.7	1.4	1.9
Textiles	0.1	10.0	0.0	0.0	0.0	0.0	8.8	8.6	4.0
Apparel	0.0	23.3	0.0	0.0	14.6	10.5	10.7	10.7	6.7
Wood&Paper	0.2	9.2	5.1	0.0	0.0	1.1	11.4	2.3	0.8
Chemicals	0.2	8.1	9.4	0.0	6.5	2.0	21.8	2.1	4.5
Automotive Prods	0.1	11.9	0.0	0.0	2.8	0.0	15.6	2.2	3.2
Machinery&Equip	0.0	6.6	6.9	10.3	0.0	2.3	5.0	1.1	11.8
Other Manuf	0.2	1.6	3.0	16.7	0.3	3.5	15.6	0.1	1.6
Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Utilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trade&Transport	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: GTAP v.6 Database

Annex 4: Tariffs after the formation of Free Trade Areas with EU and SEEs

Tariffs into Albania after FTAs with EU, Bulgaria, Croatia and Romania

	EU	EFTA	BUL	ROM	CRO	FOR SU	TUR & MENA	NAFTA	ROW
Agric Crops	3.1	8.7	5.3	5.0	5.0	5.0	5.0	5.0	7.6
Fruit & Veg	5.9	10.8	9.2	0.0	0.0	9.7	10.7	9.6	6.5
Animal Prods	9.6	8.4	9.4	0.0	3.8	8.0	6.5	10.0	7.7
Fisheries	19.3	18.8	0.0	0.0	0.0	0.0	15.2	0.0	8.2
Forestry	6.0	5.0	7.7	0.0	0.0	0.0	0.0	0.0	0.0
Processed Food	6.1	10.8	8.8	5.9	11.6	8.9	10.2	12.2	8.6
Tobacco & Bev	19.8	18.7	15.5	0.0	14.6	14.7	16.7	19.1	3.7
Minerals	0.0	16.5	0.0	0.0	0.0	8.8	11.3	9.3	8.9
Metal Prods	0.0	16.1	0.0	0.0	0.0	12.9	17.4	14.6	12.3
Textiles	0.0	11.9	0.0	0.0	0.0	16.1	11.7	8.9	11.4
Apparel	0.0	16.1	0.0	0.0	0.0	11.8	19.0	2.3	18.0
Wood&Paper	0.0	10.8	0.0	0.0	0.0	8.7	16.0	8.9	11.5
Chemicals	0.0	3.9	0.0	0.0	0.0	5.3	13.3	3.8	11.5
Automotive Prods	0.0	11.0	0.0	0.0	0.0	13.9	10.3	6.3	13.3
Machinery&Equip	0.0	5.5	0.0	0.0	0.0	6.2	6.8	5.7	5.9
Other Manuf	0.0	7.9	0.0	0.0	0.0	15.8	14.5	10.0	10.3
Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Utilities	3.2	5.0	0.0	0.0	5.0	0.0	0.0	0.0	0.0
Trade&Transport	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Author's Calculations

Tariffs into EU, Bulgaria, Croatia and Romania tariffs after FTAs with Albania

	EU	EFTA	BUL	ROM	CRO	FOR SU	TUR & MENA	NAFTA	ROW
Agric Crops	0.0	7.8	2.5	28.4	4.3	3.1	32.9	4.6	1.6
Fruit & Veg	0.0	80.0	22.8	0.0	7.0	0.0	5.0	0.3	0.0
Animal Prods	0.0	61.5	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Fisheries	0.0	8.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Forestry	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Processed Food	0.0	49.3	18.2	0.0	14.8	0.0	7.7	0.1	0.1
Tobacco & Bev	0.0	24.8	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Minerals	0.0	12.6	0.0	0.0	0.0	0.0	17.0	2.2	2.1
Metal Prods	0.0	6.7	4.1	0.0	4.2	0.0	6.7	1.4	1.9
Textiles	0.0	10.0	0.0	0.0	0.0	0.0	8.8	8.6	4.0
Apparel	0.0	23.3	0.0	0.0	14.6	10.5	10.7	10.7	6.7
Wood&Paper	0.0	9.2	5.1	0.0	0.0	1.1	11.4	2.3	0.8
Chemicals	0.0	8.1	9.4	0.0	6.5	2.0	21.8	2.1	4.5
Automotive Prods	0.0	11.9	0.0	0.0	2.8	0.0	15.6	2.2	3.2

Machinery&Equip	0.0	6.6	6.9	10.3	0.0	2.3	5.0	1.1	11.8
Other Manuf	0.0	1.6	3.0	16.7	0.3	3.5	15.6	0.1	1.6
Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Utilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trade&Transport	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Author's calculations

Annex 5: Tariffs for Albania after the Formation of a Customs Union with EU

Albanian tariffs against all regions if the EU Common External Tariff is adopted

	EU	EFTA	BUL	ROM	CRO	FOR SU	TUR & MENA	NAFTA	ROW
Agric Crops	3.1	0.8	0.6	4.4	0.3	0.5	14.0	1.3	12.7
Fruit & Veg	5.9	4.4	25.4	6.3	2.5	2.9	6.2	4.0	23.7
Animal Prods	9.6	4.4	12.5	14.6	9.1	33.1	10.5	25.3	28.4
Fisheries	19.3	2.1	0.0	0.0	1.2	6.1	1.8	8.1	3.2
Forestry	6.0	0.1	0.0	0.0	0.0	0.1	0.0	0.5	0.0
Processed Food	6.1	6.4	12.5	27.5	11.7	6.2	10.8	20.7	21.1
Tobacco & Bev	19.8	15.1	21.2	25.6	29.8	11.2	12.5	10.4	6.7
Minerals	0.0	0.3	0.3	0.1	2.7	3.1	0.6	1.2	1.6
Metal Prods	0.0	2.1	8.9	5.8	1.7	2.9	4.5	2.7	2.7
Textiles	0.0	0.5	0.2	0.5	0.6	7.6	0.9	6.2	6.4
Apparel	0.0	0.3	0.2	0.4	0.5	7.3	0.3	8.7	8.2
Wood&Paper	0.0	0.1	0.2	0.4	2.2	0.9	0.2	0.7	0.6
Chemicals	0.0	0.1	0.5	1.2	2.0	3.1	0.7	2.7	2.5
Automotive Prods	0.0	0.3	0.8	1.4	2.5	4.2	0.7	3.2	6.4
Machinery&Equip	0.0	0.1	0.1	0.2	0.1	2.4	0.3	0.3	1.3
Other Manuf	0.0	0.1	0.2	0.3	0.6	1.0	0.2	0.7	1.5
Construction	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Utilities	0.0	0.0	0.0	0.0	0.0	3.5	0.0	0.0	0.0
Trade&Transport	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Author's calculations

Annex 6: Literature Review on Trade Costs from Standards and Customs

Study	Approach	Magnitude of Barriers
Smith, Venables and Gasiorek (1992)	CGE study on the EC Single Market, including the cost from different standards and frontier controls.	Ad valorem tariff equivalent of real trade costs due to standards and border formalities is assumed to be *2.5%* – across the board for all EC countries
Francois (1998)	CGE study of EC Enlargement including the cost from different standards.	Ad valorem tariff equivalent of real trade costs due to standards and border formalities is assumed to be *10%*– across the board for all EC countries
Lejour, de Mooij and Nahuis (2001)	Gravity model of 16 industries to estimate the magnitude of trade costs from customs formalities (delays and paperwork) and technical barriers to trade that CEECs' exports face upon entry in the Single Market.	Estimated ad valorem tariff equivalent of real trade costs due to standards and border formalities varies between sectors: From 8% to 17%.
Harrison et al. 1996)	CGE analysis of the effects from the completion of the EU Single Market. Focus on standards, conformity assessment regimes, and frontier controls.	Ad valorem tariff equivalent of real trade costs due to standards and border formalities is assumed to be *2.5%* – across the board
Baldwin, Francois and Portes (1997)	CGE analysis of CEECs' accession to the single market including the cost from different standards, conformity assessment, and frontier controls	Ad valorem tariff equivalent of real trade costs due to standards and border formalities is assumed to be *5-10%*– across the board
Hoffmann (2000)	Evaluation of the EU Single Market. Remaining trade costs from partial completion of the single market	Ad valorem tariff equivalent of trade costs due to standards and border formalities is assumed to be 5% – across the board
Piazolo (2000)	Evaluation of Poland's accession to the EC through a dynamic CGE Model. The author looks at the cost from border formalities and technical barriers to trade due to differences in standards	Ad valorem tariff equivalent of trade costs due to border formalities (1.7%), technical barriers to trade (0.8%). Both of these estimates are across the board

70

Study	Approach	Magnitude of Barriers
Francois, van Meijl and van Tongeren (2003)	CGE analysis of Doha round liberalization including trade facilitation (less transparent trade barriers, such as customs, product standards and conformance certifications, licensing requirements)	Ad valorem reduction in trade costs between 1.5% of the value of trade (partial liberalization) and 3% (full liberalization).
UNCTAD (1994)	Assessment of benefits from trade facilitation globally	Ad valorem reduction in trade costs between 2% of the value of trade.
Australian Industry Commission (1995)	Assessment of benefits from trade facilitation in the APEC region	In APEC, trade facilitation could bring ad valorem reduction in trade costs of 5-10% of the total value of trade, through reduced transaction costs.
Japan EPA (1997)	Assessment of benefits from trade facilitation in the APEC region	In APEC, trade facilitation could bring ad valorem reduction in trade costs of around 2% of the total value of trade, through reduced transaction costs.
EC - The Economics of 1992	Econometric calculation of intra-EC barriers due to different standards between European Economies before the establishment of the Single Market	It was estimated that trade facilitation through the Single Market would brings savings up to 2% of the value of trade.

Annex 7: Guesstimates on Standard and Customs Related Barriers

	Tariff equivalent on Albanian imports to the EU due to differences in standards and conformity assessment [a]	Tariff equivalent on Albanian imports from all regions due to customs procedures [b]
Agric Crops	0.13	2.65
Fruit & Veg	0.03	2.65
Animal Prods	0.08	2.65
Fisheries	0.00	2.65
Forestry	0.02	2.65
Processed Food	0.09	2.65
Tobacco & Bev	0.00	2.65
Minerals	0.05	2.65
Metal Prods	0.29	2.65
Textiles	0.11	2.65
Apparel	1.70	2.65
Wood&Paper	0.15	2.65
Chemicals	0.06	2.65
Automotive Prods	0.02	2.65
Machinery&Equip	0.22	2.65
Other Manuf	0.05	2.65

a. Based on 3% guesstimates from Francois et al. (2003), weighed by base Albanian export data to EU.
b. Based on estimate of delays from the Albanian Centre for International Trade

Annex 8: Model results under Full Employment (Selected Experiments)

Our main modelling exercise allowed for the existence of unemployment of unskilled labour in Albania. For comparative purposes, four key experiments were re-run, assuming that labour markets are fully flexible and that the economy returns to full employment levels following a policy shock. We focus on unilateral liberalization, the full Albanian SAA, standards harmonization and customs modernization.

A first key finding is that the magnitude of welfare effects is slightly smaller than under sticky wages. While the direction of welfare change is the same, we find that gains (or losses) for all regions are around 0.5-1% weaker with full employment. This is in line with other GTAP studies in the literature. Elbehri and Hertel (2004) and Keck and Piermartini (2005) report that the inclusion of unemployment tends to increase welfare effects. As before, Albania gains across all experiments, but this time it is the full SAA that produces the strongest effects. Indeed, the full SAA brings benefits of 0.2% of GDP, as compared with 0.1% and 0.11-0.15% under unilateral and non-tariff liberalizations respectively. The impact on other regions is again found to be negligible. The only experiment that produces some identifiable effects on other regions is the SAA, which as before benefits both the EU and other SE European partners.

Table A8.1 Summary welfare effects with full employment

	E1		**E5**		**E6**		**E7**	
	Unilateral		**Albania FTA with EU & SEE**		**Standards**		**Customs**	
	$m	*% GDP*	($m)	*% GDP*	($m)	*% GDP*	($m)	*% GDP*
ALB	4.4	0.109	9.1	0.223	6.2	0.151	4.6	0.112
EU	24.6	0.000	44.0	0.001	0.9	0.000	0.3	0.000
EFTA	1.3	0.000	-1.5	0.000	0.1	0.000	0.0	0.000
BUL	0.42	0.003	0.7	0.005	0.0	0.000	0.0	0.000
ROM	-0.6	-0.002	0.1	0.000	-0.1	0.000	-0.1	0.000
CRO	0.2	0.001	0.6	0.003	0.1	0.000	0.1	0.000
ForSU	0.4	0.000	-6.9	-0.001	0.0	0.000	-0.1	0.000
TUR_MENA	2.9	0.000	-8.9	0.000	-0.2	0.000	0.0	0.000
NAFTA	-2.3	0.000	-4.3	0.000	-0.7	0.000	-0.3	0.000
ROW	-3.5	0.000	-10.9	0.000	-2.1	0.000	-0.4	0.000

Source: Author's simulations

The smaller magnitude of welfare effects generally derives from the absence of endowment effects. This is evident from Table A8.2, which illustrates the channels of welfare change for Albania. As in our main discussion, welfare gains are driven primarily by strong improvements in allocative efficiency. In all experiments, tariff and non-tariff liberalization increases competition through cheaper imports from abroad and exerts greater pressure for a more efficient allocation of resources. Unilateral and SAA liberalizations produce small but negative terms-of-trade effects, which derive from the fact that Albania accounts for a very small share of world trade. As a result, liberalization makes exports prices fall faster than import prices, leading to a deterioration in the terms of trade.

Table A8.2 Albania Decomposition of Welfare Effects with full Employment

	Allocative effects	**Endowment effects**	**Technical change**	**Terms of trade**	**Investment effects**	**Total**	
	($ million)					($ m)	*% of GDP*
E1 Unilateral	31.8	0.0	0.0	-13.9	-13.4	4.5	0.1
E5 Albania FTA with EU&SEE	24.6	0.0	0.0	-5.7	-9.7	9.1	0.2
E6 Standards Harmonization	2.6	0.0	0.0	2.8	0.6	6.2	0.1
E7 Customs Modernization	1.5	0.0	2.8	0.4	-0.1	4.6	0.1

Source: Author's simulations

Turning to income effects, the full employment closure has a positive overall impact for both skilled and unskilled labour across all four experiments. As illustrated in Table A.3, total returns to both labour types increase, with unskilled labour experiencing the strongest growth. There are, however, interesting sectoral variations. Under unilateral liberalization the income of unskilled labour employed in agricultural activities contacts, while for those employed in most manufacturing industries and services it expands. By contrast, the income of skilled labour expands in most industries, except processed food, textiles and wood products. A more uniform picture is obtained under SAA and non-tariff liberalizations, where income of both the skilled and the unskilled expands across most activities. The only industries, where labour experiences some contraction in income are metals, minerals, textiles and, to a lesser extent, wood products and chemicals.

Table A8.3 Factor income by skill and activity under full employment (% change from base)

	E1 Unilateral		E5 Albania FTA with EU&SEE		E5 Standards Harmonization		E6 Customs Modernization	
	Unskilled labour	Skilled labour	Unskilled labour	Skilled labour	Unskilled labour	Skilled labour	Unskilled labour	Skilled labour
Agricultural Crops	- 0.003	0.000	0.008	0.000	0.001	0.000	0.000	0.000
Fruit & Vegetables	- 0.007	0.000	0.013	0.000	0.003	0.000	0.000	0.000
Animal Products	- 0.005	0.000	0.013	0.000	0.002	0.000	0.000	0.000
Fisheries	- 0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Forestry	- 0.001	0.000	- 0.001	- 0.000	0.000	0.000	0.000	0.000
Processed Food	- 0.005	- 0.001	0.002	0.000	0.000	0.000	0.000	0.000
Tobacco and Beverages	- 0.001	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Minerals	- 0.021	- 0.004	- 0.018	- 0.003	0.000	0.000	- 0.001	0.000
Metal Products	- 0.002	0.000	- 0.001	- 0.000	0.000	0.000	0.000	0.000
Textiles	- 0.004	- 0.001	- 0.004	- 0.001	0.000	0.000	0.000	0.000
Apparel	0.060	0.009	0.040	0.006	0.007	0.001	0.000	0.000
Wood & Paper Products	- 0.011	- 0.002	- 0.010	- 0.002	0.000	0.000	0.000	0.000
Chemicals	- 0.001	0.000	- 0.001	0.000	0.000	0.000	0.000	0.000
Automotive Products	- 0.001	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Machinery and Equipment	0.019	0.004	0.012	0.003	- 0.001	0.000	0.000	0.000
Other Manufacturing	0.005	0.001	0.003	0.000	- 0.000	0.000	0.000	0.000
Construction	0.104	0.020	0.092	0.018	0.004	0.001	0.005	0.001
Utilities	0.001	0.001	0.003	0.002	0.001	0.000	0.001	0.000
Trade_Trans	0.070	0.021	0.065	0.019	0.005	0.001	0.008	0.001
Public Services	- 0.030	- 0.038	- 0.014	- 0.014	0.002	0.003	0.003	0.003
Other Services	0.024	0.020	0.024	0.019	0.003	0.002	0.004	0.002
Total	0.191	0.030	0.226	0.049	0.026	0.009	0.022	0.008

Source: Author's simulations

With regard to trade, the direction and magnitude of effects is found to be roughly the same under full employment as it was under sticky labour markets. Table A8.4 presents the percentage change in Albanian exports and imports under unilateral and SAA experiments. As before, it is unilateral liberalization that produces the more pronounced growth in Albanian trade. Exports generally grow across both agricultural and industrial activities. The sectoral patterns are similar between the two experiments, with apparel, metals, chemicals, other manufacturing, animal products and processed food exhibiting the strongest expansion. In terms of imports, it is wood and paper products that take the lead followed by metals, textiles and processed food. This is roughly the same picture as that obtained with sticky labour markets. This suggests that with or without unemployment the model produces the same reallocation of resources, allowing the more efficient industries to expand and the less efficient ones to contract.

Table A8.4 Total trade effects with full employment under E1 and E5

	Base Value		E1 Unilateral		E5 Albania FTA with EU & SEE	
	Export	**Import**	**Exports**	**Imports**	**Exports**	**Imports**
	$ million		% change from base value			
Crops	24.1	44.9	11.2	5.7	-1.2	2.4
Fruit & Veg.	6.4	37.4	8.1	8.4	0.7	4.2
Animal Prods	13.7	26.2	15.8	18.4	0.3	1.3
Fisheries	0.3	2.6	11.8	6.1	0.9	-0.1
Forestry	2.6	0.5	3.3	1.9	1.3	-4.5
Proc Food	13.4	109.3	4.8	11.9	39.8	5.4
Tob & Bev	0.9	72.2	3.6	2.4	1.4	0.0
Minerals	7.7	300.1	19.8	9.3	13.8	7.7
Metal Prods	34.8	142.5	26.8	14.2	18.7	11.4
Textiles	13.7	93.3	16.1	11.2	9.5	8.2
Apparel	200.0	168.3	28.0	9.7	19.4	8.8
Wood&Paper	22.9	60.3	5.2	18.9	2.2	17.1
Chemicals	8.4	140.1	20.3	3.3	16.0	2.9
Autom. Prods	3.2	46.0	14.4	6.7	10.8	5.8
Mach&Equip	38.5	211.9	20.6	8.3	12.3	6.9
Oth Manuf	12.2	148.8	24.4	5.0	16.2	4.7
Construction	1.8	1.1	13.7	5.1	9.7	5.3
Utilities	2.9	129.7	-2.9	0.3	-5.6	1.6
Trade&Trans	297.7	139.2	1.9	-0.5	-0.6	0.7
Pub. Services	52.0	54.8	-2.0	-2.3	-4.2	0.0
Oth Services	90.5	116.0	-0.2	0.5	-3.4	1.8
Total	*847.9*	*2045.4*	*11.1*	*7.0*	*6.5*	*5.6*

Source: Author's simulations

Annex 9: Model Results under Alternative Estimates on Standards

Our modelling analysis of standards revealed that Albania's harmonization with EU norms and regulations on TBTs and SPS will expand bilateral trade and bring notable welfare gains. The analysis was based on a conservative guestimate of the level of trade cost reductions that was driven by that used by Francois et al.(2003).

In this Annex we perform a sensitivity analysis of the standards experiment (E6) using alternative estimates available in the literature. Our base unemployment model was re-run with two sets of assumed trade-cost reductions. The first is based on the Lejour et al. (2001) gravity estimation of standards-related trade costs between EU and the accession countries of Central and Eastern Europe. The magnitude of these estimates is the strongest among those available in the literature. The second set is based on the classic Smith and Venables (1988) estimate of trade costs between EU countries prior to the establishment of the Single Market and consists of the most widely employed estimate in the literature (for example, Harrison et al., 1996). The two sets of estimates are presented in Table A9.1. As can be seen, their magnitude is higher than those employed in our main study, which implies that our sensitivity analysis should produce stronger results.

Table A9.1 Alternative estimates of trade cost reduction due to standards harmonization

	Lejour et al (2001)	Smith & Venables (1988)
Agric Crops	9.4	2.5
Fruit & Veg	1.6	2.5
Animal Prods	5.6	2.5
Fisheries	0.1	2.5
Forestry	0.0	2.5
Processed Food	11.4	2.5
Tobacco & Bev	0.2	2.5
Minerals	13.1	2.5
Metal Prods	0.0	2.5
Textiles	0.8	2.5
Apparel	13.6	2.5
Wood&Paper	0.0	2.5
Chemicals	0.0	2.5
Automotive Prods	10.0	2.5
Machinery&Equip	8.0	2.5
Other Manuf	1.2	2.5

The welfare effects of our sensitivity analysis are presented in Table A9.2 below. We focus on Albania, as the impact on other regions was found to be negligible. As before, harmonization with EU standards leads to an improvement of welfare in Albania. The

estimated gains, however, are stronger than before. Lejour et al. (2001) estimates produce gains of 4.5% of GDP, while the Smith and Venables (1988) estimates lead to an increase of 1.1% of GDP. Allocative efficiency is again the strongest channel through which gains are realised, while both sets of estimates also produce a notable improvement in employment. Overall, therefore the analysis confirms that stronger estimates produce stronger results, but the direction and sources of change remain the same. The difference in magnitude is roughly proportionate, which suggests that, if trade costs are stronger in practice, then Albania stands to gain even more from harmonization with EU standards.

Table A9.2 Welfare effects for Albania with alternative estimates on standards

	Allocative effects	**Endowment effects**	**Technical change**	**Terms of trade**	**Investment effects**	**Total**	
Estimate Source	($ million)					($ m)	*% of GDP*
Lejour etal (2001)	65.50	41.82	0.00	40.77	26.99	175.08	4.25
Smith & Venables (1988)	17.07	10.80	0.00	10.53	6.96	45.36	1.10

Source: Author's simulations

The trade effects of our sensitivity simulations are also comparable to those of our main analysis. Harmonization with EU standards leads to an expansion of EU-Albania trade, which in turn takes place at the expense of trade with other regions. As before, imports into Albania tend to increase from all regions, but exports tend to decline throughout all non-EU countries. Overall, the Lejour et al. (2001) estimates produce significantly stronger results than our main simulations, while the Smith and Venables (1988) bring approximately the same trade changes. Sectorally, trade changes depend again on the size of the barriers. The Lejour et al. (2001) estimates peak for apparel, minerals and metal products, and it is these sectors that exhibit the strongest expansion in exports. Agricultural exports generally decline, with the exception of processed food. Similarly, the uniform Smith and Venables (1998) estimates produce relatively uniform changes in trade. Apparel products take the lead in export growth, followed by metal and textile products.

Table A9.3 Trade effects for Albania by region and sector with alternative estimates on standards (% change from base)

	Lejour et al (2001)		Smith &Venables (2001)	
	Exports	**Imports**	**Exports**	**Imports**
Regional changes (%)				
EU	15.6	7.8	3.8	2.4
EFTA	-21.8	11.1	-5.6	3.5
BUL	-20.7	7.6	-5.3	2.5
ROM	-22.1	6.8	-5.7	2.4
CRO	-23.8	9.9	-6.1	3.1
ForSU	-21.8	6.9	-5.6	2.4
TUR MENA	-22.4	8.7	-5.8	2.6
NAFTA	-21.5	10.5	-5.6	3.3
ROW	-21.3	9.5	-5.5	2.9
Sectoral changes (%)				
Crops	-1.81	13.95	-0.18	3.50
Fruit & Veg.	-17.31	9.21	-1.17	2.39
Animal Prods	-10.80	19.27	1.40	4.69
Fisheries	-13.04	6.76	-0.62	1.82
Forestry	-23.90	11.92	-7.36	4.47
Proc Food	4.19	10.76	-0.04	2.76
Tob & Bev	-10.13	3.42	-1.79	0.88
Minerals	34.51	7.98	4.32	2.11
Metal Prods	-22.49	7.24	8.53	2.61
Textiles	-24.37	17.27	7.07	3.32
Apparel	62.01	14.17	9.47	2.77
Wood&Paper	-28.02	11.15	2.18	3.09
Chemicals	-20.04	6.05	5.32	1.48
Autom. Prods	11.37	6.96	2.65	1.80
Mach&Equip	8.92	8.22	4.33	2.19
Oth Manuf	-25.00	6.61	1.49	1.74
Construction	-12.67	17.06	-3.27	4.36
Utilities	-32.93	15.66	-8.49	4.09
Trade&Trans	-20.20	12.98	-5.21	3.36
Pub. Services	-21.43	13.64	-5.56	3.53
Oth Services	-21.88	13.13	-5.64	3.39
Total	*1.50*	*10.29*	*0.25*	*2.60*

Source: Author's simulations

Annex 10: Model Results of a possible enlarged Central European FTA

On 6 April 2006, the signatories countries of the Memorandum of Understanding for Trade Co-operation and Facilitation in South Eastern Europe, agreed to begin negotiations for a unified free trade area between them.[23] As already noted in section 3.2, there are 23 bilateral FTAs either under negotiation or in the early stages of operation. The proposed unified FTA will encompass all twenty-three agreements under one commonly agreed document. Although discussions are still in the early stages, it is expected that the unified FTA will take the form of an enlarged Central European Free Trade Area (CEFTA).[24]

The purpose of this experiment is to explore the possible future enlargement of the Central European Free Trade Area. It is built on our base GTAP aggregation and maintains our modified unemployment closure rule. The experiment expands Scenario 5 on the full Albania SAA and adds the establishment of bilateral free trade areas between Bulgaria, Romania, Croatia and the EU. A unified Free Trade Area is therefore formed both between these countries/regions and with Albania. The experiment is only a rough approximation of the unified FTA, however, as it does not go into extensive detail to assess specific tariff concessions between other countries/regions. In the case of Albania, it assumes that concessions will be the same as under the current FTAs and thus retains the same shocks as Scenario 5. In the case of other countries/regions, it assumes that the unified FTA will involve full liberalization of industrial tariffs and partial liberalization of agricultural tariffs between signatories. Thus, for industrial tariffs we introduce 100% liberalization, while for agricultural tariffs we conservatively assume that tariff reductions will be around 25% of the initial levels.

The welfare effects of the unified free trade area are presented in the Table A10.1. Overall, the impact on Albania is roughly the same as that under the full SAA. Recall from Section 5.3 that the full SAA was estimated to result in gains of around $62.4 million, which was equivalent to 1.51% of GDP. Under the unified FTA, improvements in Albania's welfare amount to around $60.8 million, which is around 1.47% of GDP. As before gains grow mainly from improvements in allocative efficiency and employment. Impact on other regions, however, is stronger under the unified FTA. While the SAA produced generally small effects, the unified FTA produces notable gains for Bulgaria, Romania and Croatia. They experience welfare improvements of around 0.68% 0.45% and 0.09% of GDP, respectively. The EU also gains, although again the magnitude is relatively small, reaching 0.004% of GDP. Overall, therefore, the unified FTA is found to have a positive impact on

[23] Stability Pact Press Release, *SEE Agrees to Create Regional Free Trade Area – CEFTA to be Enlarged and Modernized*, 6 April, 2006,
http://www.stabilitypact.org/pages/press/detail.asp?y=2006&p=308

[24] Earlier discussions also considered the formation of a new South Eastern European free Trade Area (SEFTA). This idea appears to have been abandoned in later negotiations.

the potential signatories. Albania does not appear to be particularly affected by other countries' bilateral liberalizations and will benefit just as much, even under a full regional FTA.

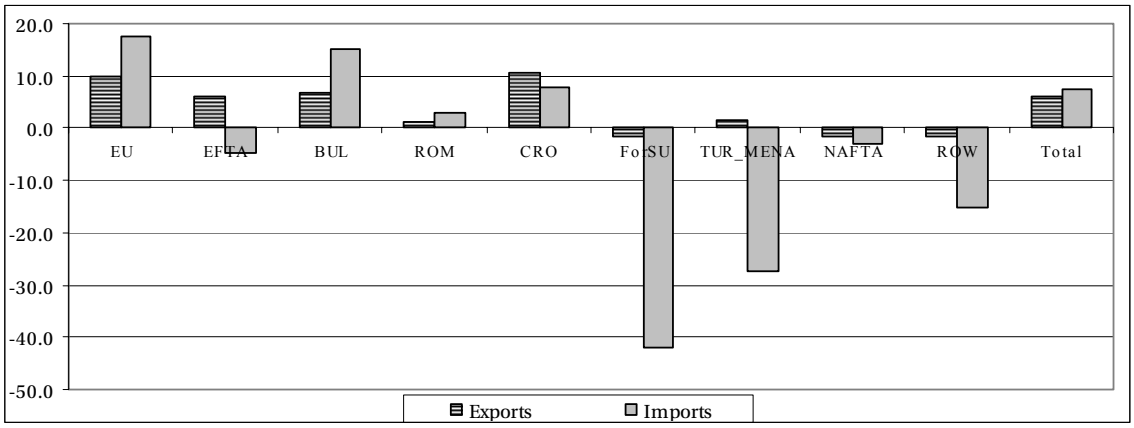
Table A10.1 Welfare effects from a hypothetical unified Free Trade Area

Source: Author's simulations

	Allocative effects	Endowment effects	Technical change	Terms of trade	Investment effects	Total	
	($ million)					($ million)	*% of GDP*
ALB	54.8	42.1	0.0	-5.4	-30.7	60.8	1.478
EU	54.5	0.0	0.0	283.5	3.5	341.5	0.004
EFTA	-2.6	0.0	0.0	-22.9	1.3	-24.3	-0.005
BUL	115.4	0.0	0.0	-22.3	-0.1	92.9	0.686
ROM	79.0	0.0	0.0	93.2	5.6	177.8	0.459
CRO	28.4	0.0	0.0	-6.1	-2.7	19.6	0.097
ForSU	-11.9	0.0	0.0	-42.2	8.9	-45.2	-0.011
TUR_MENA	-14.9	0.0	0.0	-60.4	1.9	-73.4	-0.007
NAFTA	-8.8	0.0	0.0	-60.8	-24.3	-93.9	-0.001
ROW	-47.3	0.0	0.0	-156.6	36.7	-167.2	-0.002

A similar picture is obtained in Albania's regional trade. As in the case of the full SAA, the unified FTA results in an expansion of Albania's trade with others in the region. The biggest impact is observed in Albania's trade with the EU, with exports and imports growing by 10% and 17%, respectively, followed by trade with Bulgaria and Croatia. The Impact on Albania-Romania trade is found to be positive, but minimal. However, trade with other regions is negatively affected by the formation of the unified FTA. Albania's exports and imports with the former Soviet Union countries, Turkey and the Middle East, North America and the rest of the world decline.

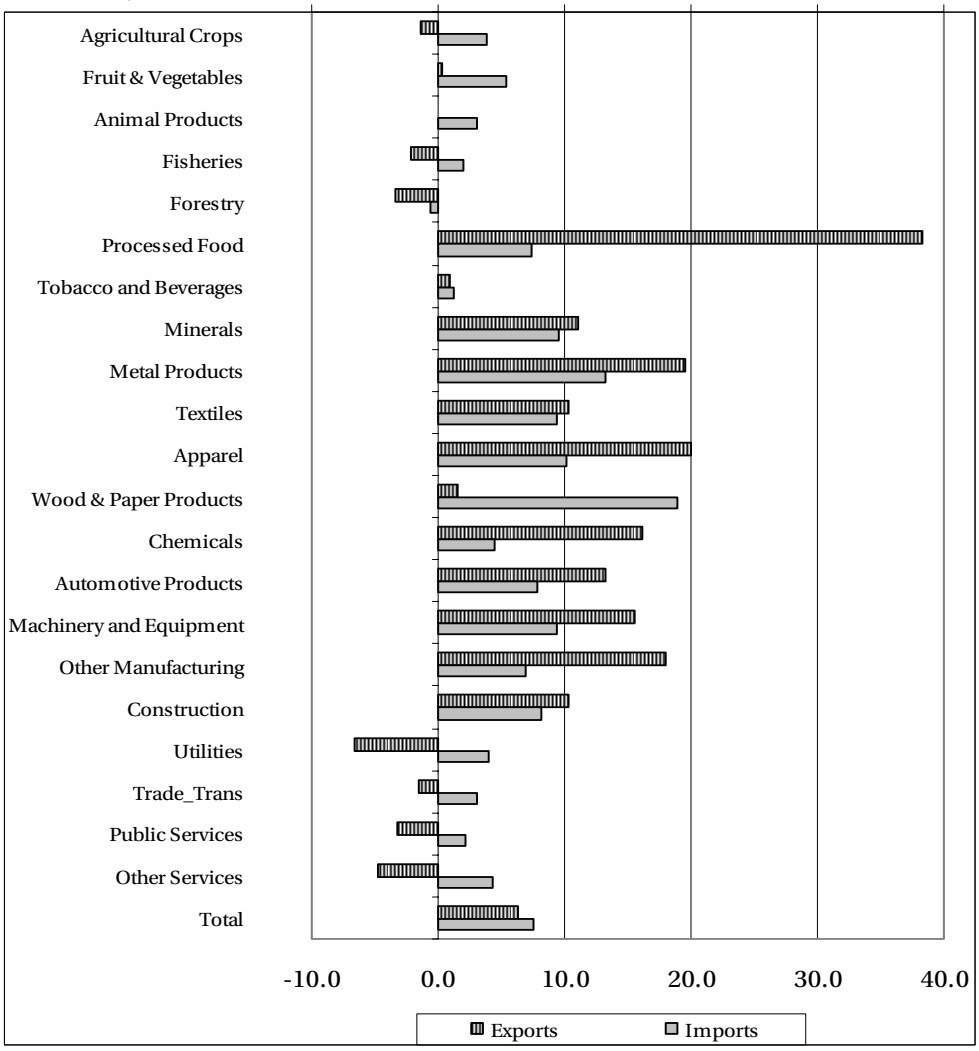
Figure A10.1 Albania's regional trade from the formation of a unified FTA (% change from base)



Source: Author's simulations

Turning finally to the sectoral impact on trade, the unified FTA reveals some interesting variations. Our results indicate that, with the exception of agricultural crops, fisheries, forestry and some services, Albanian exports expand across the board. The most notable increase is observed in processed food sectors, where exports grow by nearly 40%. This is encouraging, as it suggests that the reorientation of trade under the unified FTA benefits Albanian exporters in this sector. It allows them to take advantage of their competitive advantage relative to other signatory countries and expand exports with the enlarged unified market. Apparel, metals and other manufacturing also benefit from the reorientation of trade, experiencing an increase of around 10-15%. A final interesting point concerns imports, which generally increase in the same industries as exports. This could suggest that the unified FTA may be encouraging intra-industry trade. Our GTAP sectoral aggregation does not allow us to draw specific conclusions here, as analysis of intra-industry trade requires fine sectoral detail. It is, however, an interesting observation and could be an area for further future research.

Figure A10.2 Albania's exports and imports by activity from the unified FTA (% change from base)



Source: Author's simulations