Module 1.
Economic Integration: Convergence Criteria; and Unilateral, Bilateral and Multilateral Integration

ECN 330

Analyzing Economic Integration and Trade Liberalization

1. Integration: Convergence Criteria

1.1. Economic perspective
- Prices of goods and services
- Factor prices

1.2. Political perspective
- Policy
- Institutions

1.3. Legal perspective
- Implementation and enforcement
- Interpretation and dispute settlement

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2. Global Integration: Uni-, Bi- and Multilateral

- 2.1. Defining global integration

Global integration criteria	Basic assumptions					
	Compe-titive mkts	Identical goods, services, factors	No gov't policy or regs or technological barriers			No trans-actions costs
			Trade policy	Non-trade regs	Technology	
Trade in goods						
Trade in services						
Int'al K-mobility						
Int'al L-mobility						

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Global Integration, continued . . .

2.2. State of global integration
- Historical account
- Evidence of a trend
- Obstacles to further integration

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Global Integration, continued . . .

- "Globalisation: Integration Marches Onward . . ."
  - " . . . ***global*** economic ***integration survived financial crises, collapse of stock market bubbles,*** terrorist attacks, the need for tighter security, wars, ***fear of disease, natural disasters and*** oil ***shocks.***"
  - ***"Forces driving globalisation are . . . powerful, but . . . not 'invincible'*** The ***world economy retreated from openness*** between 1914 and the middle of the 20th century. It could do so again.
  - " . . .***dynamism of international economic transactions*** has become universal phenomena, ***embracing not just trade but also capital flows and even migration.***"

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Global Integration, continued . . .

- "Integration Marches Onward", continued …
  - "The dynamism of ***FDI is more recent.*** Throughout the 1950s through 1970s, many DCs and almost all LDCs tried to keep investment by multinational companies out… Now they are nearly all even more desperate to entice them in."
  - "The ***flow of remittances to LDCs*** jumped from $31bln in 1990 to an estimated level of $167bln in 1995, ***roughly double official aid flows.***"
  - "Behind . . . economic integration lie ***three driving forces***: (1) sharp reductions in the cost of ***transport and communications***; (2) ***economic liberalisation***; and (3) the [recent] entry into the world economy. . . of east and south Asia . . ."
  - "More people . . . ***adopted the internet and mobile telephony more quickly than any other technologies in history.***"

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Global Integration, continued . . .

- "Integration Marches Onward", continued . . .
  - "***Liberalisation of*** international ***transactions*** is ***a central element of the wider policy changes*** . . ."
  - "The sustainability of today's march toward economic ***integration depends on . . . Managing trans-border transmission of disease, on keeping borders open to flows of goods, services, capital and labour***, on avoiding large-scale economic instability . . . "
  - However, powerful the forces pushing globalisation onwards may now be, they depend on supportive and co-operative political and policy environments."

Wolf, *Financial Times*, 25 Jan 2006, p 1

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Global Integration, continued . . .

- "Nationalism Undermines . . . Corporate Sector"
  - "…***In Europe, [cross-border mergers] raises concerns*** (and hope) that the continent is being taken over by the "Anglo-Saxon model."
  - There are ***three possible reactions to the proposed deals*** … ***First***, … is ***nationalism***, 'We will ***do everything in our power to ensure that*** Spain's energy ***companies remain*** Spanish'[;] …***second*** is to see bids as an ***encouraging sign for Europe – governments may have been slow to introduce economic reform***, but the ***corporate sector is getting on with it*** - … ***third, the academic evidence on acquisitions*** (most fail to deliver value) and suspect that the current merger mania is ***driven by*** executive grandstanding and the availability of ***cheap finance and the lack of alternative options for long-term growth.***"

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Global Integration, continued . . .

- "Nationalism Undermines ... Corporate Sector"
  - "It is ***tempting to dismiss the nationalist argument***... At its most ridiculous, the ***French recently seemed to be suggesting that Danone***, the foods group, was a ***'strategic interest'***."
  - "The problem is what happens ***in the absence of takeover activity***. In markets where takeovers have been discouraged (Japan, pre-2000 Germany), ***managers can become complacent and ignore measures such as return on capital, chasing low-margin sales or financing ill-conceived new projects.***"
  - " . . . Time for ***Europe to take advantage of its continental scale and not allow petty nationalism to block the restructuring of its corporate sector.***"

Coggan, *Financial Times*, 25 Feb 2006, p 12

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Global Integration, continued . . .

2.3. Theoretical case for multilateral system of trade

- Unilateral liberalization
  - Economic implications
  - Political factors
- Bilateral liberalization
- Multilateral liberalization

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3. Regional Integration

3.1. Stages of integration

- FTA
- CU
- Common market
- Economic union

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Regional Integration, continued . . .

3.2. Rules on FTAs and CUs: GATT Article XXIV

Clauses	Compliance issues
Para 4	**Facilitate trade** between *territories* (from para 2, those with separate tariffs or other regulations of commerce) **without raising barriers** to non-members
Para 5	Create FTA/CU within a ***"reasonable length of time"***
	Restrictions during phase-in period **cannot** be **higher or more restrictive** than generally applied
Para 8	FTA/CU defined as territories in which duties/restrictions of commerce are eliminated on ***"substantially all trade"***
	CU requires CET on ***"substantially all trade"***
Para 9	Conditions on **transhipment** of non-FTA goods: collect duty equal to a rate that **eliminates arbitrage**

Source: GATT

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Regional Integration, continued . . ..

3.3. Debate on regionalism versus multilateralism

Criteria or objective	Regional bloc	Multilateral accord
3.4.1 Static gains	Benefits concentrated; trade creation/diversion	Max global benefits; trade creation
3.4.2 Promote trade:	Blocs grow and merge	Rules-based MA; fewer exceptions; non-discrim
greater liberalization	Greater MA, esp if there are common regs	Blocs slow talks; EU: all 27 must agree
facilitate trade talks	Blocs ↓ number of players; ↑ profile of small country	Blocs exclude poorest; Regional bully defines terms; blocs are political
3.4.3 Dynamic gains or L-R integration	Integration is built-into agenda; integration → more liberalization	Gains follow own course Integration not formally covered
	Effect on competition / specialization from: 1. ΔP ; 2. Δ Technology; 3. Common/approx regs	

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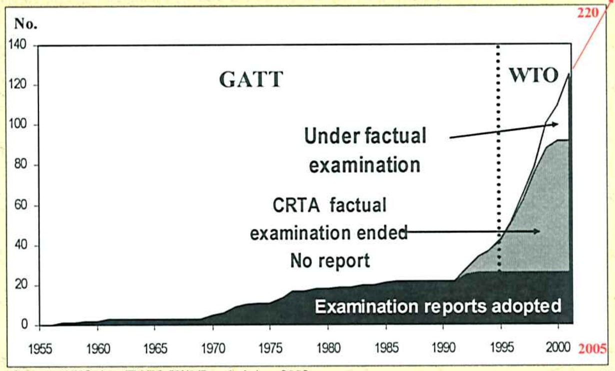
Regional Integration, continued . . .

- Number of RTAs and notifications under GATT/WTO



Source: WTO doc, TN/RL/W/8/Rev.1, 1 Aug 2002

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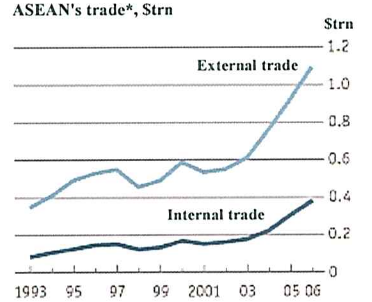
Regional Integration, continued . . .

- ASEAN regional bloc: Trade patterns



Economist, "ASEAN: Past it at 40?", 2 Aug 2007

Sources: ASEAN; IMF *Exports and imports

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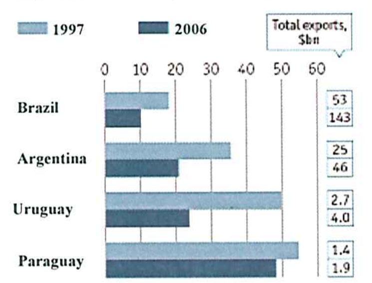
Regional Integration, continued . . .

- Mercusur regional bloc: Trade patterns



Source: IMF Economist, "Mercosur: A turning piont", 5 Jul 2007

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Regional Integration, continued . . .

- P. Lamy, DG WTO on ↑ regionalism (10 Sep 07)
  - Point is *not* whether regionalism is good or bad

    The important questions are:
    - In which manner do RTAs operate?
    - How are trade opening and creation of new opportunities affected?
    - Does regionalism affect mulitlaterally-based trading relationships?

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Regional Integration, continued . . .

- Point is how policymakers, traders and businesses think about and react to ↑ RTAs

  Policymakers:
  - What are the politics that shape RTAs?
  - Each new RTA alters degree of preference offered in existing RTAs
  - Consequence: firm's MA depends more on power of its gov't to negotiate MA than on the firm's competitiveness
  - Big powers dominate and negotiate better deals

  Traders:
  - Different rules across RTAs → incoherence + unpredictability
  - Diverse ROO, special procedures, admin complexity

  Businesses:
  - Different rules → ↑ cost of business
  - Firms look to gov't for ↑ MA

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Regional Integration, continued . . .

- Longer-term consequences/directions
  - (1) What forces or interests push trade relations in a *multilateralizing* direction? i.e., RTAs merge or consolidate rules...
  - (2) What forces/interests favor the discrimination inherent in an RTA?
  - If the latter's interests dominate, then expect more RTAs and/or the maintenance of exclusivity (i.e, discrimination).
- Transparency mechanisms
  - Characteristics and design of RTAs in terms of legal compliance
  - Ability of RTA to foster multilateralization

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Regional Integration, continued . . .

3.4. Trade, aid and preferential treatment

- Trade versus aid

From the perspective of the LDC:	
How should the county's trade patterns or changes in trade patterns be determined?	What should drive the country's strategy for specialization and comparative advantage?

- Trade through preferential treatment
  - Discriminating preferences and trade diversion
  - Limited MA with exceptions
  - MA through quotas
  - Subject LDCs to more subtle forms of protection
  - The *clash of liberalizations*

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4. Creating the EU

Motivation

4.1 Background: GATT, Marshall Plan, Treaty of Paris

- Why did Europe choose regional integration over multilateralism?
  - GATT
  - Marshall Plan
  - Coal and Steel Community Treaty (Treaty of Paris)

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Creating the EU, continued . . .

4.2. Phases of integration

- 1. Rome Treaty: institution-building beyond the state
  - Create CU – harmonization of trade policy
    - NTBs limit free movement of goods, L + K mobility
  - Sectoral integration (e.g., CAP, coal and steel)
    - Supra-national institutions to develop competition policy
  - Legal development – *Van Gend en Loos case*:
    - Where EC law confirms both rights and duties on individuals, then national courts must enforce EC law
    - Implication: private individuals and firms used national courts to oblige government to implement treaty provisions
- 2. 1980s: Changing the EC political/econ environment
  - Institution-building on supra-national level
  - Institutional change on a sub-national level

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Creating the EU, continued . . .

- Phase 3. 1990s onward – Maastricht and Amsterdam Treaties
  - Widening and deepening: complete the integration
  - Single market: area without internal frontiers: free movement of labor and capital, goods and services
  - Support single market with common policies: environment, health, safety, technology, R+D, monetary policy

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Creating the EU, continued . . .

Phases of integration: treaties bringing Europe closer

Treaties	Date	Members	Main points: deepening+widening
Treaty of Paris	1952	EC-6: Be-Ne-Lux, IT, GE, FR	***Limited pooling*** on coal + steel
Treaty of Rome	1958		**Common mkt** in goods, CAP, + trade policy; ↑ ***supra-nationality***
Atomic energy	1958		Common nuclear energy policy
Enlargement: 1973, 1981, 1986			UK, DK, Ire; GR; SP, POR
Single European	1987	EC-12	**Remove** the *last internal barriers*
T. of Maastricht	1992		European + monetary union
Enlargement: 1995			AU, FIN, SWE
T. of Amsterdam	1999	EC-15	**Movement of people**
Treaty of Nice	2003		Rules for choosing commission + voting; common defense policy
Enlargement: 2004; 2007			10 Central and East European; Bul, Rom

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Creating the EU, continued . . .

4.3. EC's initial approach to product market integration

- Two guiding principles

Creating a CU (CET)	Product market integration
Market access (MA) - phase in tariff elimination - tariffication - equivalent measures (e.g., NTBs) - other duties	MA liberalisation and "re-" regulation - free movement of goods - free movement of factors
Customs cooperation - common external tariffs - rules of origin - certificates of origin - customs procedures - revenue-pooling	Competitive conditions (approximation) - common regulations on SPS, TBT - public procurement - competition policy Market functioning - common policy on regions - institutions - courts and legal construct

Source: Pelkmans

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Creating the EU, continued . . .

- Three mechanisms at work
  - Integration through liberalization
  - Legal development through *'free movement of goods'* clause
  - Harmonization through approximation
- Success and failures

	Successes	Failures
Liberalization	Improved MA - ↑ intra-EC trade - ↑ competition Subsidies to non-ag SOEs ↓	Unequal MA/distortions Uneven sectoral application Implemented as if independent from approximation
Approximation	Pragmatic solution to national sovereignty issues Rigid harmonization can result in regulatory failure	Inconsistencies between approximation and liberalization Special interests capture approx Unanimity rule weakens approx

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Creating the EU, continued . . .

4.4. Other issues with European integration

- GATT inconsistency in creating CET
- Initially no common exchange rate regime
  - Theoretically problematic
  - Misalignments can cause tensions
- Services integration incomplete
  - Link between services and goods and factors
  - Right to establish is clear, but less clear for other modes
- Incomplete fiscal harmonization
  - Common taxation principle (tax at destination not origin)
  - Differing rates can result in fiscal competition
- Competition policy, free movement of capital and maintaining "strategic" sectors is difficult to balance

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Creating the EU, continued . . .

- Trends in mergers and acquisitions (M&A)

La grande nation
Intra-EU cross-border M&A activity
15 Jan – 15 Aug 2005

Country of acquirer	Deal value $bn	Number of deals
France	59.5	146
United States	55.6	398
Italy	27.9	76
Britain	19.8	272
Spain	18.0	53
Sweden	15.7	136
Switzerland	11.7	70
Germany	7.4	164
Denmark	6.6	91
Saudi Arabia	6.6	2
Total	286.6	2,251

Source: Dealogic

European mergers account for ⅓ of global deals.

US mergers account for ½.

Banking and utilities are largely national industries in Europe because they are considered "strategic"

Economist, "Europe's merger boom", 3 Sep 2005

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Creating the EU, continued . . .

"European energy: Breaking up is hard…", *Economist*, Sep 07, p. 71

- **Problem: *"Attempts to reform Europe's energy markets are losing out to protectionism"***
- "Commercial customers in different countries are charged ***energy prices*** that ***vary by as much as 100% across*** what is supposed to be a ***single market***"
- "…the announcement of the ***merger of*** GDF and Suez, ***two French utilities***, 3rd biggest utility in the world … put an ***end*** to ***hopes of a [French] compromise in the debate over the commission's plan to reform energy markets***, to make the market more competitive"

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Creating the EU, continued . . .

"European energy, continued…"

- France's European affairs minister: "***'unbundling' of energy production and transmission assets***, as proposed by the EC, would ***weaken the competitiveness of operators*** [relative to Russia's Gazprom] without guaranteeing lower prices to consumers"
- "… ***vertically integrated firms*** … ***keep prices high, shut rivals out*** of their transmission networks ***and avoid*** reinvesting their profits in ***improving their networks because to do so would increase competition***"
- "***EU started deregulating*** 10 years ago ***without changing the structure of the market***. Britain's example shows that ***deregulation works only when you modify the market structure first***, eg, through measures such as unbundling."
- European energy is largely within national borders… there is no European grid, no gas storage and not much of market

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5. Overview of the WTO

5.1. What is the WTO?

- Governing body dealing with rules on trade
- Forum for holding trade negotiations
- Government-to-government organization
- Multilateral organization

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Overview of the WTO, continued . . .

5.2 Structure of the WTO	Goods	Services	Intellectual property	Trade disputes
Basic Principles	GATT	GATS	TRIPS	Dispute settlement
Additional details	Agreements and Annexes			
Specific sectors or issues	Agriculture Textiles Investment SPS + TBT	Air transport Telecom Financial Tourist		
Market access commitments	Schedule of Commitments			
Country-specific requirements	Listing of tariffs, quotas and subsidy levels	Listing of limitations on market access national treat		

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Overview of the WTO, continued . . .

5.3. Principles of the WTO

- Most favored nation (MFN)
- National treatment
- Reciprocity
- Predictability
- Transparency
- Safeguards and exemptions

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Overview of the WTO, continued . . .

5.4. Trading system in perspective

- Making the case for trade
  - Economic and political grounds
  - Trade liberalization is not a cure all
    - *Fin Times*: "Pressure for Jobs Puts Vietnam in Hurry to Join WTO" 15 Jul 2005
  - Trade liberalization is part of wider reform

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Overview of the WTO, continued . . .

- Effects of trade versus technology
- Trade policy and strategy
  - Merchantilism
  - Protection
  - Support
  - Promotion
- Trade and institutional factors

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Overview of the WTO, continued . . .

5.5. Multilateral trade negotiations: process + procedures

- Perceptions of the WTO process

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Overview of the WTO, continued . . .

- Critics argue that the WTO is:
  - Too powerful
  - Run by the rich for the rich
    - Drive the trade agenda
    - Set trade rules that favor their firms, e.g., multinational corporations
  - Indifferent to the effects of trade on
    - Workers' rights
    - Child labor
    - Environment and health
  - Lacks democratic accountability
    - Too close to multinational companies
    - Prevents NGOs from access

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Overview of the WTO, continued . . .

- Process and procedures: general

Process

- Multi-player game
  - Democratic
  - All members participate
  - Identification of issues
  - Move forward by concensus
- Multi-period game
  - Iterative process over stages
  - Trust/reputation built over time
  - Advance talks though specific offers and requests
  - No backtracking: offers made are binding commitments

Procedures

- Participation thru coalitions
  - ↓ info + search cost; human effort
  - ↓ players, ↑ group size → ↑ leverage
  - Single- or multiple-issue coalitions
  - No formal rule to achieve concensus
- Multi-stage activities
  - 1st – develop the trade agenda
  - 2nd – negotiation period begins
  - 3rd – country-specific commitments
  - 4th – implementation: notification + reporting on compliance

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Overview of the WTO, continued . . .

- Process and procedures: Doha development round

Negotiating process

- Stage 1. Ministerial meeting, Nov 2001: define agenda
  - Members define the agenda
  - Coalitions form to move agenda
    - G-20 developing countries define common positions
  - Agenda sets direction of talks

Negotiating procedures

- Ministerial declaration 14 Nov 01
  - Agriculture: ↑MA, ↓DS, phase-out ES
  - MA on non-agriculture: tariffs
  - Services: broaden scope of offers, ↑MA
  - Intellectual property related issues
  - Trade and investment
  - WTO rules (dumping, subsidies)
  - Dispute settlement
  - Trade and competition policy
  - Trade and government procurement
  - Trade facilitation
  - Special and differential treatment
  - Other issues of interest to LDCs

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Overview of the WTO, continued . . .

Process

- Stage 2. Negotiations: 2001-03
  - Members signal preferences and clarify positions
  - Coalition building to narrow and strengthen negotiation positions
  - Negotiations determine specifics
- 2003 deadlines missed in time for Cancún Ministerial meeting
  - Talks stalled on agriculture
  - Disagreements on basic items of agenda

Procedures

- Detailing the agenda
  - Members and/or coalitions submit proposals and counter-proposals
  - Proposal-making by
    - Cairns Group, G-20 LDCs
    - Economies in transition
    - US and EU
- Ad hoc mechanism for consensus
  - US + EU draw up framework on agriculture
  - Blocking coalition, G-21, formed to oppose US + EU
  - 90 countries sign letter opposing new areas in Doha declaration (gov't procurement, environment, competition policy)

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Overview of the WTO, continued . . .

- 2004: general disagreement is past issue
  - Framework agreement approved laying down broad principles for negotiation of modalities
- 2005: Hong Kong Ministerial meeting – update progress
- Stage 3. Post negotiation
  - Each country will announce its specific reduction commitments
- Stage 4. Implementation
  - LDCs will have more time and flexibility
  - DCs have less time/flexibility
- Members address details of commitments
  - How much to reduce?
    - 4 bands for tariff cuts
    - 3 bands for DS reductions
  - Which formula is to be used?
  - When deadlines are to be met?
- Country-specific commitments
  - Bindings are applied
  - Phase-in periods defined
- Demonstrate compliance
  - Members submit documents
  - Report progress on compliance

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6. Concluding comments: Module 1

- Economic integration and trade liberalization have very different economic, political, and legal objectives
- No clear path to achieving greater economic integration
  - Trade liberalization → greater economic integration
  - Greater economic integration → more trade liberalization
- Whether approximation of regulations is superior to harmonization will depend on case-by-case basis and country-by-country basis

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