BREXIT AND ITS POTENTIAL IMPACT ON THE ALBANIAN ECONOMY

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ABSTRACT

The historical decision that the Great Britain took on June 23rd 2016 referendum to leave the European Union has led to many uncertain and questions about the future of European Union (EU), affecting not only the member states but also those aspiring to be part of the European family, such as Albania. Even though, Brexit is a political shock, it has a significant impact also on the economy. There was a strong reaction from the financial market actors after the Brexit, which was reflected on the shock of the stock market prices and exchange rates that can be compared to the collapse of Lehman Brothers.
The objective of this paper is to explore some of the implications of the Brexit impact on the Albanian economy and integration in the EU. The methodology used for the purpose of this paper is based on the quantitative analysis of economic data such as exchange rate, export ratios, foreign direct investments and remittances. The source of data used in this paper include trustful economic information sources such as Bank of Albania (BoA), World Bank, Yahoo Finance, Bloomberg etc. We expect that the direct influence of Brexit on the Albanian economy to be moderate, due to small level of trade and investment between the two countries. Although, any reduction of the remittances from the UK, can have a significant impact, as they hold an 11% share of total remittances of the country. In our opinion, the indirect impact, which include a new Eurozone recension, Euroscepticism, market uncertainty and worries about the future of globalization, would cause a more significant impact on the Albanian economy and its European Integration objectives.

Keywords: *Brexit, European Union, exchange rates, remittances, Euroscepticism*
JEL Classification: *F15*

1. A brief introduction to the European Union and Brexit

The European Union (EU) is one of the most influential and important politic, economic, social and cultural realities in the world. Nowadays the EU is composed by 28 Member States[3], which have relinquished part of their sovereignty to the European Union institutions, with many decisions made at the European level (European Union, 2017). After World War II, European integration was seen as an antidote to the extreme nationalism, which had devastated the continent. Even though the EU origins are from economic and industrial agreement[4] between

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[3] After the Brexit and after the Article 50 of Lisbon would be applied, there are 27 Member States left, which compose the EU.
[4]The EU traces its origins from the European Coal and Steel Community (ECSC) and the European Economic Community (EEC), formed by the Inner Six countries in 1951 and 1958, respectively.

some of the most important western European countries, the European Union, in the dimension that we know it today, grew out of a desire for peace in a war-torn and divided continent. Moreover, currently the EU has fulfill this objective as it has delivered more than 60 years of peace, stability and prosperity in Europe (EU, 2016). It has since grown to become a “single market” allowing goods and people to move around basically as if the member states were one country. It has its own currency, the euro, which is used by 19 of the member countries; its own parliament and it mow sets rules in a wide range of areas, including on the environment, transport, and consumer rights etc.

There are seven institutions which work together to run the EU. These institutions are the 1) European Commission, which is responsible for proposing legislation, implementing decisions, upholding the EU treaties and managing the day-to-day business of the EU; 2) The European Parliament, which is the directly elected parliamentary institution of the EU; 3) The Council of the European union, which holds the budgetary power of the Union and controls the intergovernmental areas of the EU ; 4) The European Court of Justice, which is the highest court in the EU in matters of the EU law; 5) The European Council, which is in charge of defining the EU’s overall political direction and priorities; 6) The European Central Bank, which is the central bank for the euro and administers monetary policy of the Eurozone, which consist of 19 EU member states and is one of the largest currency areas in the world; 7) The Court of Auditors, which is a professional external investigatory audit agency. Its primary role is to externally check if the budget of the EU has been implemented correctly (European Union , 2017)

One of the most important projects of the EU is the European enlargement, which means other European countries not part of the EU became part of the EU Member States. In order to do so, the enlargement countries has to fulfill a set of objectives and complete a set of reforms, where the key challenges are the overcoming of the economic crisis, social welfare, strengthening of the rule of law and public administration, freedom of expression and media and reconciliation, regional cooperation and bilateral issues in the Western Balkans (European Commission, 2015). However, while almost all eastern European countries aspire to be part of the European Union, one of the most important countries of the EU, the Great Britain, has decided to leave the EU after almost 60 years of membership. After decades of increased European integration with Europe’s elites planning a future of “ever deeper union”, one of the largest member states has decided to exit from the European Union altogether. The exact impact that this development will have on the future shape of the EU is highly uncertain but the effects are likely to be profound.

In the past, the UK has chosen to opt out of some key EU decisions, like the single currency or euro and the Schengen Treaty, but when the possibility of holding a referendum to decide whether to continue to remain in the EU became a reality, it was a real shock. The United Kingdom’s prospective withdrawal from the European Union is widely known as Brexit, an abbreviation of “Britain” and “exit”. In late February 2016, the then GB prime minister, David Cameron, announced that the GB was going to hold a referendum to decide on the continuance of the GB’s membership on the EU. Just a few months later, in a historic referendum on June 23rd, the people of Britain voted for a British exit, or Brexit from the EU. The leave vote won by 51,9 % to 48,1%. The referendum turnout was 71,8 %, with more than 30 million people voting (Hunt & Wheeler, 2016). Leave voters base their support for Brexit on a variety of factors, from the global competitiveness of British businesses to the European debt crisis to concerns about immigration. Leavers tend to stress issues of national pride, safety and sovereignty, but they also have economic arguments, such as the fact that according to them the UK could save 350 million pound per week (Goodwin & Heath, 2016). Although the relationship of the UK and the EU was

a source of debate ever since it joined the EEC in 1973 the outcome was a surprise for most observers. It is worth noting that Brexit is very different from the Grexit, the potential exit of Greece from the euro currency zone made up of 19 of the 28 member countries of the EU. The GB is not part of the euro zone and so Brexit does not directly threaten the euro currency. However, the GB is the second largest economy in the EU so its potential exit could have important ramifications for the entire union.
For the UK to leave the EU it has to invoke an agreement called Article 50 of the Lisbon Treaty, which gives the two sides two years to agree the terms of the split. Article 50 is a plan for any country that wishes to exit the EU. It was created as part of the Treaty of Lisbon- an agreement signed up to by all EU states, which became law in 2009. Before that treaty, there was no formal mechanism for a country to leave the EU (European Parliament, 2016).
After 40 weeks of topsy-turvy politics since the referendum vote last June, the GB Prime Minister Theresa May will pull the trigger by invoking Article 50 of the Lisbon Treaty on March 29. Once the European Union is formally notified that the U.K. intends to leave the bloc, a two-year countdown will begin. During those two years, British government and EU officials will lock horns over the terms of divorce (Bloomberg, 2017). Questions have swirled around the process, in part because Britain's constitution is unwritten and in part, because no country has left the EU using Article 50 before.

2. Market reaction after Brexit

European stock markets are highly integrated. Investors can shift between markets easily and many companies have strong cross-border ties, both result in a steady co-movement of stock prices within Europe (Raddant, 2016). European equity markets have developed significantly since the advent of electronic trading over two decades ago, in terms of both the variety of execution venues and manner in which equities can trade (BlackRock, 2011). Stock markets are showing signs of convergence. Stock market returns of EU economies are showing signs of convergence. Correlations of stock market returns for EU countries compared to returns of the benchmark country have increased over time, showing that stock markets are becoming increasingly connected to each other (PwC, 2015). In equity markets, the introduction of the Euro eliminated exchange risk and thereby stimulated cross-border equity investments. Internationalization of equity issuance, more cross-border mergers and acquisitions and the consolidation of stock exchange have enforced cross-border activities. In addition, it is also evident that investor behavior has changed from country- based toward cross-border investments. The European Commission regularly monitors developments in the financial sector in the EU, and has been publishing annual reviews of its monitoring of financial market integration in Europe.As a response to the recent financial crisis, the EC created the annual European Financial Stability and Integration Report (EFSIR) in 2010, which has an additional focus on the stability of financial markets. Although national differences between stock markets remain with respect to market capitalization and the number of initial public offerings (IPO) these are probably more an indication of increased regional specialization and concentration of equity markets (exchange) in an integrated European market. However, due to the liberalization of capital markets and globalization, the market for wholesale financing has developed substantially and has become more integrated and competitive. It seems that larger companies in particular have access to international financing markets, whereas only very small firms still depend on their local financial system (Financiere de l'Echiquier, 2014).

Even though the co-movement between the UK and the rest of the EU has been a little weaker than between other member states, the June 23 referendum's result severely affected markets worldwide, though in some cases the effects were short- lived. The European stock market indices were in a slight upward movement in the first half of 2016 until the beginning of June (Financial Times, 2016). After the Brexit vote, stock prices dropped by around 10 percent and have since then only slowly returned to mid-June levels (Raddant, 2016). Exchange rates also have a huge shock after the Brexit referendum result; as an example, the pound dropped to its lowest level in 30 years against the world's biggest currency the US dollar as it became clear the UK had voted to leave Europe. The pound was at the sharp end of market's reaction, with the currency at one point tumbling 11.1% to $1.3229, its weakest level since the mid-1980-s (The Guardian, 2016). Its decline comfortably eclipsed that of Black Wednesday in 1992, when the UK left the Exchange Rate Mechanism. By the close of trading in New York, sterling had bounced from its low to trade down 8% at just under the $1.37 mark. Even though, the impact of the first days after the referendum result was a total shock for the exchange rates, experts argue that the most influential currency from the Brexit leave vote is the GBP. On the day after the referendum the pound depreciated significantly, as it has lose its value by 8% against the euro and 10% against the dollar, while the euro depreciated against the dollar by 3,5%. After the initial shock, the pound was further weakened by a series of unexpected political developments and poor data releases (Expatica, 2016).

Below we will see a summarized analysis of stock index trends for a period of about 10 month after the Brexit referendum. The objective of this analysis is to provide a framework of the trends of some of the most important stock index through using historical data from June 23 2016 until March 2017 on a weekly base, in order to see the impact of Brexit leave vote to these stock indexes. We will the compare the 10 months trends of these indexes with their first post referendum days reaction, in order to see if the impact was just a momentary shock or a long-term impact. The index, which will be subject of this analysis, are 1) DAX, which is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange; CAC 40 is a benchmark French stock market index, which represents a capitalization weighted measure of the 40 most significant values on the Euronext Paris; FTSE 100 which is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. We have taken in consideration these indexes because they represents the most important stocks of the largest economies in the EU, UK, France and Germany. In the table below (Table 1) we have shown some characteristics of the above mention indexes.

Table 1: Stock indexes summarized information

INDEX	COUNTRY	CURRENCY	AVERAGE PRICE	AVERAGE RETURN (*) (%)	STANDARD DEVIATION
DAX	**Germany**	**EUR**	**10.957,45**	**0,57%**	**1,97%**
CAC 40	**France**	**EUR**	**4.625,88**	**0,45%**	**1,83%**
FTSE 100	**Great Britain**	**GBP**	**6.982,38**	**0,3%**	**1,4%**

Source: Historical price dates are taken by Yahoo Finance. All calculations are made by the authors

A) DAX trends after the Brexit Referendum

As mention above, we have taken evidence of DAX historical data prices on a weekly basis using a trustful source such as Yahoo Finance. We have then calculate the average return and standard deviation and the result is that DAX index during the period 23 June 2016- 23 March 2017 has have an average return of 0,57% with a standard deviation of 1,97%. The first day after the Referendum result DAX had an decrease of about 700 points and about 6,82%, counting to the lowest price of €9,557.00 (Martin, 2016). As we see, from our calculations the average price of the index for the period taken in consideration has been 10.955,45, about 15% greater than the price during the first days after the Brexit shock. As we can see even from the chart below, the shock of DAX from the Brexit may be consider as a short- lived impact.

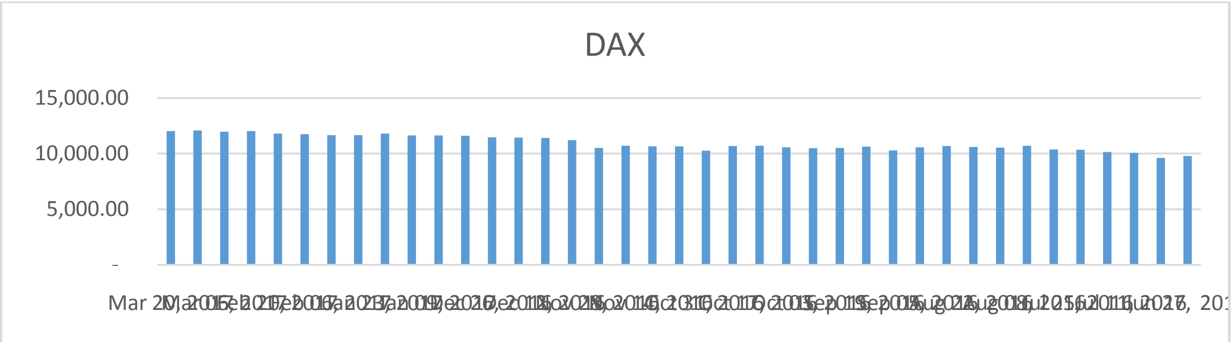

Fig. 1: DAX index historical price trends (June 2016- March 2017)
Source: Yahoo Finance. All calculations are made by the authors

B) CAC 40 trends after the Brexit Referendum

CAC 40 had a decrease of 350 points and about 7,84% after the referendum results, counting to a price of €4.115, 80. During the period taken in consideration, CAC has have an average return of 0,45% with a standard deviation of 1,83%. The average price of the period has been around 12% higher that the post referendum price (Martin, 2016). In our opinion, the index has been recovered by the shock of the first days after the Referendum result and the impact may be consider as a short- lived impact

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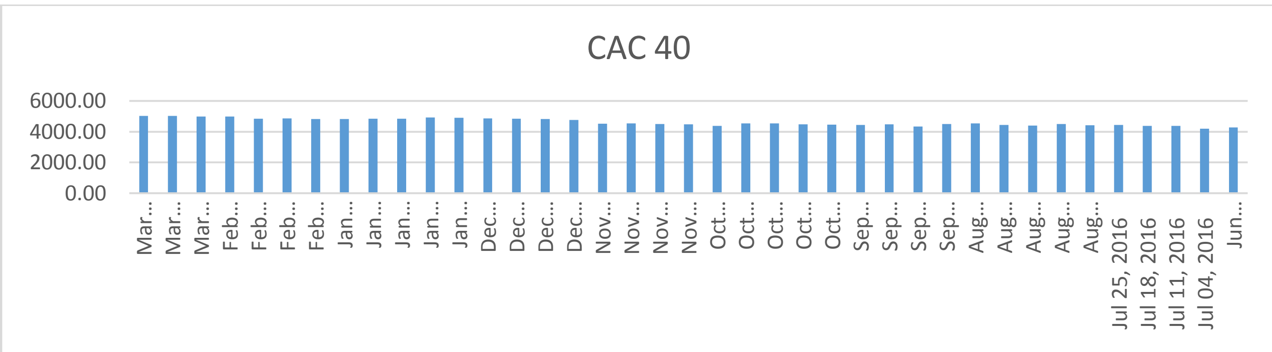

Fig. 2: CAC 40 index historical prices trends (June 2016- March 2017)
Source: Yahoo Finance. All calculations are made by the authors

C) FTSE 100 trends after the Brexit Referendum

The first days after the Referendum the FTSE 100 opened down by about 9% but recovered to the close to end trading down just over 3%, thanks largely to the high number of companies in the index which denominate their assets in dollars(Martin, 2016). The FTSE had a decrease of 204 points and about 3,22%, with a price of 6.134,00 GBP. According to our calculations, the average return for this period of the FTSE 100 has been of 0,3% (the lowest among the three indexes) with a standard deviation of 1,4%. The average price of the period is about 14% higher than the price during the first days after the Referendum. As we can see from the chart below, there have been ups and downs for the prices of this index, but we could not say that the strong impact of the first days has continued during all these period.

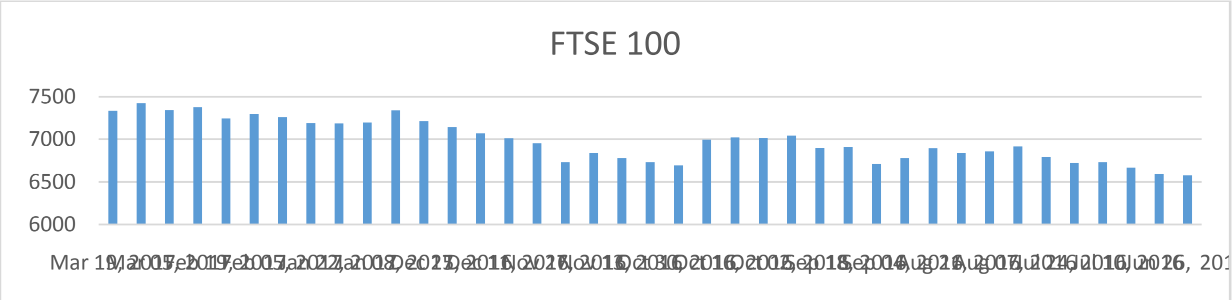

Fig. 3: FTSE 100 index historical prices trends (June 2016- March 2017)
Source: Yahoo Finance. All calculations are made by the authors

As a conclusion, we can mention that the Brexit vote had similar effects in Germany, France and the Great Britain. The stock prices declined sharply and returned close to their previous levels within about 3 week. But for the experts this recovery is only partial, furthermore in the case of the UK. For them, uncertainty about necessary changes in the future EU financial infrastructure remains, together with very pragmatic questions about the market access of the UK-based financial institutions to the EU. According to experts, the fact that the UK Prime Minister Theresa May has announced that the UK will pull the trigger by invoking Article 50 of Lisbon Treaty on March 29, 2017 led to a range of uncertainties about what the two year "divorce" process impact will be on the European financial markets. The uncertainness are even bigger taking in consideration that no other country has leave the EU according to the Article 50 before.

3. Albania's EU aspirations

Now day, Albania is a democratic and developing country in the Southeastern Europe, with upper-middle income economy. Albania became a Communist country after the World War II and remain so for 45 years long. As part of the eastern and central Europe movement, which led to the fall of the Communist regime in most of the Eastern European countries, even in Albania started the anti-communism movement. The popular protest, which began in 1989 led to the fall of the Communist regime in Albania between 1991 and 1992. After that, for Albania started the long period of political, economic and social transition. After the fall of communism the main objective of the Albanian people has been to become part of Europe, not only geographically, but also part of the European community and identity. The European integration has been one of the most important priorities in the political agenda of all the governments after the '90. Furthermore, the Integration case of Albania into EU is one of the most debated cases into the political and public life of Albania. Albania's path toward EU membership has been similar to other Western Ballkan nations. Although there are some key points, which have marked Albania's journey toward the EU association, which are listed below (European Commission, 2017):

1) In 1992 Albania and the EU signed a Trade and Co-operation Agreement and Albania became eligible for funding under the EU Phare programme.
2) In 1999 the EU proposed the new Stabilization and Association Process (SAP) for five countries of Southeastern Europe, including Albania.
3) Albania was identified as a potential candidate for EU membership during the Thessaloniki European Council summit in June 2003.
4) On 9 November 2006 the European Commission decided to start visa facilitation negotiations with Albania, and on 13 April 2007 the visa facilitation agreement was signed in Zagreb.
5) In 2009, Albania submitted its formal application for EU membership. In its Opinion on Albania's application (in 2010), the Commission assessed that before accession negotiations could be formally opened. Even though, Albania still had to achieve a necessary degree of compliance with the membership criteria and in particular to meet the 12 key priorities identified in the Opinion.
6) On 15 December 2010 visa-free access to the Schengen area entered into force
7) In October 2012, Commission recommended that Albania be granted EU candidate status, subject to completion of key measures in the areas of judicial and public administration reform and revision of the parliamentary rules of procedures.
8) In June 2014, Albania was awarded candidate status by the EU.

In order to become a member state of the EU, Albania has to fulfill all the criteria set by the EU for the candidate states. Those criteria cover a range of political and economic reforms, in order to meet the European standards regarding justice, freedom and security. The process of joining the European Union is a national objective, in view of the democratization and transformation of the Albanian society. Albania has done a lot of work in fulfilling these requirements, but a lot of work has to be done yet in matter of economic, political and social development.

4. Brexit potential impact on the Albanian Economy and integration to the EU

The United Kingdom was a great supporter of the European Union enlargement project in the South and Eastern Europe. In such case, the decision of the GB to leave the union may affect the process of enlargement and has economic effect in the countries, which are not part of the EU, but are in the process of negotiations to become a member state. Political changes have in most cases economic impact, which are transmitted in a chain reaction. Even though Albania is not part of the European Union, the economic impact of the Brexit may be transmitted even in our country, exactly for the fact that economic impacts are easily transmitted from one country to another. Our objective is to assess the impact of Brexit on the Albanian economy. We will take in consideration some economic indicators such as trade exchange, foreign direct investments, remittances, deposit and loan levels, exchange rates.

A) Trade exchange between UK and Albania

Trade relationship indicates the amount of exchange (buying and selling) of goods and services between two countries. Trade relationship is a very important indicator of the connection and dependence of two countries with each other. As for these reason, we have analyzed the level of trade relationship between Albania and UK for the last 25 years, in terms of exports and imports between the two countries. As we can see from the table below and also illustrated in the Chart 4, exports with GB hold an average of 0,22% of exports with European countries and 0,21% of total exports. As for imports, they hold an average of 1,53% of imports with European countries and 1,37% of total imports. As we can see, the trade exchange between Albania and UK is low even compering to other European countries and even compering to total trade exchange of Albania. This means, that possible changes and scenarios after the official Brexit of the UK may have no/or very low impact on the trade balance of our country.

Table 2: Export/Import between Albania and United Kingdom

	EXPORTS WITH UK/ EUROPE	EXPORTS WITH UK/TOTAL	IMPORTS WITH UK/ EUROPE	IMPORTS WITH UK/TOTAL
AVERAGE % RATE	0,22	0,21	1,53	1,37

Source: Instat Albania. All calculations are made by the authors

Fig. 4: Trade Exchange between Albania and GB (1993- 2016)
Source: Instat. All calculations are made by the authors

B) Direct foreign Investments

Foreign direct investment (FDI) is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. FDI are also an important indicator of the relationships between two countries. If the level of the FDI from one country is high than it is of great importance the continuity of the bilateral relationships between the two countries, because any changes may have direct economic effects. In order to analyse if this is the case of Albania and UK we have taken in analyze the stock of FDI from GB origin to our country for three years 2012- 2014 (last update from BoA).

Table 3: FDI from UK

	2012	2013	2014	AVERAGE
FDI- UK/EU (%)	0,13	3,68	1,11	1,64
FDI- UK/TOTAL (%)	0,08	1,36	0,45	0,63

Source: Bank of Albania. All calculations are made by the authors

As we can see from the table above, the FDI from UK hold an average of 1,64% of the FDI from the EU in Albania and 0,63% of total FDI-s in our country. The stock of UK FDI in our country is very low comparing to other partners countries, (such as Italy, Turkey etc.) In these conditions, any changes regarding FDI- s after the Brexit may have no or low impact on the Albanian economy.

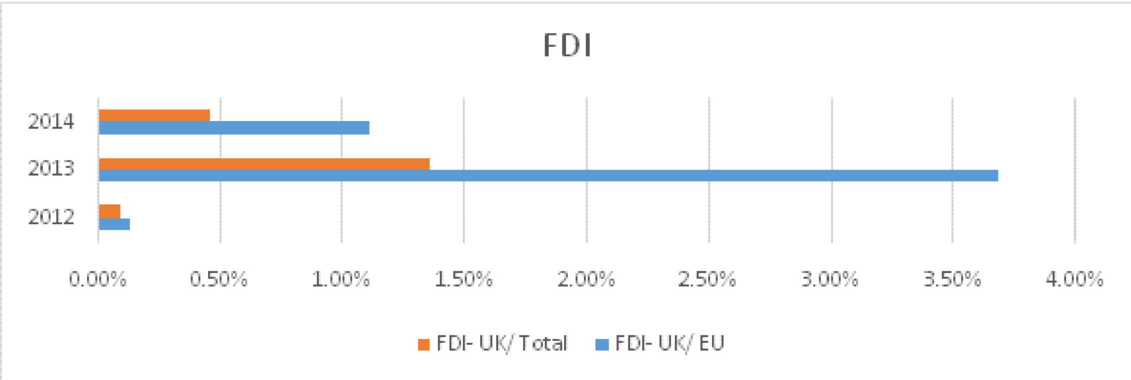

Fig. 5: FDI from GB
Source: Bank of Albania. All calculations are made by the authors

C) Remittances

Remittances refer to a transfer of money from a migrant worker to their families or other individuals in their home countries. In many countries, remittances constitutes a significant portion of the GDP. Furthermore, for devotement countries such as Albania FDI and remittances are very important financial sources for their economy. As for the specific nature of people movement terms between Albania and UK, the number of Albanians emigrants in the UK is low comparing to other European countries (Italy, Greece etc). According to BoA, remittances from Albanian migrants in UK to their hometown, hold 11% of total remittances, with an impact of 0,6% of the nominal GDP (Bank of Albania , 2016). This fact indicates that a decrease of the Albanian remittances from UK; as illegal immigrants may leave the UK or more strict immigrations rules may be apply in UK after the Brexit; the consume and the economic growth in our country may be affected. Nevertheless, the total stop of remittances from the UK is the worst scenario and it is not probable to happen.

D) Exchange Rates

The exchange rate indicates the price of a nation’s currency in terms of another currency. Now, we will see the trends of the exchange rates between the Albanian Lek (ALL) and Great Britani Pound (GBP) during the referendum year, January to December 2016. From the table below we see that the average monthly exchange rate for the 2016 between the two currencies has been

168,1684, far above the normal exchange rate between these two currencies. The chart below, which indicates the trend of the exchange rate during the year, shows that during 2016 has been a decrease in the exchange rate between ALL and GBP, emphasized in the months following the referendum June- October 2016, influenced by the international exchange rates trends of the time. The pound depreciation has made cheaper loans in pounds, but has also have negative impact to deposits in pound. However, according to the BoA the loan in pound has not an important share of the loan portofolio in our country, holding 0,002% of the total loans (Bank of Albania , 2016). The same situation for the deposits in pound, which represent 1,17% of total deposits (Bank of Albania , 2016). The pound depreciation makes our imports cheaper and our export more expensive, even though the trade exchange between our two countries has not an important impact on the total trade exchange of Albania.

Table 4: Exchange rate between ALL and GBP 2016

	AVERAGE RATE	MAX	MIN
EXCHANGE RATE ALL-GBP	168,1684	183,1363 (January)	153,1385 (October)

Source: Bank of Albania. All calculations are made by the authors

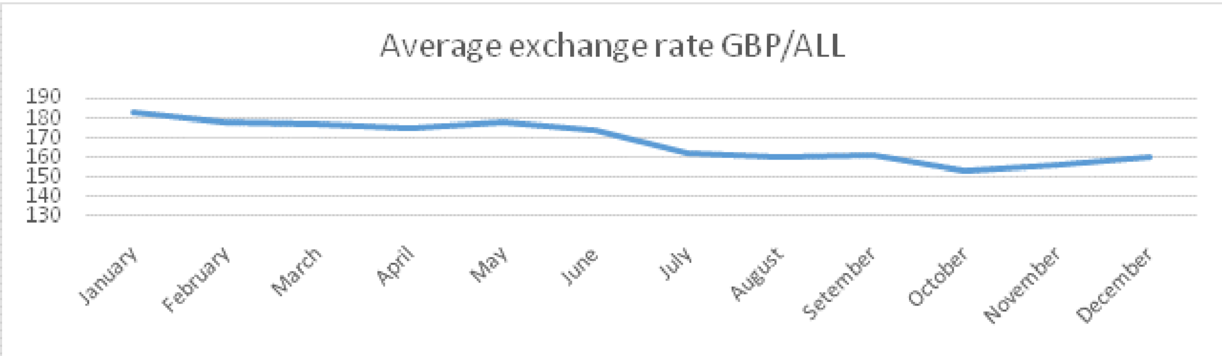

Fig. 6: Exchange rates between ALL and GBP for the year 2016
Source: Bank of Albania. All calculations are made by the authors

5. Conclusions

As a conclusion, in our opinion the impact of a negative scenario of the Brexit decision on the Albanian economy would tend to be low to moderate impact. We argue this opinion, taking in consideration the result of our analyze of some key factors for the economic stability and growth such as trade exchange, FDI, remittances, exchange rates, loans and deposits. In our opinion the fact that our country is not part of the European Union, has low trade exchange with GB, has a moderate number of immigrants comparing to other countries, and has a low stock of FDI from GB are the reasons why the possible impact of Brexit in the Albanian economy would tend to be low to moderate. Taking the consideration the fact that the GB has always have a different position from the rest of EU for some important issues for Albania, such as the free movement, the Brexit would not have any direct impact in the free movement of Albanian citizens.

In our opinion, most importance must be paid to non-economic indirect impact that Brexit may have in our country. The consequence of the Brexit is both structural- the ability of the EU to act

and integrate new members and normative- the ability of the EU to promote a particular type of democratic, consensus- oriented system of government. This directly affect the aspirations of Albania to become a member state. On the one hand the EU would spend time and effort for the Brexit negotiations, leading to less time to dedicate to the enlargement process and on the other hand the risk of increasing Euroscepticism, antiglobalization, anti-immigration, nationalism trends; directly affect the process of negotations between our country and other aspiring countries and the EU. And of course that these non-economic impact, if happens to be true would have also a future economic impact in our country.
The uncertainty that Brexit produces makes prediction difficult. What we hope is that the European Union continue to be the democratic and peace keeper reality which is today and that soon our country Albania become part of this reality with full rights.

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