
The Trade Flows between Algeria and Europe: A Historical Overview and An Empirical Evidence

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Abstract

The idea of establishing a free trade agreement between Algeria and the EU is mainly driven by the development of a European strategy. The new generation of free trade agreements is different from the partnership and cooperation agreements of the sixties and seventies, respectively. The former agreements had mainly focused on the trade relations between the EU and the Mediterranean countries; whereas, the new agreements are broader than simple preferential trade agreements, and are extended to the financial, technical and economic cooperation. That is, the FTA and the DCFTA pave the way for real platforms on economic, social, political and cultural cooperation. For Algeria, the negotiation efforts have finally resulted in the signing of the free trade agreement after 21 rounds and over four years of negotiations.

1. The Algerian-European cooperation before cooperation agreement

During the sixties, Algeria did not sign any partnership agreement with Europe due to the preferential treatment of its exports since March 28th, 1963. In fact, the privileged status was granted to Algeria since the late fifties (1957) when the country was under the French occupation (Houaidi, 2013, p. 50). Before 1976, 95% of the Algerian exports went to Europe and 80% of the Algerian imports came from Europe (Houaidi, 2013, p. 67).

In the late of the sixties, some European countries and especially Italy refused to grant the same preferential treatment to Algeria. As a consequence, Algeria launched its negotiations with Europe in 1972 and after four years of negotiations, Algeria signed its first partnership agreement with Europe in April 26th, 1976. This partnership agreement entered into force on November, 1978. However, Morocco and Tunisia signed their partnership agreements in 1969 (Bahlouli, 2012, p. 114).

2. The cooperation agreement

Algeria has signed its first cooperation agreement with the EU on July 1st, 1976 and for a period of twenty years, during which the trade relations, as well as the financial support plans had been reviewed and revised every five years. The trade relations were regulated by protocols; while the financial support schemes were supported by the European Investment Bank (EIB).

Europe worked on the deepening of its trade relations with the southern-Mediterranean bank through the enactment of the regulation 1764-95 of June 26th, 1992. In this regard, the imports of the agricultural products had been facilitated and also the article one of the regulation enunciated the acceleration of the tariffs' reductions to less than 2% for the South-Med partners (Bahlouli, 2012, p. 114).

Before the expiry of the cooperation agreements, the EU has proposed to the Maghreb countries to initiate negotiations in 1993, and thus the negotiations went quickly in the early of 1994 with the establishment of six workshops that were presumed to treat the different

aspects of the new agreement between Algeria and the EU. In 1997, Algeria has frozen negotiations with the European part in order to identify the main impediments. That is, the following inconsistencies were identified by the Algerian authorities :

- The liberalization should be progressive and accommodated to the specificity of the Algerian economy;
- The cooperation areas should be extended beyond the commercial sphere;
- The categorical refusal of Algeria to lift totally the protection on the industrial sector;
- The rejection of the idea about the continuous abolition of the customs duties;
- The Algerian proposal for a periodic reviewing of the tariffs over three or five-year schedules.

However, funding mechanisms had been set up for the purpose of financing the economic and social projects in the southern-Mediterranean bank. These funding mechanisms were working through financial protocols, and there were four financial protocols during the period from 1976 to 1996. Accordingly, the financial value of these four protocols is shown in the table (1). After 1996, these protocols had been replaced by the MEDA program (Bahlouli, 2012, p. 114).

<i>Protocol</i>	<i>Sources</i>	<i>Committee (Allocation + EBI)</i>	<i>Allocation</i>	<i>EBI</i>	<i>Special Resources</i>	<i>Total</i>
Protocol 1 (1976-1981)	Grants Special loans EBI's loans	44.000.000	25.000.000	19.000.000	70.000.000	114.000.000
Protocol 2 (1981-1986)	Grants Special loans EBI's loans	44.000.000	28.000.000	16.000.000	107.000.000	151.000.000
Protocol 3 (1986-1991)	Grants Special loans EBI's loans	56.000.000	52.000.000	4.000.000	183.000.000	239.000.000
Protocol 4 (1991-1996)	Grants Special loans EBI's loans	70.000.000	52.000.000	18.000.000	280.000.000	350.000.000

Note : the monetary values are expressed in euro. Source : (Houaidi, 2013).

Overall, Algeria received € 949 million during the 1976-1996 time period. € 640 million were provided by the EIB in the form of remunerated loans, while € 949 million represented the European grants. The latter resources had originated from the four financial protocols (€ 214 million) and the structural adjustment funds (€ 95 million) (Houaidi, 2013, p. 69).

3. The conference of Barcelona and the Algerian-European cooperation

The starting point of the Barcelona process for Euro- Mediterranean cooperation was launched on November 27-28th, 1995. The cooperation framework was extended to include the fifteen members of the EU and their twelve partners on the southern-Mediterranean bank. This conference has clearly defined the three corners of the Euro- Mediterranean cooperation as follows :

1. The political security cooperation
2. The cultural and human cooperation
3. The economic and financial cooperation

The economic cooperation was achieved through the MEDA program, which was enacted by the decision 1488-96 of July 23rd, 1996. This program consisted in providing the financial assistance and the technical support to the South-Med partners in the furtherance of helping in counterbalancing the harmful effects stemming from the partial liberalizations of their trade sectors. At the same time, the EU was trying to pave the way for the implementations of free trade agreements with the South-Med partners (Bahlouli, 2012, p. 114).

4. The MEDA program

The support program for the Euro-Mediterranean Partnership (MEDA) has offered more than € 3.435 billion during the period 1995 to 1999, and € 3.350 billion for the second period from 2000 to 2006 (Kheladi, 2007, p. 5).

For Algeria, the EU has granted only € 30 million euros and € 114.6 million euros under the frameworks of MEDA1 and MEDA2, respectively. That is, the two financial packages represent no more than 18 % and 42% of the European commitments for the two time periods (Houaidi, 2013, p. 58). In fact, this program tried to assist the partner countries in the transitional phase by providing them with the financial support in order to overcome the adverse effects stemming from the customs tariffs' reductions. However, the limited absorption capacity of each country and the long administrative process through which the funds were allocated, had impeded the full implementation of the MEDA program (Houaidi, 2013, p. 57).

5. Some insights about the free trade agreement

The negotiations were launched in 2001 and the final agreement was reached in December 5th, 2001. In December 19th, Algeria and the EU signed the partnership agreement in Brussels and the official signing was in Valence (Spain) in April 22th, 2002. The free trade agreement entered into force in September 1th, 2005.

The Partnership Agreement contains 110 articles, over nine sections, in addition to six extensions and protocols. The nine sections focus on the following areas :

1. The political dialogue
2. The free movement of goods
3. The trade in services
4. The movement of capital
5. The Competition
6. The social and cultural cooperation
7. The financial cooperation
8. The cooperation in the field of justice and security affairs
9. Institutional and public provisions (arrangements).

The Algerian authorities are expecting the invasion of the national economy by the European products after the total elimination of the customs and duties in the horizon of 2017. In fact, this scenario is the most evident and many Algerian economists are convinced that the consequences may be disastrous for the economy if no measures are taken to overcome the competitiveness's weakness, the non-access to the European markets and the poor diversification of the Algerian exports.

We can state that the free trade agreement will undermine the national industry, the employment and also the Algerian trade balance over the next decade (see the Gravity model's outcomes). For this reason, Algeria is renegotiating with the EU in order to postpone the zero tariffs' deadline till 2020. Under the free trade agreement, Algeria is also obliged to

withdraw its temporary and additional duty which is charged on more than 340 products (Kheladi, 2007, p. 2). Accordingly, this import's duty was eliminated in January, 2006.

The original text of the agreement provides three stages through which the dismantling and thus the abolition of the customs will be proceeded. The dismantling process will be realized within the following three frameworks (Kheladi, 2007, p. 3):

- The first stage deals with the raw materials, the materials for the semi-manufactured products in the chemical industry, the metallurgy, the construction and the ceramic materials, and the textile. In this regard, the tariffs' dismantling will deal with 2076 products which are subject to tariffs between 5% to 15%. In fact, the zero tariff is being effective immediately after the official entry into force of the agreement in 2005.
- The second stage will concern the agricultural equipment, the industrial equipment, the pharmaceutical products, the mechanical products as well as the pneumatic ones, the electrical and electronic equipment, the automobile and railways' equipment, the measurement and control equipment, and the products which are related to the energy's group of products. During this stage, a list of 1100 products is encompassed under the gradual dismantling that will occur over the five years following the third year after the official entry into force of the agreement.
- The last stage will achieve the full dismantling process over the ten years that follow the third year of the official entry into force of the agreement. That is, a set of 1964 (final) products will be subject to the application of the zero tariff's rule.

The above timetable can be revised if Algeria faces serious threats on a given product and even when there is an infant industry which has to be protected for a certain period of time. In addition, the dismantling may be postponed in the case of industry's restructuring (Kheladi, 2007, p. 3).

The table (2) illustrates the provisional timetable for the liberalization of the industrial products :

<i>Products</i>	<i>Reference</i>	<i>Number of Tariff Lines</i>	<i>Entry Date</i>	<i>Rate of Reduction</i>
<i>Products referred to in Article 9, paragraph 1.</i>	Annex 2	2076	01/ September/2005	100%
			01/ September/2007	20%
			01/ September/2008	30%
			01/ September/2009	40%
<i>Products referred to in Article 9, paragraph 2.</i>	Annex 3	1089	01/ September/2010	60%
			01/ September/2011	80%
			01/ September/2012	100%
			01/ September/2007	10%
			01/ September/2008	20%
			01/ September/2009	30%
<i>Products referred to in Article 9, paragraph 3.</i>	Other Products (not listed in annexes 2 & 3)	1964	01/ September/2010	40%
			01/ September/2011	50%
			01/ September/2012	60%
			01/ September/2013	70%
			01/ September/2014	80%
			01/ September/2015	90%
			01/ September/2016	95%
			01/ September/2017	100%

Source : Kheladi (2007).

The agricultural products benefited from precautions and temporary advantages under the free trade agreement. In fact, the agricultural products as well as the transformed agricultural products, and the fishery products have benefited from transitional concessions over the five years that follow the official entry into force of the agreement. Once the five-year period has been surpassed, the partners will renegotiate furthest liberalization's step (Kheladi, 2007, p. 4). For the moment, the Algerian agricultural products are subject to the four types of concessions :

- A free access to the agricultural products, with no duties or customs;
- A partial reduction of duties and customs;
- A free access with tariffs' quotas or quantities' quotas;
- An exemption from customs along with a specific duty which is imposed on the transformed agricultural products.

The table (3) presents the provisional timetable for the liberalization of the agricultural products :

<i>Products</i>	<i>Reference</i>	<i>Number of Tariff Lines</i>	<i>Entry Date</i>	<i>Rate of Reduction</i>
<i>Products referred to in Article 14, paragraph 2. (agricultural products)</i>	Protocol 2	75	01/ September/2005	20%-50% or 100%, according to the nature of the product.
<i>Products referred to in Article 14, paragraph 4. (fishery products)</i>	Protocol 4	112	01/ September/2005	25% or 100%, according to the nature of the product.
<i>Products referred to in Article 14, paragraph 5. (transformed agricultural products)</i>	Protocol 5. List 1. Immediate Concessions	168	01/ September/2005	20%-25%-30% or 100%, according to the nature of the product.
<i>Products referred to in Article 15.</i>	Protocol 5. List 2. Deferred Concessions	112	01/ September/2010	NA

Source : Kheladi (2007).

The seasonal agricultural products are only exempted from the ad valorem customs; while the specific duties and the entries' schedules are maintained and even reinforced. Moreover, Algeria has abolished the temporary and additional duty on a set of 108 agricultural products.

6. The statement of the problem

Kheladi (2007, p. 1) argued that Algeria is "un cas d'école" that deserves to be studied, especially, because after 25 years of socialism, central planning and no openness; the country recollected structural weaknesses and disoriented policymaking. Indeed, the transition into a market economy in the late of the eighties has been done blindly and without conviction on the one hand, and even the transition is actually made at the cost of higher unemployment, inflation and deindustrialization on the other hand. Furthermore, the harsh liberalization of the public industrial sector was accompanied by a total disinvestment of the state during more than ten years (1889-2001).

By the mid-90s, Algeria was in a quasi-bankruptcy and was resigned to undertake some structural reforms to address the disastrous economic situation. Among the structural reforms, Algeria tried to open up its economy to the private investment through the privatization of the national companies, the engagement of the negotiations to join the WTO and the signing of the trade agreement with the EU. However, only the latter action was accomplished in 2005; while the other actions are still inconsistent and even more disorganized.

In this study, we will try the determinants of the bilateral trade flows between Algeria and the EU over the period from 1991 to 2011. This time period is particularly sound due to the fact that 1990 represents the year in which Algeria engaged a partial liberalization of its trade sector and also many monetary reforms. Accordingly, the assessment of the determinants of the bilateral trade flows between Algeria and the EU will be achieved through the use of the Gravity model within the framework of the panel data estimation techniques.

7. The Gravity model

The gravity model takes the following form (Khar, 2014, p. 18) :

$$Trade_{ij} = G \frac{(GDP_i GDP_j)^{\gamma_1}}{D_{ij}^{\gamma_2}}$$

Where $Trade_{ij}$ denotes the trade flows (the sum of the exports and imports) from i to j , GDP_i and GDP_j represent the sizes of i and j 's economies, the transaction (transportation) costs are denoted by D_{ij} which represents the distance between i and j (in kilometres), γ_1 and γ_2 represent the elasticities, and G is the gravitational constant (Wang, Wei and Lui, 2010, p. 901).

Paas (2000) has employed the following gravity model :

$$Trade_{ij} = G Y_i^{\beta_1} Y_j^{\beta_2} D_{ij}^{\beta_3} A_{ij}^{\beta_4} u_{ij}$$

In addition to the above factors, many dummy variables can be added in order to capture the potential effects of the existence of a trade agreement, a common spoken language and a common historical past among the trading partners (Frankel and Wei, 1993, p.3).

That is, we can formulate our gravity model in the following log-linearized form :

$$\ln(Trade_{ij}) = \beta_0 + \beta_1 \ln Y_i + \beta_2 \ln Y_j + \beta_3 \ln D_{ij} + \beta_4 A_{ij} + u_{ij}$$

After the replacement of the Y_i , Y_j , D_{ij} and A_{ij} , we obtain the following Gravity model :

$$\ln(Trade_{ij}) = \beta_0 + \beta_1 \ln GDP_i + \beta_2 \ln GDP_j + \beta_3 \ln Dist_{ij} + \beta_4 A_{ij} + u_{ij}$$

In addition, we will estimate the Gravity model with the per capita GDP in the place of the GDP in order to examine the potential effects of the per capita income on the bilateral trade flows between Algeria and the EU (more details in Khar, 2014, p. 22-23).

$$\ln(Trade_{ij}) = \beta_0 + \beta_1 \ln PCGDP_i + \beta_2 \ln PCGDP_j + \beta_3 \ln Dist_{ij} + \beta_4 A_{ij} + u_{ij}$$

7.1. The variables of the study

7.1.1. The dependent variable is

$Trade_{ijt}$: the bilateral trade flows (the average of exports and imports) between Algeria and each European country j . The monetary value of the trade flows is expressed in million U.S at constant prices (2005 as the base year).

7.1.2. The independent variables are

GDP_{it} : is the Gross domestic Product of Algeria at time t .

GDP_{jt} : is the Gross domestic Product of each European country j at time t .

$PCGDP_{it}$: is the Gross Domestic Product per capita of Algeria at time t .

$PCGDP_{jt}$: is the Gross Domestic Product per capita of each European country j at time t .

All the four variables are expressed in million U.S at constant prices (2005 as the base year).

$Dist_{ij}$: is the distance (in kilometres) between Algeria and each European country j .

A_{ij} : is a set of dummy variables which include the trade agreement's dummy, the common language's dummy and the colonial past's dummy.

FTA_{ij} : is a dummy variables that takes the value of one (1) if the two trading countries are part of the same regional trade agreement and the value of zero (0) otherwise (Khlar, 2014, p. 26).

$Comlang_{ij}$: is a dummy variables that takes the value of one (1) if the two countries have or speak the same language and the value of zero (0) otherwise (Khlar, 2014, p. 26).

Col_{ij} : is a dummy variables that takes the value of one (1) if the two countries have a common historical (former colony) link and the value of zero (0) otherwise (Khlar, 2014, p. 26).

$i = \text{Algeria (Fixed)}$;

$j = 1, \dots, 9$ (nine European countries);

u_{ijt} : the error term.

7.2. The Hypotheses of the Study

The elasticities (β 's) are assumed to take positive or negative signs (Khlar, 2014, p. 26) :

$\beta_1(GDP_i)$: is assumed to take a positive sign

$\beta_2(GDP_j)$: is assumed to take a positive sign

$\beta_1(PCGDP_i)$: is assumed to take a positive or a negative sign

$\beta_2(PCGDP_j)$: is assumed to take a positive or a negative sign

$\beta_3(Dist_i)$: is assumed to take a negative sign

$\beta_4(FTA_{ij})$: is assumed to take a positive sign

$\beta_5(Comlang_{ij})$: is assumed to take a positive sign

$\beta_6(Col_{ij})$: is assumed to take a positive sign

7.3. Data sources

The bilateral trade flows between Algeria and the EU necessitate datasets on the Algerian imports and exports over the 1991-2011 time period. A panel of 9 European countries is constructed in order to explore the determinants of the bilateral trade flows. In this regard, the selected countries are : France, Italy, Germany, UK, Greece, Spain, Portugal, Belgium and Sweden. The limited availability of the data is behind our choice.

Datasets of the Algerian exports and imports are collected from the National Office of Statistics in Algeria (NOS, 2012). Thus, the statistical retrospective of 1962-2011 is used as the only reference for the bilateral trade flows between Algeria and the EU. In addition, the trade flows are expressed in millions of the national currency (Algerian Dinars) in nominal terms. They are recalculated and expressed in millions U.S by using the Real Effective Exchange Rate index (the data is available upon request).

The GDP as well as the GDP per capita of Algeria and the European countries are taken from the website of the world bank (WDI, 2014). They are expressed in real U.S dollar (2005 as the base year). Finally, the distance separating between Algeria and each European country is extracted from the CEPII (le Centre d'études prospectives et d'informations internationales). The distance is expressed in kilometres.

8. The empirical findings

The Pooled Ordinary Least Squares (POLS), the Random Effects (RE) and the Fixed Effects (FE) estimations are performed. The empirical outcomes are reported in tables (4) & (5) :

Table 4: The gravity model panel estimates (POLS, RE & FE)
The Dependent variable is the log of the real (average) trade flows

<i>Regressors</i>	Pooled OLS (POLS)		Random Effects (RE)		Fixed Effects (FE)	
	Coefficients (β)	<i>t</i> -statistic ^a	Coefficients (β)	<i>t</i> -statistic ^a	Coefficients (β)	<i>t</i> -statistic ^a
<i>Constant</i>	-8.60	-2.38**	-8.54	-2.58***	-13.81	-3.82***
<i>LnGDPi</i>	1.26	3.84***	1.27	4.93***	1.38	2.19*
<i>LnGDPj</i>	0.79	18.48***	0.78	5.40***	0.62	0.85
<i>LnDistance</i>	-1.90	-19.52***	-1.90	-6.21***	-	-
<i>FTA</i>	0.22	3.29***	0.22	5.02***	0.22	5.48***
<i>Language</i>	0.49	10.15***	0.48	7.15***	-	-
<i>Col</i>	-0.16	-2.57***	-0.15	-1.12	-	-
<i>No. of obs</i>	189		189		189	
<i>No. of pairs</i>	9		9		9	
<i>R²</i>	0.88		0.69		0.69	

Notes : ^a the *t*-statistics are heteroskedasticity robust.

***, ** and * denote 1%, 5% and 10% significance level, respectively.

Source : the author.

Table 5: The gravity model panel estimates (POLS, RE & FE)
The Dependent variable is the log of the real (average) trade flows

<i>Regressors</i>	Pooled OLS (POLS)		Random Effects (RE)		Fixed Effects (FE)	
	Coefficients (β)	<i>t</i> -statistic ^a	Coefficients (β)	<i>t</i> -statistic ^a	Coefficients (β)	<i>t</i> -statistic ^a
<i>Constant</i>	2.72	1.32	2.82	1.21	-4.46	-4.48**
<i>LnPCGDPi</i>	0.60	0.99	2.35	2.92***	2.98	3.14***
<i>LnPCGDPj</i>	3.10	16.12***	1.30	2.18**	0.65	0.99
<i>LnDistance</i>	-3.16	-21.50***	-2.56	-4.39***	-	-
<i>FTA</i>	0.23	3.33***	0.19	4.21***	0.17	3.92***
<i>Language</i>	-0.01	-0.22	0.14	1.06	-	-
<i>Col</i>	0.30	5.56***	0.36	4.30***	-	-
<i>No. of obs</i>	189		189		189	
<i>No. of pairs</i>	9		9		9	
<i>R</i> ²	0.86		0.81		0.70	

Notes : ^a the *t*-statistics are heteroskedasticity robust.

*** and ** denote 1% and 5% significance level, respectively.

Source : the author.

For the estimation with the GDP as dependent variables, we decided to retain the FE estimation against the RE estimation after performing the Hausman test statistic (more details in Khier (2014)). Consequently, we will base our interpretation on the FE estimation rather than the Pooled OLS or the RE estimations. However, the interpretation of the time-invariant variables (distance, common language and colonial past) will be based on the RE estimation (the empirical results are listed in the appendix).

The Hausman test statistic indicated that the RE estimation should be retained against the FE estimation for the estimation with GDP per capita as dependent variables. So we will base our interpretation on the RE estimation.

9. Interpretation of the results and conclusion

It is obvious that the Algerian trade sector has generated more than 44% of the GDP in 2011 and that the EU is the main trading partner of Algeria since its independence in 1962. In fact, the EU is still preponderant as a trading bloc which is exporting to Algeria more than 55% of its total imports; while more than 50% of the Algerian exports are going to the EU. Furthermore, the Algerian trade to GDP ratio has increased by 10% between 1991 and 2011.

In 2011, the imports-GDP ratio recorded 28% and the EU imports-GDP ratio is simply equal to 15%. Moreover, the trade to GDP ratio registered a slight decline to about 44% in 2011 compared to 48% in 1991; but the trade with the EU-GDP ratio has raised from 35.7% up to 38% during the same time period.

By the year 2013, Algeria increased its imports from the EU by 11% compared to 2012. That is, the EU is still the main trading partner, and France, Italy and Spain are the main European exporters to Algeria with 22%, 20% and 18%, respectively.

The reported results show that if the Algerian GDP increase by 1%, then the bilateral trade flows with the EU will increase by more than 1.38%. This finding is in accordance with the trade theory which stipulates that the larger is the economic size of the country, the larger

are its trade flows with its trading partners. The GDP of the European countries is found to be positive; but statistically insignificant.

In the trade theory, the bigger is the geographical distance, the lesser are the trade flows between the countries because of the transportation (transaction) costs which increase with longer distances (in theory). Our empirical findings are in line with the theory, and 1% variance in the distance between Algeria and the different (European) trading partners, will reduce the bilateral trade flows by 1.9%.

The existence of a free trade agreement and the common (spoken) language are reported to influence the trade flows positively by 59% [$\exp(0.22) = 59\%$] and 130% [$\exp(0.48) = 130\%$], respectively. The coefficient of the colonial past is found to be negative and statistically insignificant.

Concerning our second estimation in which the GDP per capita is employed in order to capture the potential effects of the raise in the consumers' purchasing power. In fact, our empirical results indicate clearly that 1% increase in the Algerian GDP per capita is accompanied by an increase in the trade flows by more than 2.3%, and the trade flows will also increase by 1.3% if the GDP per capita of the European trading partners increase by 1%. The former finding can be attributed to the increasing demand for the European imports, and thus for more differentiated goods; whereas the latter outcome is mainly due to the economies of scale and the capacity of the European trading partners to exports their products to Algeria through their performant exporting infrastructures.

The geographical distance is also reported to have an inverse relationship with the bilateral trade flows. That is, if the distance vary by 1%, there will be a 2.5% contraction in the trade flows between Algeria and the EU.

The trade agreement and the colonial past are found to impact positively on the bilateral trade flows by 51% [$\exp(0.19) = 51\%$] and 130% [$\exp(0.36) = 98\%$], respectively. The coefficient regarding the common language is found to be positive; but statistically insignificant.

Last but not least, the Gravity model matters in explaining the trade patterns between the EU and Algeria. However, any sound assessment of the free trade agreement is better suited after its full entry into force in the horizon of 2020. Algeria needs a huge investment and development plans which make the trade opportunities available and promising.

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