Albania and the EU: A path to convergence?

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Abstract. The aim of this paper is to assess the degree of relative convergence achieved by Albania in relation to the EU during the last decade through a descriptive empirical analysis. The paper is divided into three sections related to real and nominal convergence in the fields of economic performance; trade openness and balance; and monetary convergence, according to the Euro criteria established in the art. 140 (1) of the TFEU and the protocol Nº 13 (price stability, public finances, exchange rate, and long-term interest rates). In order to have a wide perspective about convergence-divergence trends inside and outside the EU, the tendencies followed by Germany and Greece are also mentioned, as paradigmatic cases of divergence within the EU. Finally, a summary table is presented reviewing each of the analysed variables regarding the last decade evolution and the current situation.

Keywords: European Union, growth, divergence, integration, Euro.

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1   Introduction

Albania experienced a period of dramatic economic turbulence during the '90. The change of regime and the subsequent financial crash determined a decade with an annual average growth of the real GDP per capita (in local currency) of 0,7% (see appendix). Not only slow growth, but also extreme instability, with peaks of economic contraction of -29,2 in 1991 and   -9,6% in 1997, both followed by a couple of years of two digits growth rates.[1]

After the pyramidal financial crisis of 1997, Albania started since the beginning of the new century a more stable economic growth path, making efforts to strengthen their institutional framework and taking steps towards European Union integration. This is a long way, as it entails institutional, legal and economic reforms, but some steps have already been taken.

In this report we try to analyse the economic path followed by Albania towards EU integration. Although this is only a partial and descriptive approach, it is important to assess the economic progress experienced by Albania in the last decade, to see how much it has moved forward, and how long the way ahead is.

Thus, we will compare EU and Albania economic progress in the last decade, to see whether there has

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[1] According to World Bank data.

happened a convergent or divergent evolution. We will also mention the German and Greek cases to see how divergence may happen even within an economic and monetary union.

So the structure of the paper is the following: section 2 reviews theoretical and methodological aspects of convergence analysis. Section 3 focuses on economic performance, looking at the evolution of GDP, national income, investment and productivity. Section 4 studies evolution of trade openness and balance. Section 5 applies the Euro convergence criteria (price stability, public finances, exchange rates and long-term interest rates) to Albania. In section 6 there is the conclusion of the aspects mentioned above.

2   Theoretical and methodological aspects

The convergence debate is quite controversial in economic literature. The first point is to define what we understand by "convergence". Convergence may be referred as _real_, _nominal_, _structural_ or _social_. Each of them alludes to different aspects of socioeconomic reality.

Considered in real terms, convergence refers to the production capacity of different economies regardless of price evolution (i.e. constant prices). Production capacity is usually studied in relation to the population (i.e. per capita) so it reflects better the real average wealth of each individual.

We can also look at monetary variables, as prices, interest or exchange rates. This is the chosen perspective adopted by the Maastricht Treaty and therefore the key to understand the convergence criteria we will review later in this paper. Nominal convergence is important to achieve a monetary union, but as we have seen in the current Euro crisis, it is not enough to assure an optimal currency area (cfr. Mundell 1961; Baldwin and Wyplosz, 2004).

For structural convergence we understand the similarity in the production capacity of different economies; not the total production capacity, but the composition of it; that is, which goods and services are being produced, and what are the main economic sectors and branches of activity. Primary specialization is usually linked to the first steps of economic development, while most developed countries are service intensive, having relocated their former industrial capacity to developing countries. However, production structures are dynamic and usually related to international division of labour (cfr. ILO, 2006), and global value chains (cfr. WB, 2010, UNCTAD, 2013; WTO, 2013).

Finally, by social convergence we understand the equality in living standards among different populations. For instance, it could happen the case that two countries have similar production capacity (so "real" convergence seems to be achieved), but with very different income distribution, so one country is far more unequal than the other. Therefore, although the total production per capita may be similar, there are important differences in living standards between the two societies.

We must also make a difference between absolute convergence, which consists in reaching the same level of economic development, and relative convergence, which refers to the tendency according to what poorer countries grow faster than richer ones, leading a catching up process in the long-term.

In this paper we will analyse relative real (section 3), and monetary convergence (through Euro convergence criteria, section 5), in addition to the evolution of international trade (section 4), but taking into account that this is a preliminary and partial report and that structural and social convergence should also be studied.

Convergence hypothesis states that poorer countries tend to grow faster than richer ones, so a convergence process usually happens among countries. According to Barro (1997: 2): *"the convergence property derives in the neoclassical model from the diminishing returns to capital. Economies that have less relative capital per worker (relative to their long run capital per worker) tend to have higher rates of return and higher growth rates"*.

Many empirical researches have tried to test this hypothesis -based in Solow growth theory (1956)- with several econometric methods, from the seminal works of Barro (1991), Sala-i-Martin (1997) and Mankiw-Romer-Weil (1992) to the contemporary ones as Gáspár (2010). Also within the EU at a regional level interesting studies have been carried out as Monfort (2008).

However, the goal of this paper is not to test the hypothesis itself, but only to analyse the bilateral relationship between EU and Albania regarding the aforementioned variables, related to the economic growth, trade openness and monetary and fiscal developments. Consequently, we will carry out an empirical descriptive research on data from EU and Albania, making also references to Greece and Germany to compare different convergence-divergence phenomena inside and outside the EU.

The data is taken from multiple sources, so there may be discrepancies between the different parts of the paper. The main sources are Eurostat, European Commission, European Central Bank, Bank of Albania, World Bank and Groningen Growth and Development Centre. We must be also aware that the high degree of informality may distort the data about Albania (see note 2).

3   Economic performance

3.1   Economic growth

Although the need of economic growth is discussed in western societies (cfr. Daly, 1997; Meadows et. al. 2004, Jackson, 2011) it is necessary for integration processes to have similar development levels across the countries that form the Union. Although according to the Convergence Hypothesis poorer countries tend to grow faster than richer ones, this is not an automatic process, as many social factors are involved in economic performance. So we will analyse in this section if this is the case of Albania in relation to the EU, looking also at the trends followed by Germany and Greece.

The first point we should look at is per capita GDP measured at Power Purchase Parity (PPP)[2]. In the graph 1 we can see the data of Albania, Greece and Germany in relation to the EU average (100). In 2012 the purchase power of Albanians was 0,3 that of the EU average (probably a bit higher due to the underestimation of Albanian informal economy; see note 2). Although it is still far from the EU average, it has improved 8 percentage points since 2005.

It is interesting to observe the tendency of Greece and Germany in relation to the EU average. It can be noticed a very slow convergence trend before the crisis (Germany descended 1 pp, while Greece

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[2] The PPP measure allows us to see the effective purchase capacity of each country independently of exchange rates and price level differences among them. We must have in mind that due to the high level of informality present in Albanian economy, it is probable that its purchase power is effectively higher than the one depicted by statistics, which do not gather this important part of economic activity. Recent research shows that informal economy in 2012 could amount between 24,4% (electrical energy consumption method), and 34,7% (national accounts discrepancies method). Although these figures are still high, its tendency since 1996 has been descendent (Boka and Torluccio, 2013).

improved 2, in seven years)[3], *versus* a rapid divergence from 2009 so far, increasing the difference of per capita GDP between Germany and Greece from 20 pp in 2009 to 49 pp in 2013, 29 percentage points in only four years.

As we have already seen, during the last decade Albania has grown at a higher rate than the EU average in terms of per capita GDP in PPP. We can clearly see this trend looking at the average annual growth rates of real Gross National Income (GNI)[4]. Considering the period as a whole (2001-2012), Albanian growth rate was more than 5 times that of the EU, which shows a clear convergence path with the Union. This growth has reduced by half since the crises of 2008, but remains positive oppositely to the negative growth rate of the EU (annual average of -0,5% between 2009-2012), therefore persisting the aforesaid convergence path.
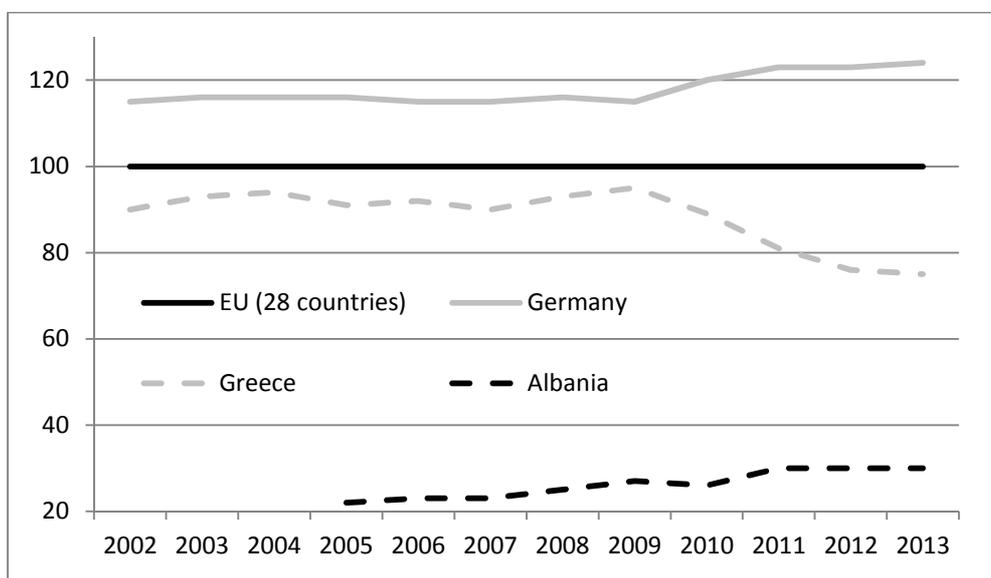
Source: own elaboration based on Eurostat data.

Figure 1 Compared per capita GDP of Albania, Germany and Greece in relation to the EU (28) average (=100), for the years 2002-2013.

What has been already mentioned about German-Greek convergence-divergence relationship may be clearly seen in Table 1. Greece growing faster than Germany between 01-08, and the posterior downturn of Greece whereas Germany maintaining a modest positive growth rate. Although the causes and the roots of these serious divergence are complex (Cfr. Borrel and Missé, 2011; Gómez, 2011; Lapavitsas, 2012), it must be pointed out that membership of EU is not a sufficient requirement to achieving convergence. Although it was one of the main goals of European integration, the crisis has shown that monetary integration is not enough by itself, and that the previous convergence trend was not sustainable in the long-term.

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[3] Provided that the date is relative to UE average (index=100), the slight downward German trend does not mean that it has a negative economic growth, but that its economic growth is slower than the UE average.

[4] Gross national income (GNI) is defined as the sum of value added by all producers who are residents in a nation, plus any product taxes (minus subsidies) not included in output, plus income received from abroad such as employee compensation and property income. The main difference with GDP is the "nationality" criterion instead of the "territoriality" one.

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Table 1 Gross National Income average annual growth rates for the periods 2001-2012, 2001-2008, and 2009-2012.

GNI growth rates (%)	01-12	01-08	09-12
Albania	5,2	6,2	3,4
European Union	1,0	1,8	-0,5
Germany	1,6	1,7	1,5
Greece	0,4	2,8	-4,4

Source: own elaboration based on World Bank Data.

3.2. Investment and productivity

As it is widely known, investment (either public or private) is the main variable in economic growth, as it is an essential component of aggregate demand, but having also important effects on supply. As a component of Aggregate Demand[5] its fluctuations determine those of AD and thus create business cycles. As far as the supply side is concerned, investment boosts capital accumulation, improving productivity and fostering economic growth.

Having seen growth data, it is not surprising that investment as a percentage of GDP is higher in Albania than the EU. For the whole period (2001-2013) it has been 7 percentage points higher. It is surprising however, that while in the EU gross capital formation has dropped 2,6 pp after the crisis from its previous level, in Albania it has not dropped, but increased until 28,1% of GDP, being almost 10 percentage points higher than UE average.

And as it can be imagined, investment has decreased more sharply in Greece than in Germany after 2008, both standing under the EU average.

Table 2 Gross Capital Formation as percentage of GDP. Average for the periods 2001-2012, 2001-2008, and 2009-2012.

GCF/GDP (%)	01-13	01-08	09-13
Albania	26,9	26,3	28,1
European Union	19,8	20,8	18,2
Germany	18,3	18,9	17,3
Greece	21,5	24,7	15,8

Source: own elaboration based on World Bank Data.

But in addition to the amount of investment in relation to the GDP, it is important to see in which sectors this new investment is located. While investment in construction may be profitable, it is not much productive if it is based on residential assets rather than infrastructure. Likewise, investment in tech-intense manufactures is usually more productive in the long-term than housing and real estate. A

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[5] AD = C + I + G + NE (Aggregate Demand equals to Consumption, Investment, Government expenditure and Net Exports -i.e. exports less imports-)

good example of this may be seen in the relationship between German and Spanish economic growth models. While Spain focused most of its new investment in construction and financial-real estate sectors (López Prol, 2014), Germany intensified its high-tech manufacturing sector (Luque de Haro, 2014), achieving a strong commercial position, whereas Spain has suffered a serious crisis once its real state bubble burst. Although sectorial analysis is not in the scope of this paper, more research is needed to assess the sectorial composition of Albanian production capacity.

Finally, economic growth may be discomposed in productivity and labour growth, so it may be sustained either by job creation (as Spain 94-07) (López Prol, ídem), by productivity improvement (as Germany 95-06) (Luque de Haro, ídem) or by both factors. For the period 2001-2013 Albanian annual economic growth was 5,1%. Productivity[6] grew at an annual average rate of 4,3% whereas labour increased the remaining 0,8%. Consequently, we can clearly affirm that Albanian economic growth was mainly based on the growth of productivity. Besides, it was much faster than in the EU.

Table 3 Annual productivity (GDP per person employed) growth rates for the periods 2001-2012, 2001-2008, and 2009-2012.

Productivity growth	01-13	01-08	09-13
Albania	4,3	5,3	2,8
European Union	0,9	1,3	0,3
Germany	0,6	1,1	0,0
Greece	0,8	1,9	-1,0

Source: own elaboration based on Total Economy Database Data, Groningen Growth and Development Centre.

Despite this productivity growth, in absolute terms it is still far from EU average. The real GDP per person employed at PPP was in 2013 less than 25.000 $ according to the Total Economy Database developed by the Groningen Growth and Development Centre, that is to say, less than one third that of the EU average (see appendix). That explains the high growth rates registered in comparison with the EU, but also leaves a large space for economic growth through productivity improvements.

4   Trade openness and balance

Becoming a member of a common market means to have perfect openness with all the members of the Union. If the productivity and competitiveness of the members differ sharply, it could cause the deindustrialization of the worst performers, losing jobs and contracting economic growth. That is why countries must open their economies slowly, giving time to national industries to adapt to international competence. In this section we analyse Albanian trade openness and its commercial balance with the EU and the rest of the world.

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[6] Productivity is given by the ratio output/labour. Labour may be measured as workers, or as hours worked. Although the second measure (hours) is more accurate, due to the lack of data of Albanian working hours we use in this paper the workers measure. As the workday is presumably longer in Albania than in the EU, this measure probably overestimates Albanian productivity.

4.1   Trade openness.

The trade openness of a country is measured by adding exports plus imports, and dividing it by the country's GDP ((X+M)/GDP). This indicator shows how interrelated with the world a country is in terms of goods and services trade. Openness is not good or bad itself, it depends on how that openness is structured. However, before becoming part of a common market, a certain degree of openness is required, in order to adapt domestic economy to international competence.

As may be seen in Figure 2, trade openness has had a solid upwards trend both in Germany and Albania, and in the EU as a whole. On the other hand, although not showing a clear path, Greek openness has dropped by almost 5 percentage points since 2000, and stands 20 pp below the EU average.

But as we have already mentioned, it is not so relevant the trade openness itself, but its composition. And how it can be analysed from the previous two graphs, although the Albanian trade openness is slightly higher that the EU's, this is balanced between exports and imports, while the Albanian one is unbalanced by the high weigh of imports (more than 16 percentage points higher than exports), what leads to an important trade deficit which will be seen in the next point.

Therefore, Albanian industry is already exposed to international competence. Although the share of exports in relation to GDP is high, it may be caused by a relative small GDP and the weaknesses of internal demand, more than for international competitiveness, as the imports share is much higher, showing the Albanian dependence on external production and the lack of strong internal industries globally competitive and able to satisfy internal demand.

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4.2   Exports and imports

Exports, as a percentage of GDP, are a good measure of an economy's competitiveness. A high percentage of exports in relation to national GDP means that the national industry has a strong international position. That may be caused by high productivity, low labour costs, weak exchange rate, lack of competence in the products offered or product quality and differentiation. However, a high share of exports related to GDP may also reflect the narrowness of the domestic demand, that is why exports and imports must be studied as a whole to get an ample perspective of a country's relationship with the rest of the world.

In the Figure 3 we see that Albanian exports in relation to GDP have been growing at a considerable rate since 2000, having increased 15 percentage points in 13 years. The EU as a whole has increased its exports as percentage of GDP as well, but at a lower rate than Albania, so the distance between them has decreased almost 10 percentage points.
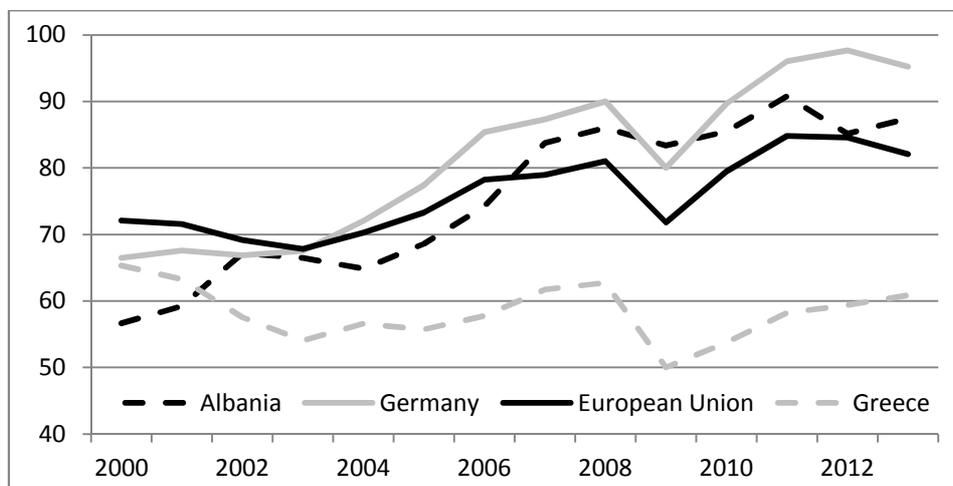
Source: own elaboration based on World Bank Data

Figure 2 Evolution of trade openness ((X+M)/GDP) for Albania, EU, Germany and Greece for the period 2000-2013.

It can also be noticed that Germany has a solid international position, exporting more than half of its GDP, and with a positive tendency since 2000. On the other hand, we see Greece, that exported less than its 25% GDP until 2011. Although it is increasing from 2009, this may be caused more by the contraction of the GDP than for the improvement of competitiveness.
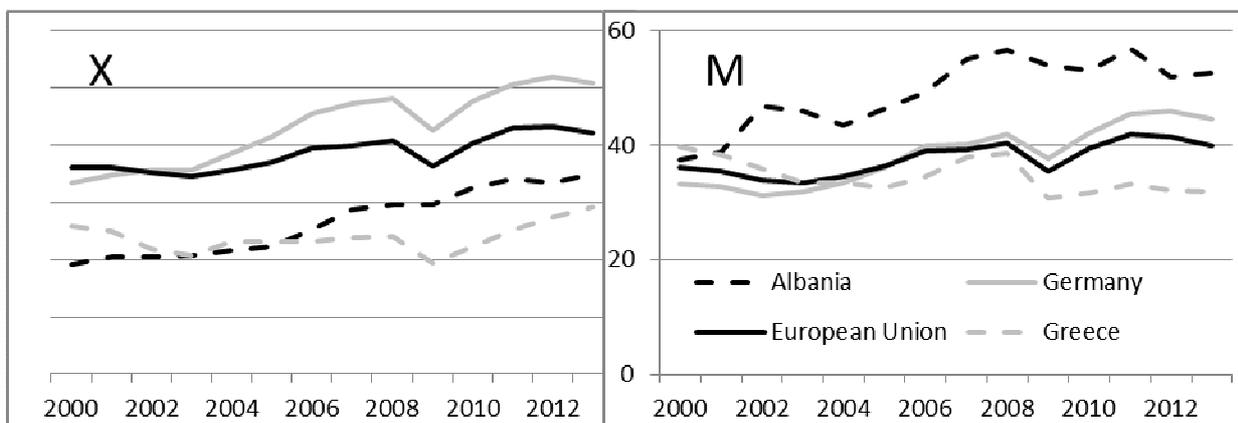
Source: own elaboration based on World Bank Data

Figure 3 Evolution of exports (X) and imports (M) as percentage of GDP for Albania, EU, Germany and Greece for the period 2000-2013

Although Albanian productivity is still low, its improvements, in addition to the low labour costs and the exchange rate effect might have made its products more competitive in European and international markets, causing this exports upwards trend.

On the other hand, imports represent the internal demand which is not satisfied by national production. The point of imports is to study its tendency in relation to exports. Increasing imports is not a problem if exports grow at the same or higher level, but if it does not happen, there will occur a trade deficit

which forces the national economy to finance it, either by transfers (e.g. remittances), primary income (e.g. profit repatriation) foreign investment (e.g. direct foreign investment), or indebtedness.

In the Figure 3 we see the rapid growth of Albanian imports, mainly between 2000 and 2008, when they rose 29 percentage points in only 8 years. Since then so far they have stabilized and even decreased slightly to around 52% of GDP, still far higher than the UE average (39,9%). This high import dependence shows the inability of internal industry to provide the products demanded by Albanian households and companies.

We can also see the divergent path of Germany and Greece. Although close to the EU average until 2008, they have experienced different patterns since 2009, rising of imports in Germany *versus* quick drop and stabilization in Greece, probably due to the austerity measures aimed to shrink internal demand.

4.3   Trade Balance.

The trade balance shows the difference between exports and imports. If exports are higher there is trade surplus, while there is deficit in the opposite case. Trade balance, together with income and transfers balances form the current account balance (being the trade balance the most important in quantitative terms). Consequently, if we have current account surplus (usually led by trade surplus), we can finance the rest of the world. Instead, if we have current account deficit (usually caused by trade deficit) we must be financed, either by transfers, primary income, foreign investment or indebtedness.

Looking at the Figure 3 we can already know the trade balance of each country, which is depicted in Figure 4. The EU as a whole has a balanced trade account, with a slight surplus during the last years. Germany has been improving its balance since 2000, mainly during the first three years. In 2013 Germany accounted a trade surplus above 5% of its GDP. On the other hand is the case of Greece, with a constant trade deficit of about -15% until 2008. Since then, it has been decreasing so far until the current -2,6%.

The worst case is the Albanian. We have already seen that imports are far higher than exports, which caused a constant deficit of about one fourth of the GDP since 2002 to 2008. Since then, it has been decreasing so far to the current -17,7%, which is still too high. Current account balance (trade of goods and services, transfers and incomes) registered a deficit of -10,6% in 2013 . As trade deficit must be financed, it is not sustainable in the long term. That scenario makes it necessary to carry out policies aimed at reducing trade deficit. Those policies may be oriented at discouraging imports (e.g. import substitution industrialization, contraction of internal demand), or preferably at fostering exports (e.g. productivity, innovation and guidance policies).

5   The Euro convergence criteria

This section is based on the analyses carried out by the European Central Bank (Convergence Reports)[7] and the European Commission (2014b) in accordance with the article 140 (1) of the Treaty on the Functioning of the European Union (TFEU) about the achievements of EU countries towards

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[7] Available in https://www.ecb.europa.eu/pub/convergence/html/index.en.html

European Monetary Union (EMU). Although Albania is still far from the EMU (as EU membership is a prior step), this is a preliminary analyses of how distant Albania is from the achievement of the € convergence criteria established in the above mentioned article 140 of the TFUE, the Protocol Nº 13 on the Convergence Criteria, and the Stability and Growth Pact (SGP).
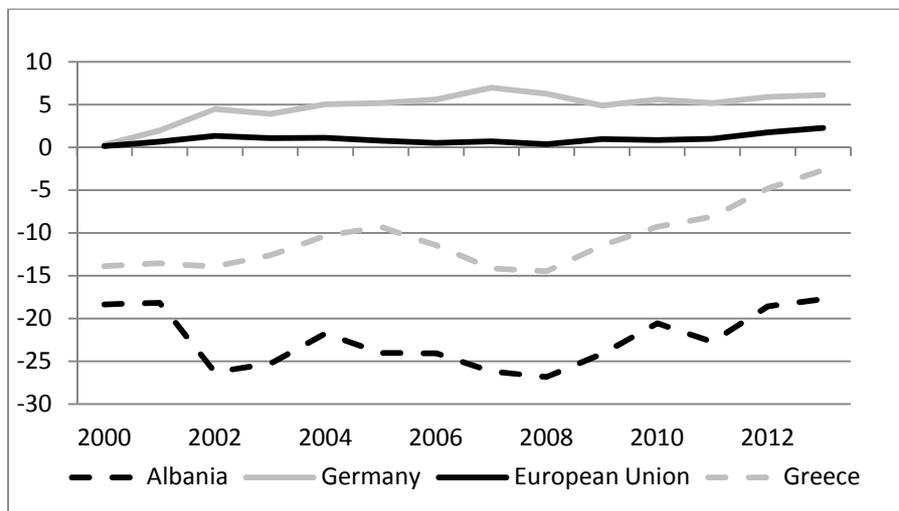
Source: own elaboration based on World Bank Data

Figure 4 Evolution of trade balance ((X-M)/GDP) for Albania, EU, Germany and Greece for the period 2000-2013.

The four convergence criteria (price stability, public finances, exchange rate stability, and long term interest rates) are developed in the protocol Nº 13 on the convergence criteria annexed to the Treaty. As a result, this section will consist in a long term review (always data is available) of the Albanian performance regarding the aforesaid convergence criteria to the EMU. Although the Convergence report of the ECB and the EC assesses a variety of other issues as regulatory developments, the Central Bank performance, etc. we will be focusing only on the 4 convergence criteria stipulated in art. 140 (1) TFEU and Protocol Nº 13.

5.1 Price stability.

The price stability criterion is defined in the Article 140(1) of the TFEU: *"the achievement of a high degree of price stability […] will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability"*, and the Article 1 of the Protocol on the convergence criteria: *"the criterion on price stability […] shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best-performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions"*.

The price performance must be "sustainable". That means that price evolution should be studied in the medium/long-term (although the Protocol specifies that a year is enough), and regarding structural facts which determine that evolution, rather than circumstantial factors. However, we will not be seeing here what the determinants of the inflation rate are, but we will study the evolution of it as a

whole in the long term in comparison with the Euro Zone (EZ) and the reference value calculated by the ECB.

The reference value below which all other countries must be located in terms of price stability is calculated by the ECB as the unweight average of the average inflation rates of the three best performers of the EU (not EZ), plus 1,5 percentage points. But here there is a discussion about what countries should be considered as "best performers". Although the target average of the ECB is 2%, there seems to be a deflationary bias both in the ECB and the EC, since the best performers are not those closer to that 2%, but those with lowest inflation rates, discarding some countries with negative ones caused by economic stagnation.[8]

That deflationary bias of the ECB and the EC may be seen in the Convergence Report 2014 (European Commission, 2014b: 6), where it is said: *"Bulgaria fulfils the criterion on price stability [...]. The average inflation rate in Bulgaria during the 12 months to April 2014 was -0.8%, well below the reference value of 1.7%. It is projected to remain well below the reference value in the months ahead."* The difference between the reference value and the country's inflation is -2,5 percentage points. This would have been unacceptable if it was higher, but is not a problem being below the reference value. Even although deflation can be as prejudicial for economic performance as inflation, or even worse, provided that deflation may cause a vicious circle of stagnation-deflation-stagnation and the increasing of real debt. Even more, the reference value for 2010 is 1%, having added the 1,5pp margin, so the "best performers" average is -0,5%, that is, deflation. It can be concluded that it is not a representative year, and so the data registered that year should be interpreted carefully.

Figure 5 shows the evolution of inflation (measured as consumer prices annual percentage change) since 2000 for Albania and the EZ (World Bank and European Commission data). In the first years of this century Albania has experienced high fluctuations in its consumer prices, going from 0,05% in 2000 to almost 8% in 2002. Nevertheless, we see that since 2004 the consumer prices have evolved at similar annual growth rates in both Albania and the EZ. Inflation has been higher in Albania than in the EZ between 2009 and 2011, but this may be related to the stagnation of the EZ in that period, which led to very low (and even negative) inflation rates in some countries.

Whereas consumer prices have been growing between 2 and 4% during the last five years (within the limits established by the Central Bank of Albania), producer prices have been growing slower (even decreasing in 2009 and 2013), and food prices have been rising at higher rates. Slow evolution of producer prices boosts competitiveness (relative to faster growth producer prices in competitor countries), but food prices increasing fast reduce purchase power of lower and middle income population, increasing the risk of poverty and undernourishment and boosting inequality (as lower incomes spend higher proportions in food).

While ECB inflation target is 2%, the Bank of Albania (BoA) has an inflation target of 3%, (with a tolerance margin of ± 1 percentage points). Inflation has been kept in this acceptable range for the last 9 years, and even the ECB target of 2% has been met by Albania in the last two years. We must be aware that higher growth rates are usually related to higher inflation rates, so it is reasonable that Albania has a more flexible inflation target due to its faster growth.

Finally, regarding the reference value (RV) established by the ECB, we must make a prudent interpretation, considering the abovementioned criticism. For instance, for 2013, we observe the

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[8] For more information about reference value calculation see the methodological notes in the original Convergence reports made by ECB: https://www.ecb.europa.eu/pub/convergence/html/index.en.html

paradoxical situation that meeting ECB's general target of 2% inflation, Albania does not fulfil the RV of 1,7%. That requirement was fulfilled in 2012, but this was due to the higher RV instead of for a better price performance in Albania, what shows the high arbitrariness of the reference value.

To summarize, we have three levels of price performance interpretation: (i) according to the BoA the inflation target has been met since 2004; (ii) based on the ECB general standard it has been met the last two years; and (iii) the Albanian inflation rate has only been below the euro criteria reference value in 2012 within the last five years.

Due to the volatility of the reference value and to the stagnation (and so deflation) in some of the EU countries, it does not seem too representative for the last years. Instead, we can see that the price performance has been quite similar in Albania and the EU in the pre-crisis period (2004-2008). Between 2009 and 2011 inflation has been higher in Albania, which is quite reasonably due to its higher growth rate. Finally, in last years, Albanian inflation seems to have been stabilised around 2%, which is the inflation target of the ECB.
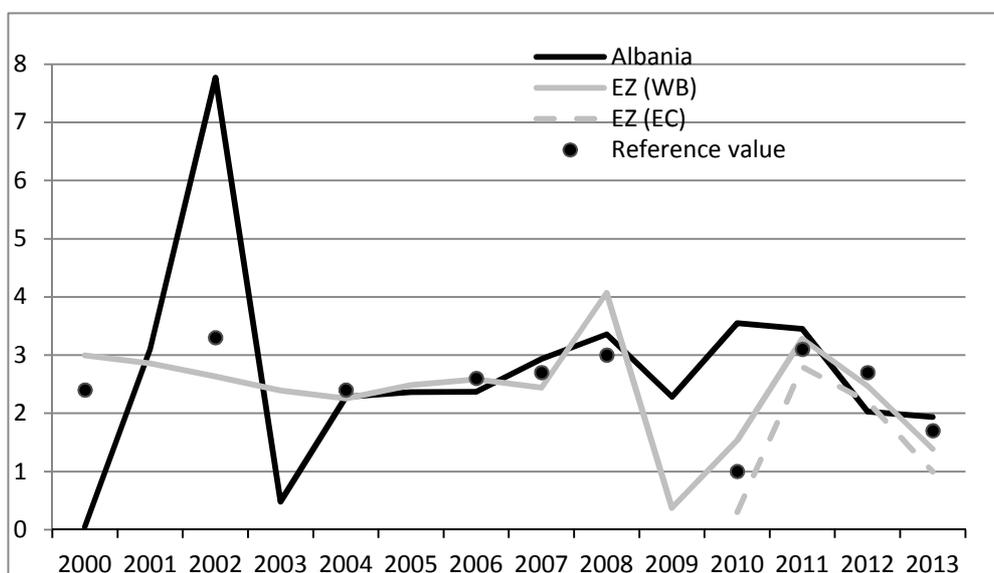
Source: own elaboration based on World Bank (WB), European Commission (EC) and European Central Bank (ECB) data.

Figure 5 Inflation annual growth rates (measured as Consumer Price Index, CPI), for Albania and the EZ (data from World Bank and European Central Bank), and the reference value calculated by the ECB according to the convergence criteria.

5.2   Public finances

The Public finances convergence criterion is also established in the Article 140 (1) of the TFUE and the Article 2 of the Protocol on the convergence criteria. Finally, the Stability and Growth Pact (SGP, 2011) based on the articles 121 and 126 of the TFEU determined how to measure the maximum deficit of 3%, and the threshold of 60% debt related to national GDP.

Figure 6 shows government deficit and debt as percentage of GDP. We can see that government deficit has been increasing during the last four years, from 3,1% of GDP in 2010 to 4,5% in 2013, surpassing thus the limit of 3% established by the € convergence criteria. Public debt has followed the

same trend, growing 7,5 percentage points in 4 years, exceeding the 60% threshold since 2012.

Thus, Albania does not fulfil the public finance criterion. Although the figures were quite acceptable in 2010, the negative path followed by government deficit (and so public debt) in the last 4 years has distanced Albania from the Public finance standard. This evidences the need of strengthen tax system in order to achieve a balanced fiscal position. It is also related to the formalization of the informal sector, where some developments have already been made in the last years according to Boka and Torluccio (2013) stimations.
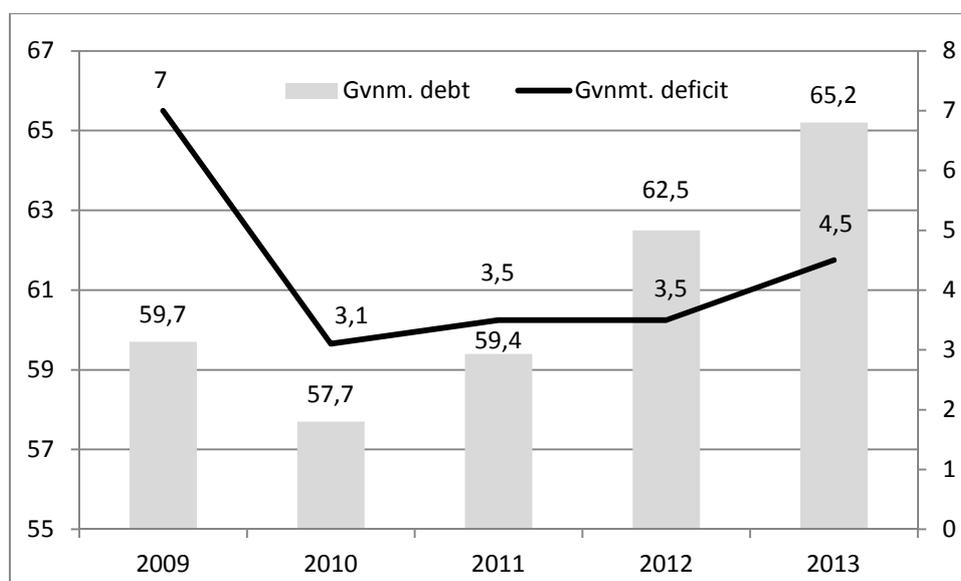
Source: own elaboration based on European Commission data.

**Figure 6** Government deficit and debt as percentage of GDP.

5.3   Exchange rate

The exchange rate criterion is defined in the Article 140(1) as *"the observance of the normal fluctuation margins provided for by the exchange rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro",* and article 3 of the Protocol on the convergence criteria: *"The criterion on participation in the exchange rate mechanism of the European Monetary System (…) shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against the euro on its own initiative for the same period"*

During the last five years, ALL/EUR exchange rate has risen from 132,06ALL/EUR to 140,26. That means a total depreciation of the ALL by 6,2%. ALL depreciation has happened mainly in 2009, and between mid-10 and mid-11. Afterwards it has appreciated slowly with moderate fluctuations until 09/12, and since then so far the exchange rate has been quite stable between 137,38 and 138,55ALL/EUR. So we can differentiate three periods: 1) 08/09 to 05/11: depreciation; 2) 06/11 to

09/12: slight appreciation with seasonal fluctuations; and 3) 10/12 to 07/14: stabilization around 137-138ALL/EUR.

As a result exchange rate between ALL and € has experienced a stabilization process in three steps. After an important depreciation and a slight correction, it seems to have stabilised between 137-138ALL/EUR, with short depreciation tensions concentrated in 2013, but not affecting the medium-term stability seen in the last two years.
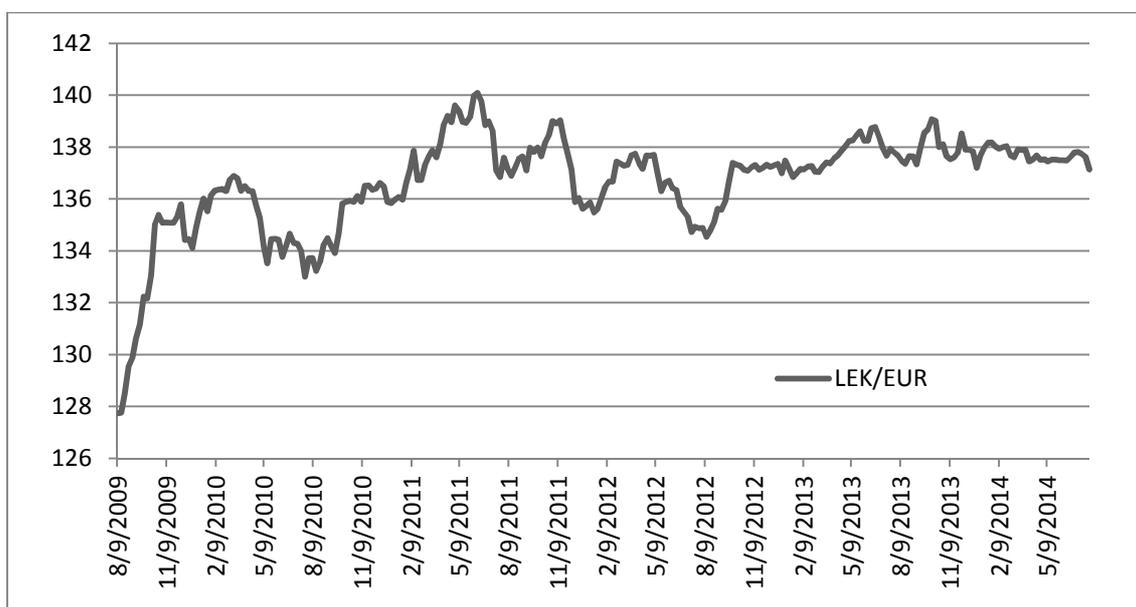
Source: own elaboration based on Oanda data.

**Figure 7** ALL/EUR weekly exchange rate between 09/08/2013 and 27/07/2014.

5.4 Long term interest rates

Finally, the last convergence criterion refers to the long term interest rates. Article 4 of the Protocol on the convergence criteria stipulates that *"the criterion on the convergence of interest rates (…) shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions"*.

Ten-year sovereign bonds are used as a reference for comparing long term interest rates among countries. However, most of the Albanian bonds have a maturity of two years, and 10 years bonds have been issued mainly in the last two years, according to the information provided by the Bank of

Albania (BoA)[9]. Thus, we use both 2 and 10 year-bond to analyse Albanian performance in terms of long-term interest rates. The data of the 2-years bonds for the last 5 years (presented in Figure 8) shows a downward trend. This data cannot be directly compared with the other figures showed in the graph as it refers to a maturity of 2 years instead of 10, but we can clearly appreciate a descendent path followed Albanian bond yields.

For the last two years, there has been provided some information about the weight average of Albanian 10-year bond yield. This data is directly comparable with the Euro Zone (EZ) average and with the reference value, as they refer to the same type of asset: 10-year sovereign bond. We can see that the Albanian bond yields are well above the EZ average and also over the reference value, so Albania would not meet the long-term interest rate criterion, but the trend experienced during the last years is positive. The spread between the reference value and the 10-year Albanian bond has fallen in the last year from 3,75 percentage points to 3,05 (i.e. seventy basic points). So although the interest rates are still high, they have been falling in the last years towards convergence with EZ standards and the reference value.
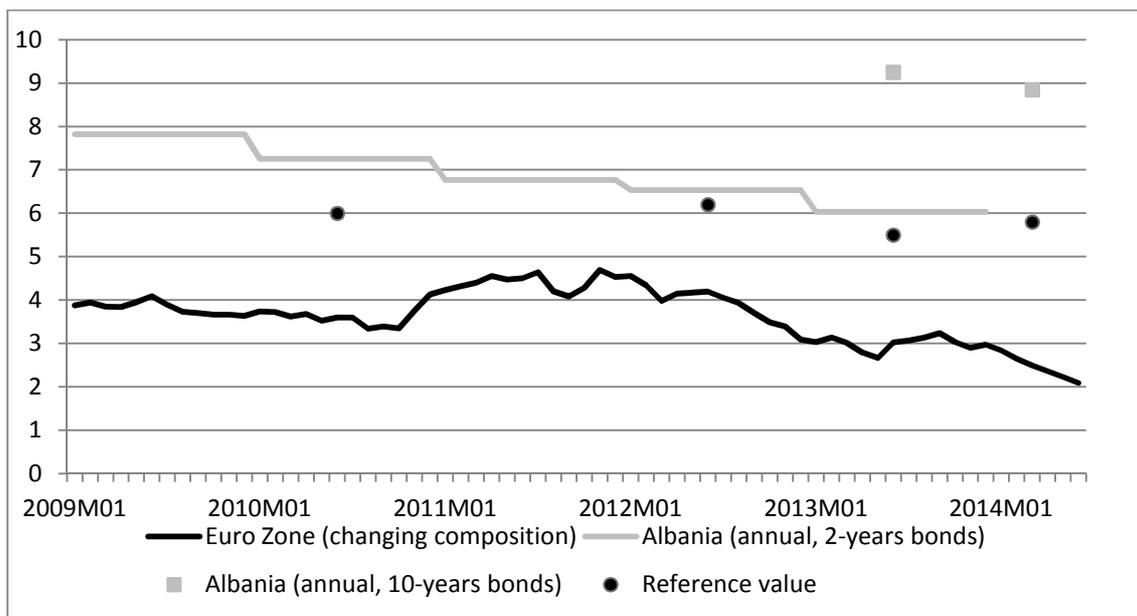
Source: own elaboration based on Eurostat, ECB and BoA data.

Figure 8 Long term interest rates measured as bond yield for the Euro Area (10-year bond monthly average, changing composition. Black line), and Albania (2-year bond, yearly average. Grey line). Reference value established by the ECB (black points) and Albanian 10-year yearly average bond yields (grey squares)[10]

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[9] http://www.bankofalbania.org/web/Bond_auctions_2314_2.php?list=allankand

[10] For the sake of simplicity, German and Greek data have not been included in that graph. However, due to the high relevance of that information a long-term graph with all these information has been included in the appendix (graph A.4). We can see how the construction of the EU and the EZ led to the convergence of the bond yields to the level of the German bond (considered without risk). These levels maintained until the crisis when Greek bond yields went through the roof causing the bankruptcy and the bailout of the country.

6   Conclusions

Although Albania is still far from absolute real and nominal convergence with the EU, it has experienced a positive path over the last decade, achieving relative convergence (better performance that the EU), diminishing thus the differences between the two zones in most of the variables studied.

In the economic development section all variables have performed satisfactorily, with higher economic and productivity growth rates than the EU. Despite this greater growth, in absolute terms both per capita GDP (in PPP) and productivity are far from the EU average, accounting for only about a third of them respectively. Investment effort (Gross Capital Formation in relation to GDP) has been higher in Albania than in the EU for the whole period, with that difference increasing after 2008.

Albania has approximately the same levels of trade openness ((X+M)/GDP) than the EU, but whereas the EU is balanced, Albania has a large trade deficit of almost 18% of its GDP. That is caused by the huge amount of imports required by the internal demand, which accounts for more than half of Albanian GDP since 2007. There has been however, a turning point in 2008, since when exports are increasing faster than imports therefore reducing slowly the trade deficit.

Strictly, Albania only fulfils one of the four € convergence criteria (exchange rate stability). Nevertheless, economic stagnation in some EU countries has led to low inflation rates (or even deflation) causing extraordinary low reference values. Thus, although this criterion (price stability) has only been met in 2012 during the last five years, inflation has been within BoA thresholds (2-4%) since 2004, and it has been around 2% (ECB's inflation target) during the last two years. Therefore, inflation has been moving within acceptable levels for the last 10 years, and it has even achieved ECB's standard in the last two.

The public finances requirements have not been fulfilled in the last 3 years. Although the levels were admissible in 2010, since then both government deficit and debt have had an upwards trend, surpassing the 3% and 60% (respectively, in relation to GDP) thresholds established by the € convergence criteria.

Bond yields are still far higher in Albania than in the EZ, and 3 percentage points higher than the reference value. However, although Albania does not fulfil this criterion, its bond yields have been decreasing in the last 5 years.

In conclusion, Albania is still far from economic convergence in absolute terms, but all the indicators studied, except from trade balance and public finances, have shown a positive tendency and faster growth rates than the EU, leading to a relative convergence process. But these results should not lead us to conformism, as it is statistically easier to grow faster when you departure from a much lower starting point. Besides, sectorial analyses is needed to assess the sustainability of this growth, and social development research should be also carried out to verify whether economic growth has translated into higher living standards, or only in more inequality. Finally, what we have also learnt from the crisis and from the data showed in this paper, is that a certain degree of convergence is a prerequisite to joining an economic and monetary union, but the Union, if proper policies are not applied, is not a guarantee of convergence itself, as we have seen with the cases of Germany and Greece.

7   Appendix

Summary table Evolution of the main indicators in the last decade and current situation (2013-2014) for the three sections considered: economic performance, trade openness and balance, and € convergence criteria (indicators with unfavourable evolution shadowed).

| Section	Indicator	Evolution	Current situation
3. Economic performance	**Economic growth**	+	1/3 of EU GDPpc PPP
	Investment (%GDP)	+	10 pp above EU (09-13)
	Productivity	+	1/3 of EU productivity
4. Trade opensess and balance (%GDP)	**Exports**	+	7 pp below EU
	Imports	**-**	12 pp above EU
	Trade openness	+	same levels approx.
	Trade balance	**-** (till 08); + (09-13) **0** (00-13)[11]	-18% GDP
5. € convergence criteria	**Price stability**	**0** (till 10); + (12-13)	2% **X**[12]
	Public finance (deficit %GDP)	**-** (since 10)	4,5% (threshold: 3%) **X**
	Public finance (debt %GDP)	**-** (since 10)	65,2% (threshold: 60%) **X**
	Exchange rate	(mid09-mid11): **-** depreciation (mid11-end12): **0** fluctuant slight appreciation	stable (13-14) **V**
	Long-term interest rate	+	3 pp above ref. value **X**

Source: own elaboration

Table interpretation:

Evolution: +: positive performance; **-**: negative performance; **0**: neither positive nor negative.

Current situation: pp: percentage points; GDPpc PPP: Gross Domestic Product per capita in Power Purchase Parity; **V**: criterion fulfilled; **X**: criterion not fulfilled.

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[11] Although for the whole period (00-10) the values maintained, considering that that value is an important deficit we must consider the stability of that deficit as a bad performance.

[12] Although it is officially above the reference value for 2013 (1,7%), taking into account that it meets both BoA and ECB inflation targets, and that reference value is affected by economic stagnation in some EU countries, we would say that price stability have been achieved, at least, for the last two years.

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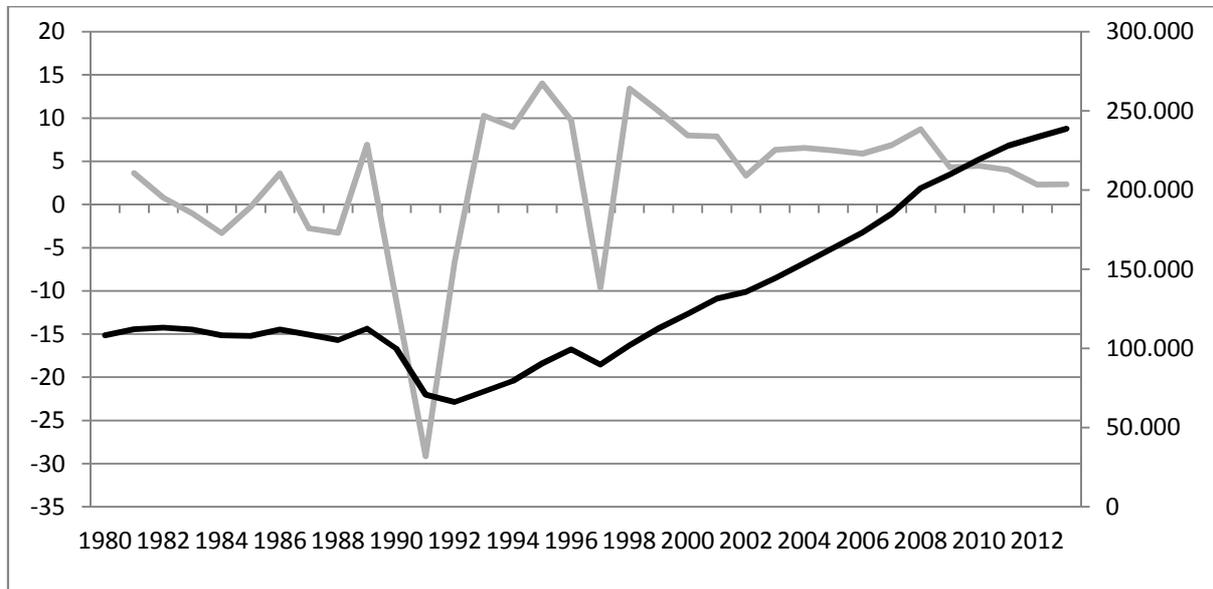
Source: own elaboration based on World Bank data.

Graph A.1 Constant GDP per capita in local currency (right axis) and annual real GDP per capita growth rate (%, left axis).
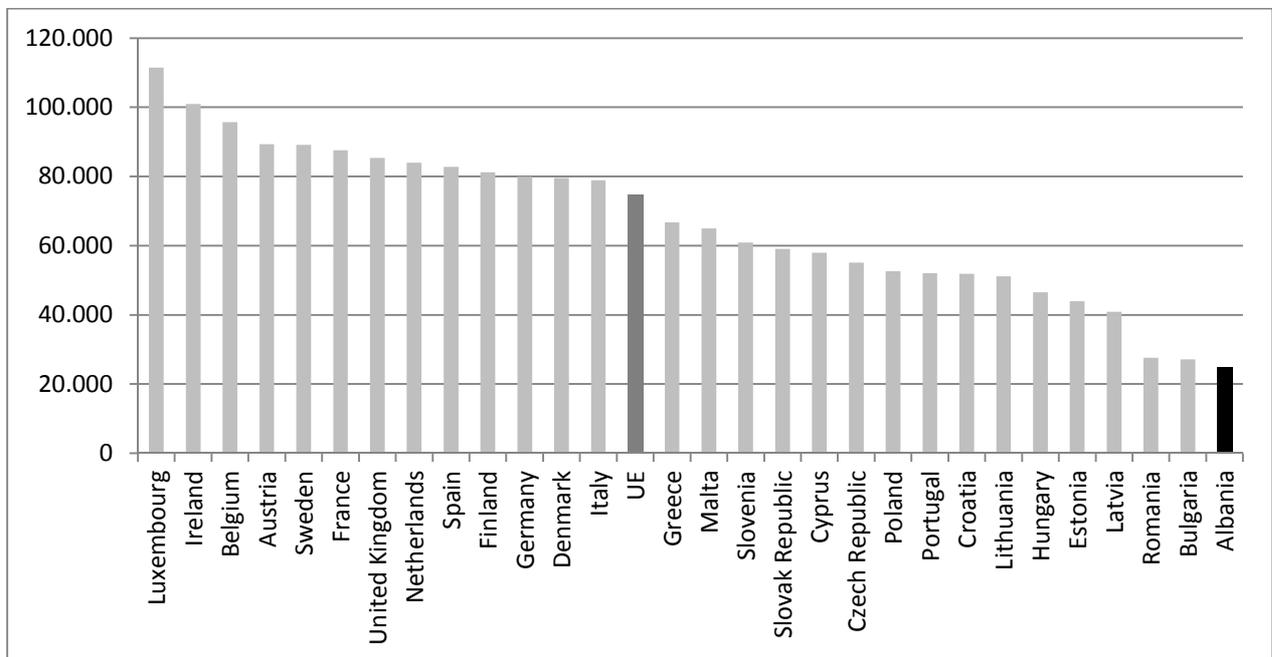
114

Source: own elaboration based on Total Economy Database Data, Groningen Growth and Development Centre.

Graph A.2 Labour productivity per person employed in 2013 US$ (converted to 2013 price level with updated 2005 EKS PPPs)
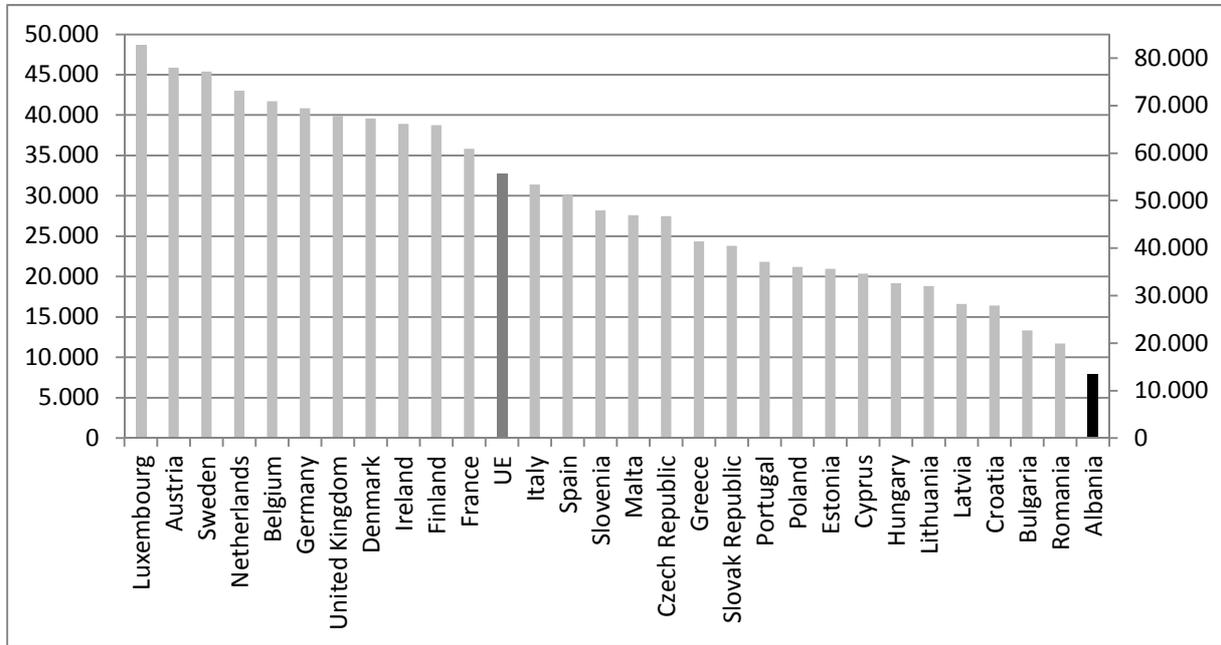
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Source: own elaboration based on Total Economy Database Data, Groningen Growth and Development Centre.

Graph A.3 GDP per capita in 2013 US$ (converted to 2013 price level with updated 2005 EKS PPPs) (Luxembourg showed in right axis due to its high per capita GDP)
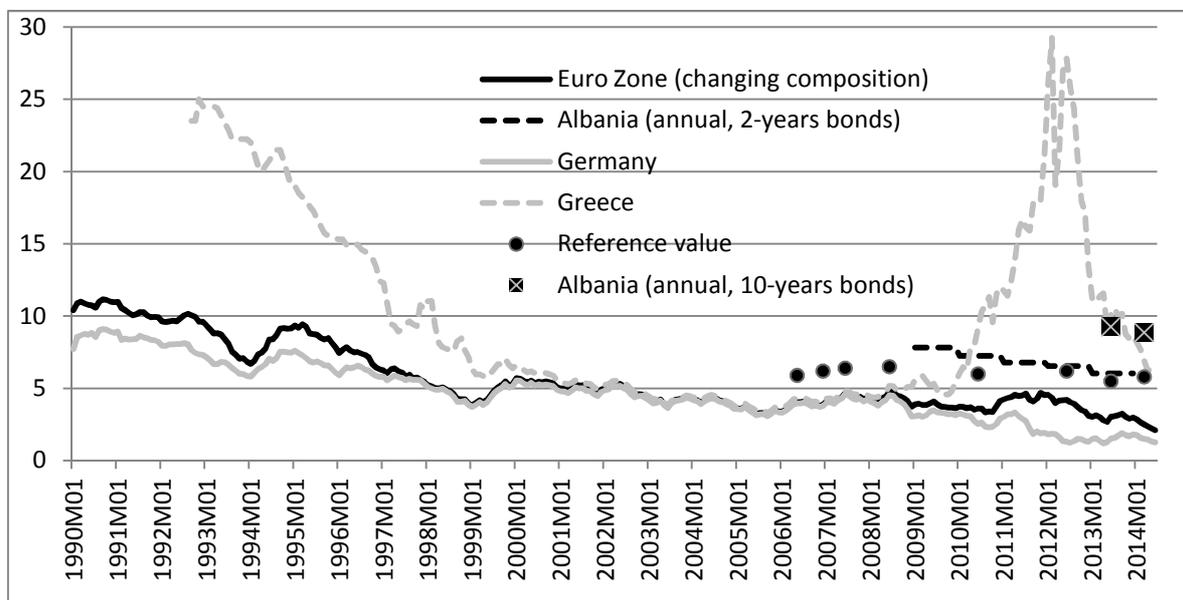
Source: own elaboration based on Eurostat, ECB and BoA data.

Graph A.4 Long-term interest rates measured as bond yield for the Euro Area (10-year bond monthly average, changing composition), Germany (10-year bond monthly average), Greece (10-year bond monthly average) and Albania (2-year bond, yearly average). Reference value established by the ECB (black points) and Albanian 10-year yearly average bond yields (grey squares)

8   Acknowledgements

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