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Economic Integration

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Main elements of this session

- **What is economic integration?**
- **Why should we be interested in the process of economic integration?**
- **What are the advantages or disadvantages of economic integration?**
- **What are the characteristics of the integration process in Europe?**

1. Introduction

- **Economic integration**
- **Stages of the integration process**
- **Effects of economic integration**
- **European integration process**

What are the arguments in favor of regional economic integration?

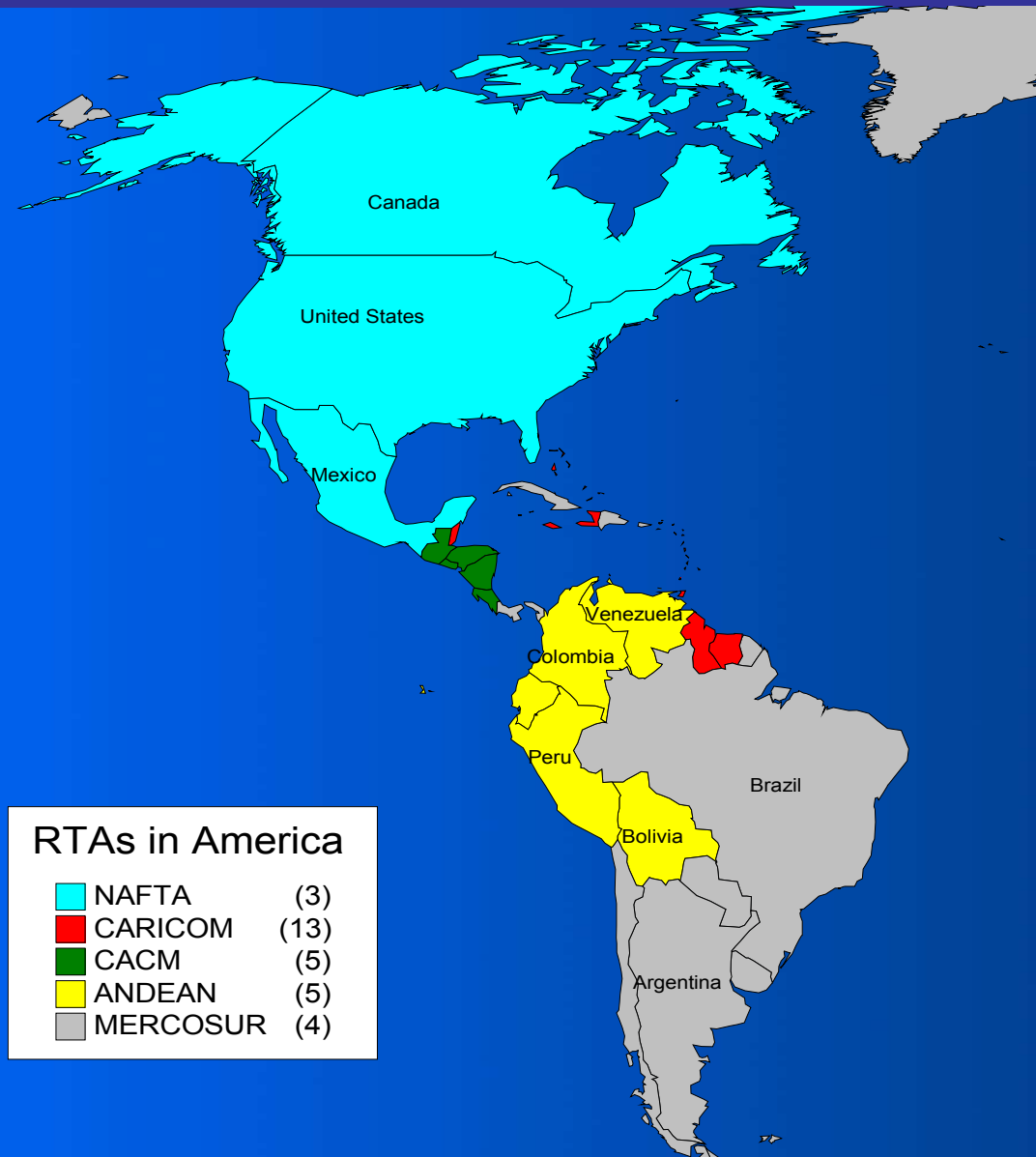
2. Economic Integration

- ...means the gradual elimination of economic frontiers between independent states
- ... is concerned with the establishment of certain elements of cooperation and coordination between the participating nations
- ...is a dynamic process, in which the economies of these participating states gradually become more and more one entity

Economic Integration

- Facilitation of international trade
- Liberalization of markets
- Political liberalism
- *But:* is not an objective in itself
 - Economic welfare
 - Peace
 - Democracy
 - Human rights

Regional trade agreements



Regional trade agreements



ASEAN

Regional trade agreements



COMESA
countries

Regional trade agreements



European Union

3. Stages of economic integration

- **Free Trade Area**
- **Customs Union**
- **Common Market**
- **Economic Union**
- **Political Union**

Free Trade Area

- Eliminates all barriers to the trade of goods and services within the area only
- No discriminatory tariffs, quotas or administrative impediments are allowed
- Each country is allowed to determine its own policy towards non-members

⇒ *NAFTA, EFTA*

Customs Union

- Eliminates trade barriers between member-countries
- Common external trade policy to the free trade area
- Combination of common and national policies vis-à-vis third countries

⇒ *Andean Pact*

Common Market

- No barriers to trade between member-states
- Common external trade policy
- Factors of production, like labor and capital can flow freely between member-countries
- Significant degree of harmony and cooperative fiscal, monetary policy

⇒ *EU*

Economic Union

- Common market with common determination of some structural and macroeconomic policies:
 - *Weak version:*
 - fixed bilateral exchange rates (rigidly or within a band)
 - each member undertakes monetary policies to defend the rates
 - *Strong version:*
 - individual currencies are replaced by a common currency
 - individual monetary authorities are replaced by a single authority
 - harmonization of tax rates

⇒ EMU

Political Union

- Free movements of goods, services, labor and capital
- Common economic, monetary and fiscal policy
- Common foreign policy and policy of defense

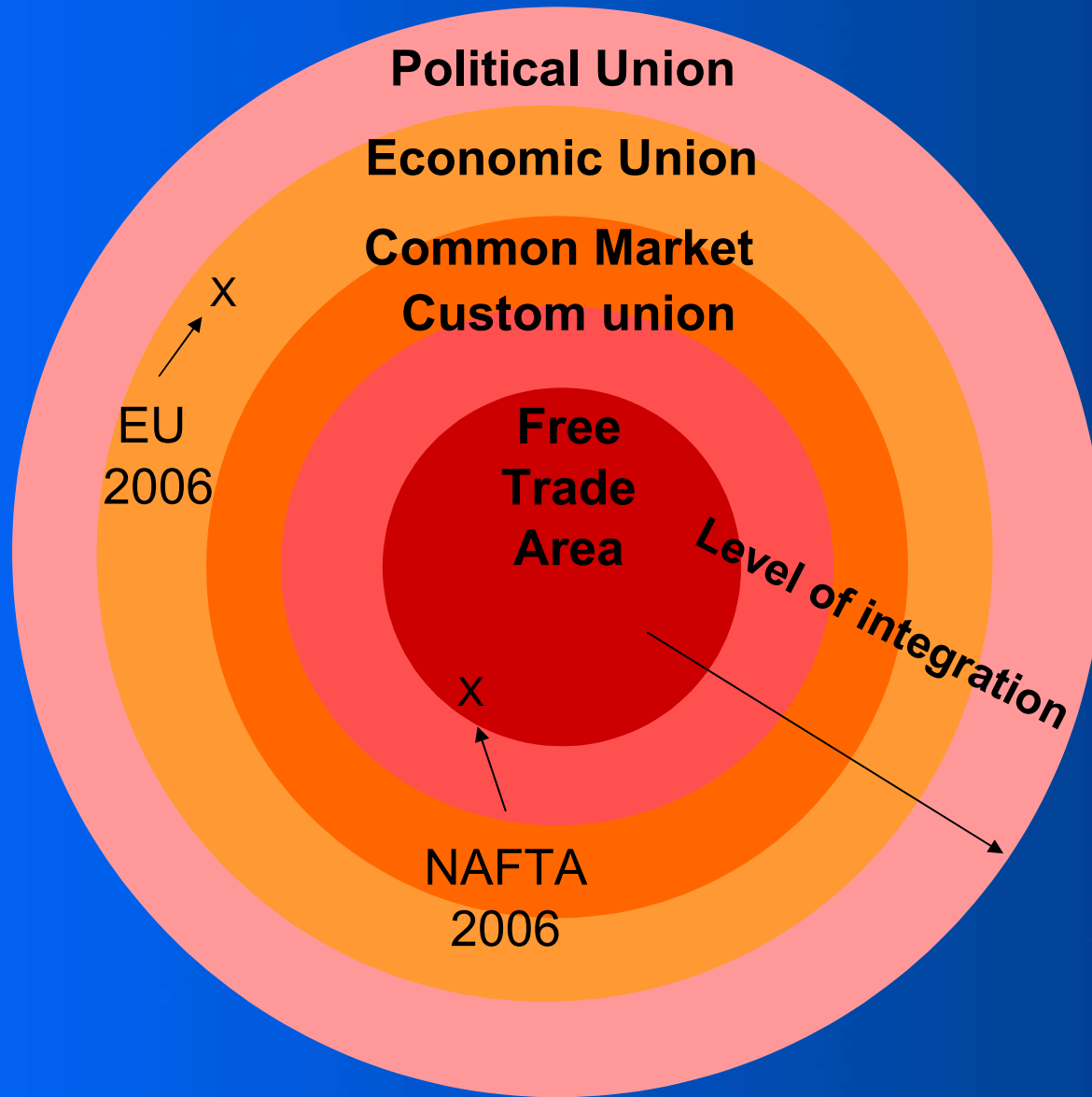
⇒ *Germany in 1990*
EU in the future?

Types & Extent of Economic Integration

	FORMS OF INTEGRATION				
AREA OF INTEGRATION	Free Trade Area	Customs Union	Common Market	Economic Union	Political Union
Free Movement of Goods	■	■	■	■	■
Free Movement of Services	○	○	■	■	■
Movement of Capital					
– Free movement of Payment	■	■	■	■	■
– Free movement of Capital	○	○	■	■	■
Free Movements of Workers			■	■	■
Rights of Establishment			■	■	■
Common External Tariff		■	■	■	■
Competition policy		○	■	■	■
Co-ordination of Economic Policy					
– Monetary Policy			○	■	■
– Fiscal Policy			○	○	○
– Exchange Rate Policy			○	■	■

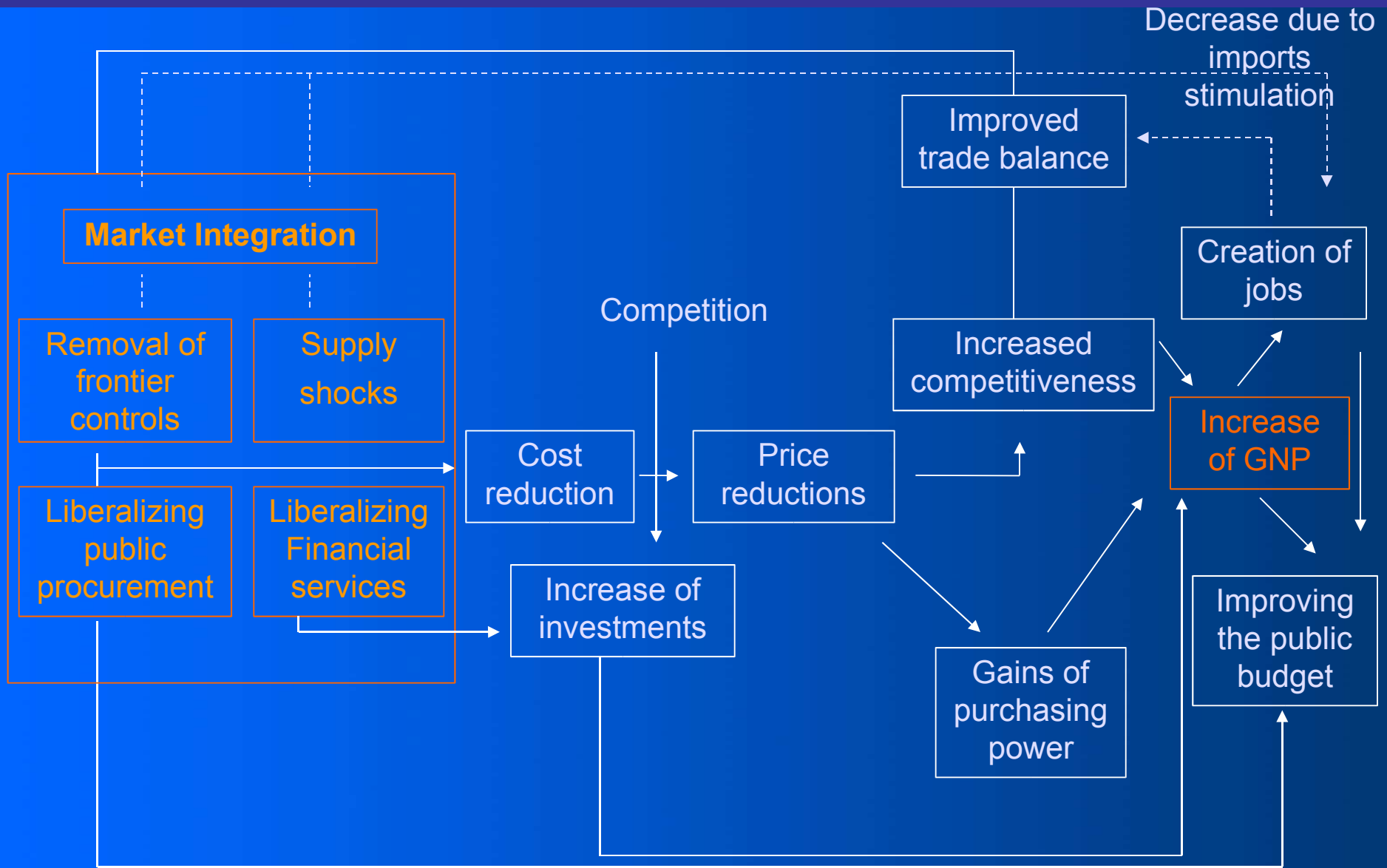
■ *Integration necessary* ○ *Integration useful due to economic inter-dependencies*

Levels of Economic Integration



4. Effects of economic integration

Macroeconomic effects



Welfare Gains I

COMPARATIVE – STATIC EFFECTS

Short-term growth (level effects) because of

- Increased economic competition
- Better allocation of production factors
- Higher economic efficiency

⇒ That means:

- Relatively low prices
- Higher real income
- Additional jobs

Welfare Gains II

DYNAMIC EFFECTS

Long-term increase of the growth rate (acceleration effects) because of

- Higher capital stock
- Increasing economies of scale and scope
- More investments in research and development
- Higher innovation rate, thus
- Accelerated technical progress

5. European Integration Process



European Integration I

1st Phase: initial attempts and the customs union

1946: the speech of Winston Churchill in Zurich: “The United States of Europe”

1950/51: Robert Schuman’s plan for the foundation of a European Coal and Steel Community (ECSC): Benelux, France, Germany, Italy

1957: European Economic Community and Euroatom

⇒ *military and political integration motives*

European Integration II

2st Phase 1969-1973: establishing the process of deepening and enlargement

1968: Customs Union completed

1972: merger of the European Economic Community, Euroatom and the European Coal and Steel Community to the European Community (EC)

1973: UK, Ireland, and Denmark join the EC

⇒ *EU-9*

European Integration III

3rd Phase 1973-1986: Single Market and the second and third enlargement

1981: Greece joins the EC

1986: Single European Act → Single Market
Completion of internal market by 1992

1986: Spain and Portugal join the EU

⇒ *EU-12*

Single European Act (1987)

Establishing a common market (EEC treaty) with ***four freedoms***:

- Free movement of goods
- Free movement of services
- Free movement of persons
- Free movement of capital

Free movement of goods and services

- Freedom of trade in goods and services
- Freedom of choice for enterprises
- Common competition policy and control of state aid
- e.g. similar goods which can be produced at lower costs will become more competitive since no tariffs apply

Free movement of persons

- Free mobility of labor
- Sufficient adjustment capacities
- Workers move from areas with low wages to areas of high wages
- Movement of workers to areas with high wages tends to reduce the wages of existing workers
- Redistribution effects motivates conservative resistance

Free movement of capital

- Capital moves from areas where the return on capital (interest rate) is low to areas where the return is high
- Movement of capital to areas with high interest rate tends to reduce the interest rate in the areas and increases the interest rate in the areas with low rates
- As for labor there are significant redistribution effects that motivate conservative resistance

European Integration IV

4th Phase 1986-1995: European Monetary Union and the fourth enlargement

1989: Delors Report on the introduction of European Monetary Union

1991: Maastricht → Treaty on European Union

- aim: monetary union

- went into force on November 1, 1992

1995: Austria, Sweden and Finland join the EU

⇒ *EU-15*

European Integration V

5th Phase since 1995-2002: preparation and entry into the European Monetary Union

1999/ 2002: Introduction of the common currency, the Euro; start of the European Monetary Union

6th Phase 1998 onwards: preparation of the fifth enlargement

Institutional Reform

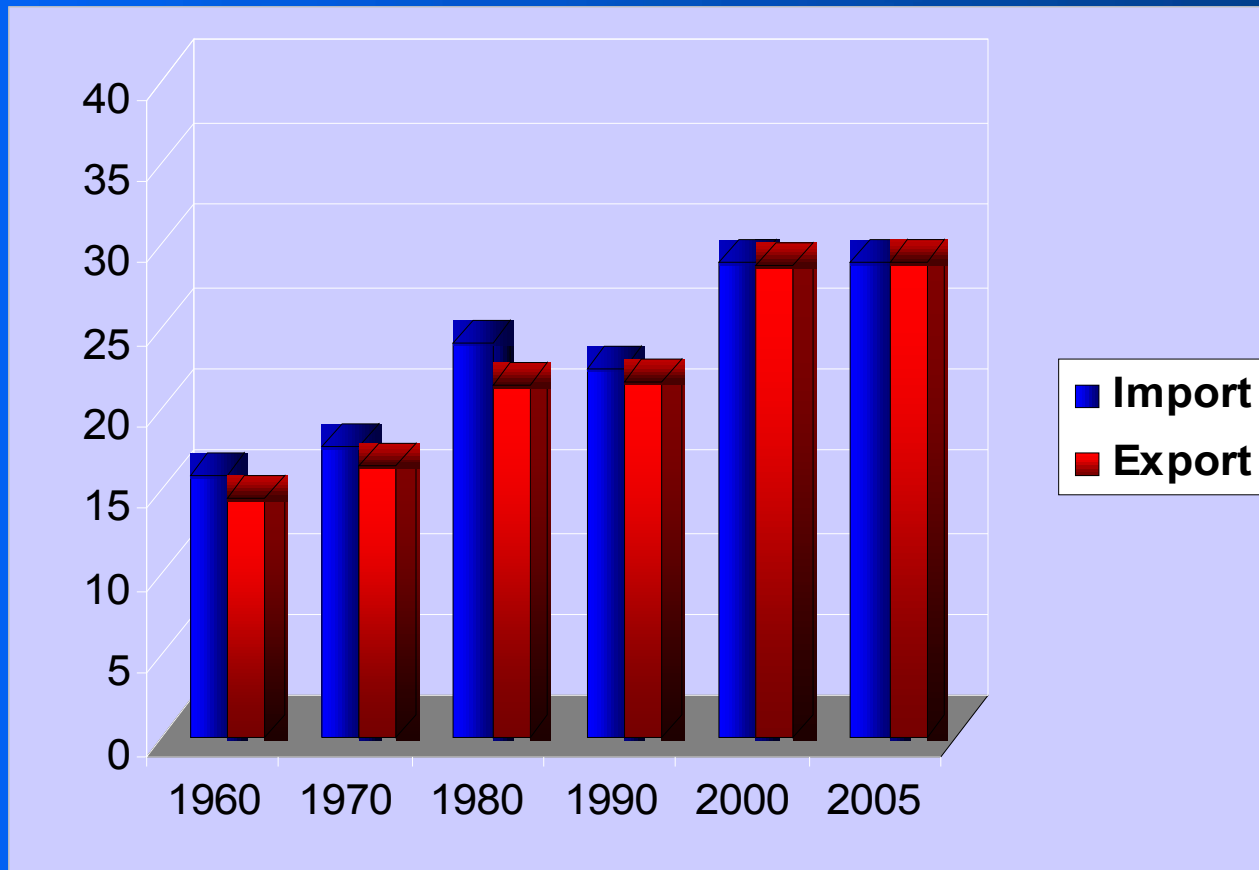
2004: 10 new member states \Leftrightarrow EU-25

2007/2008: Bulgaria, Romania

Advantages of the Integration

- Facilitation of international trade
 - Competition and comparative advantages
 - Liberalization of capital flows and direct investments
 - Free movement of people as precondition for trade
 - Macroeconomic stability
- Liberalization of Markets
 - A common market \Leftrightarrow competition
 - A common currency
 - Economic stability
- Political Liberalism
 - Democracy
 - Political stability
 - Openness and free movement of people

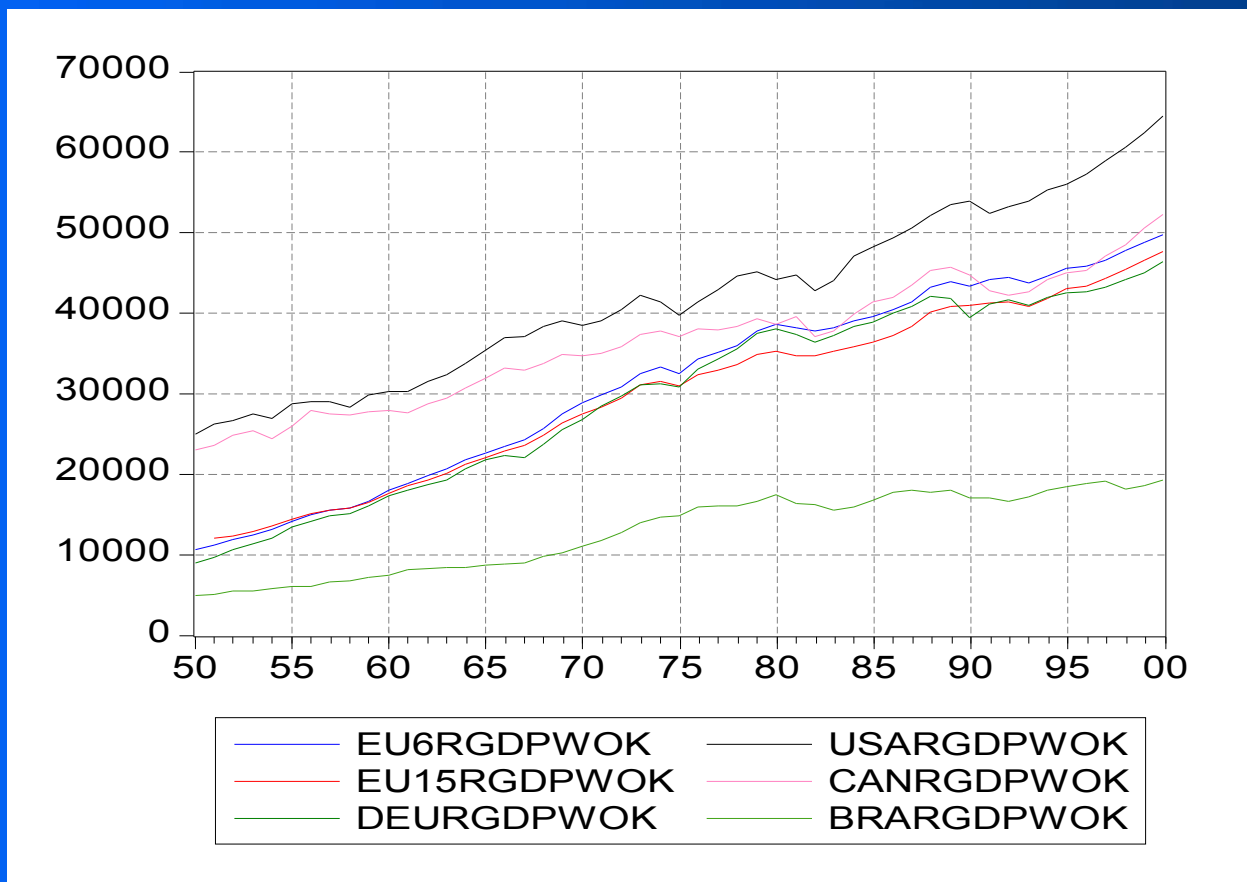
Relative importance of total foreign trade



EU-15: Percentage share of goods imports and exports in total GDP of member states (current prices), 1960 - 2005

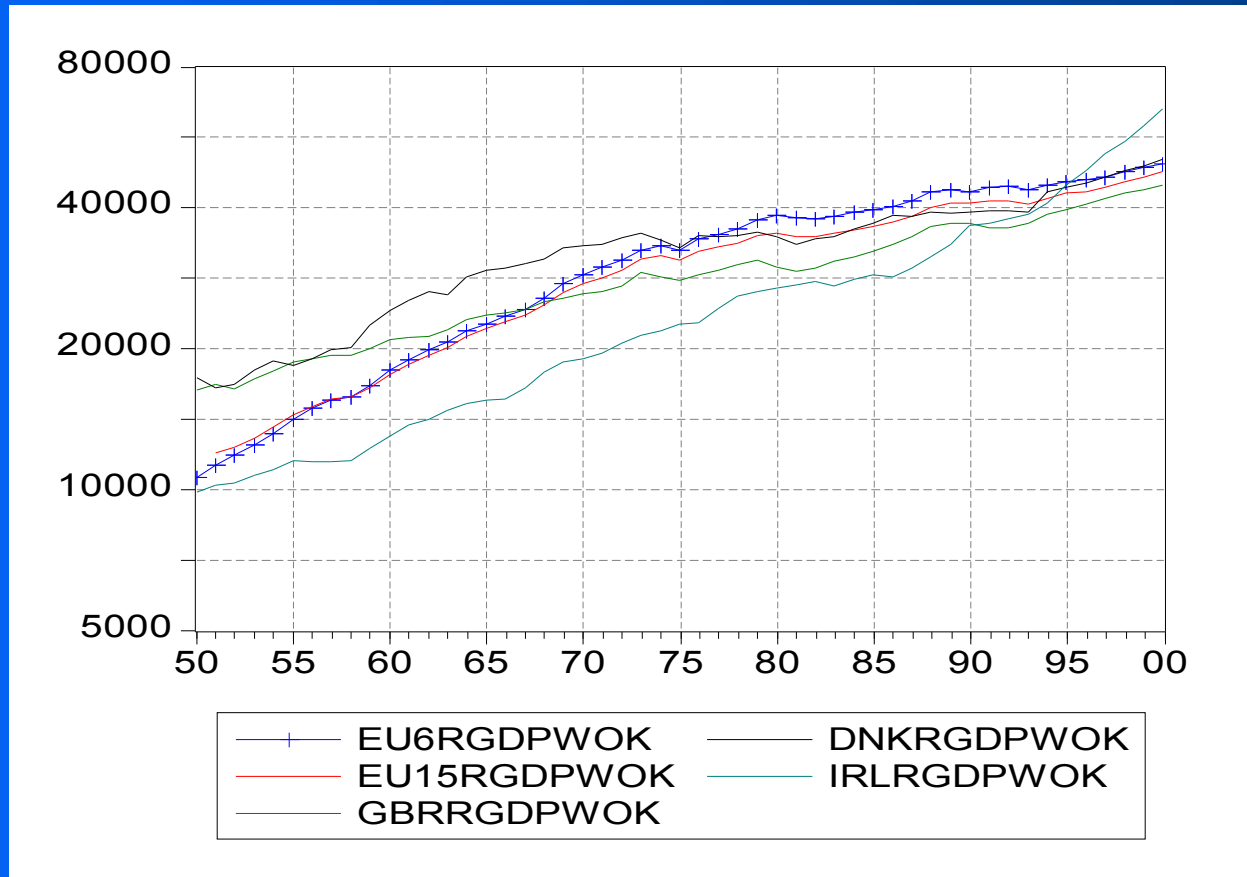
Source: European Commission, Statistical Annex of Economy, 2006, Tables 38,39, 42,43.

Convergence of Productivity



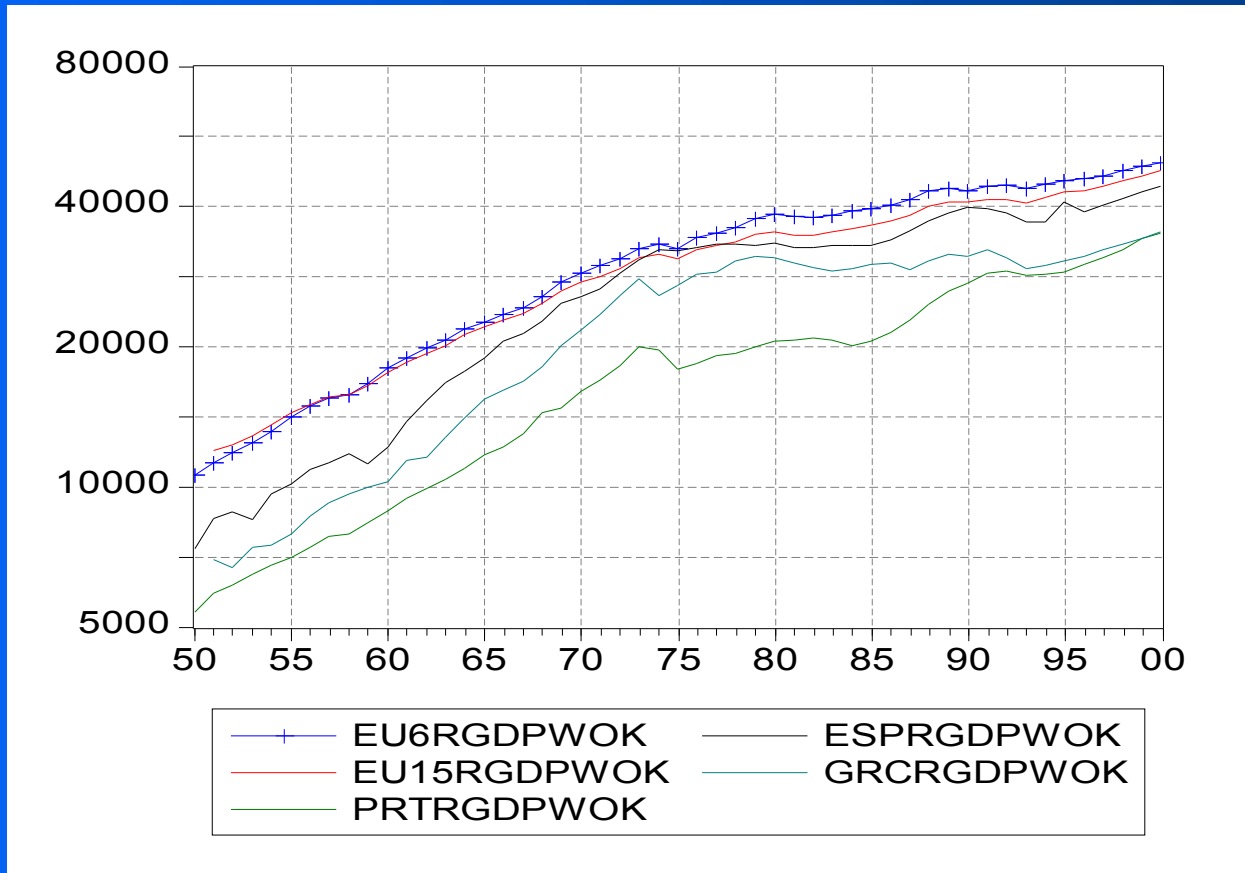
EU-6, EU-15, Germany, France, Italy, Benelux, US, Canada, Brazil

First Enlargement 1973



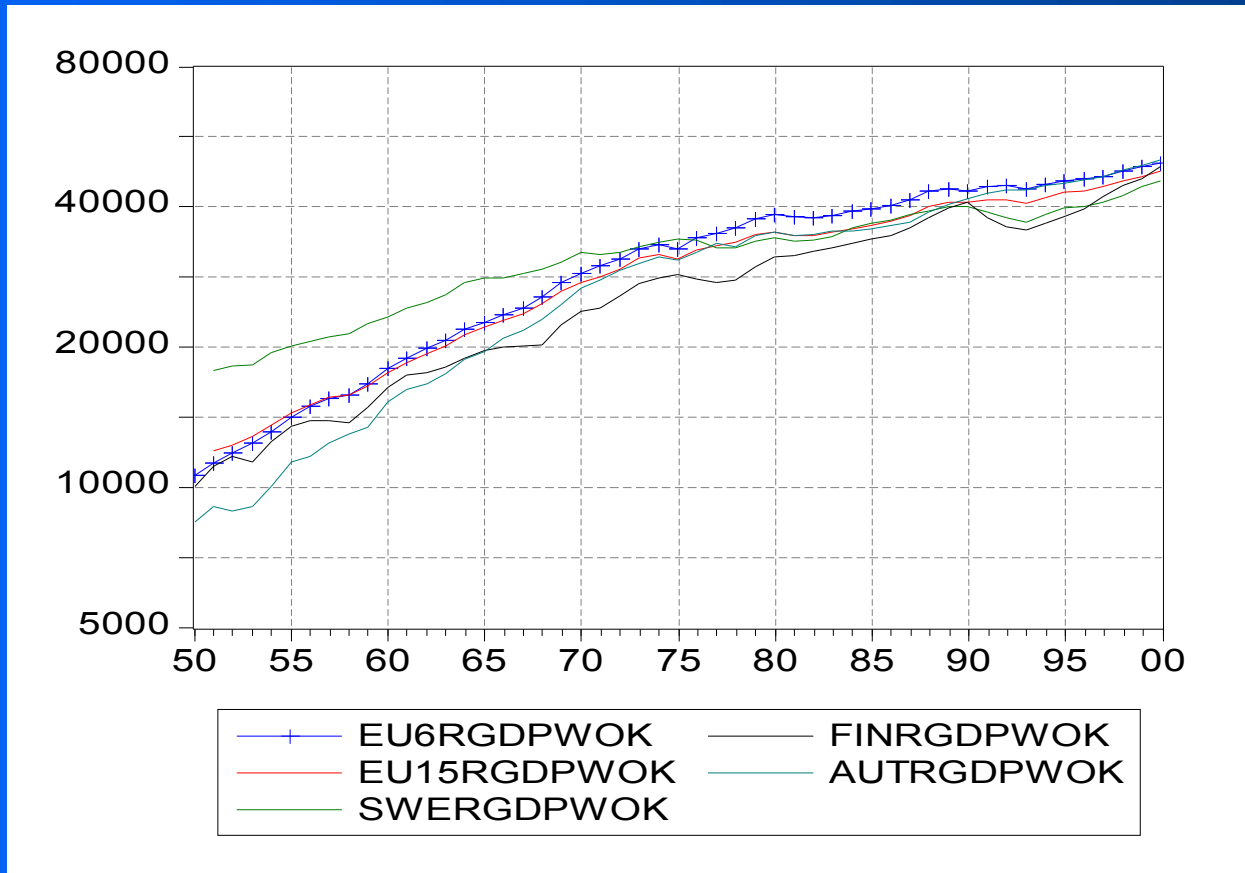
EU-6, Eu15, United Kingdom, Ireland and Denmark

Southern Enlargement 1981/1986



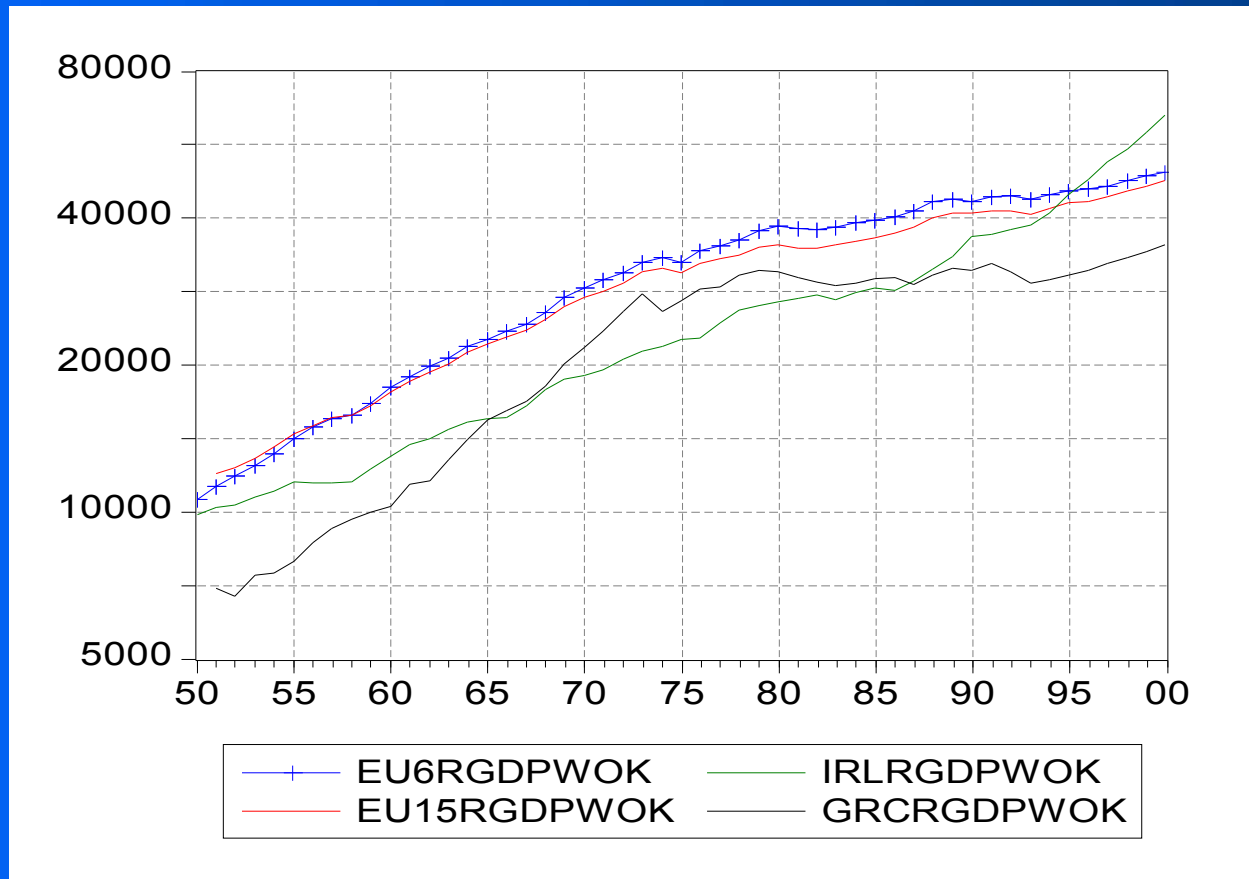
EU-6, Eu-15, Portugal, Spain and Greece

Third Enlargement 1995



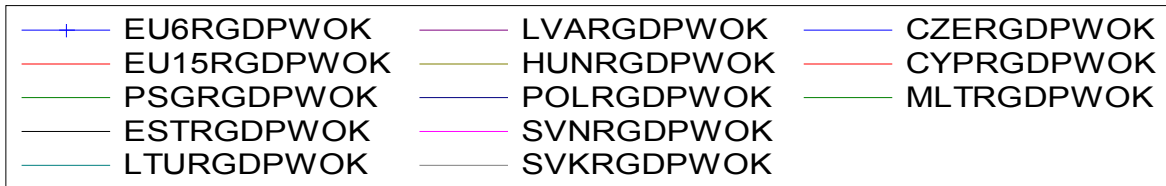
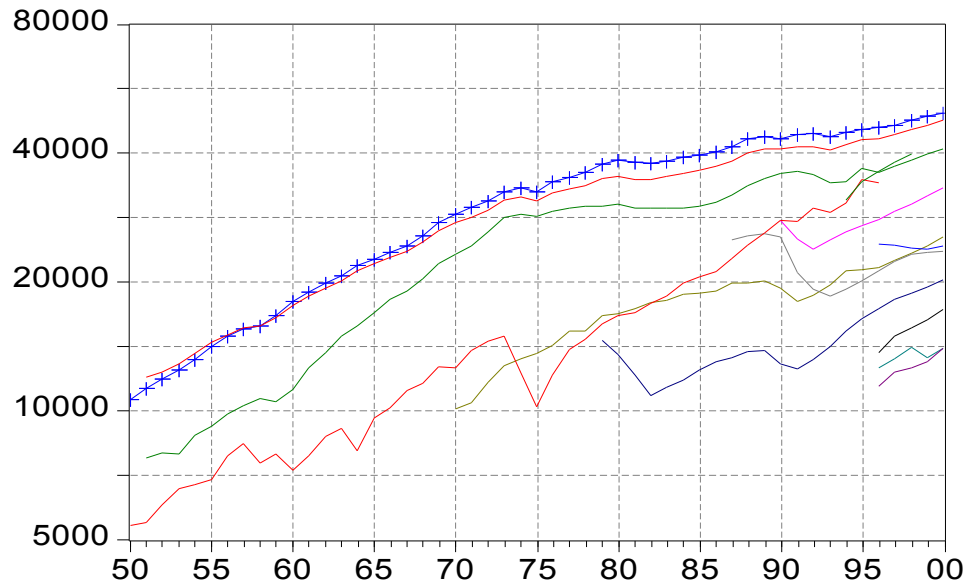
EU-6, EU-15, Sweden, Finland and Austria

Comparison of different EU-countries



EU-6, EU-15, Ireland, Greece

Eastern Enlargement 2004



EU-6, EU-15, Southern Europe, MEEC

Why don't we see more integration in
the world economy?

Disadvantages of the Integration

- Increasing regionalism?
- Fear of alien nation?
- Discriminatory effects?
- Negative social effects?
- Loss of sovereignty?
- ...

Conclusions

- Distinguishing free trade areas, customs union, common market, economic union and political union
- Economic integration in general increase welfare through trade, but the discriminatory nature may make the net welfare effect negative
- Increased popularity of Regionalism rather than Multilateralism may be bad for the world economy
- EU is the most successful and powerful economic integration scheme