

Introduction – The Sequencing of Regional Economic Integration

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WHEN superimposed on a map of the world, the complicated network of bilateral and regional economic integration agreements (EIAs) appears – as many have described – like a ‘spaghetti bowl’, using a term cleverly coined by Jagdish Bhagwati several years ago. Whereas two decades ago the number of regional EIAs was quite small, today the number of economic integration agreements exceeds 300 – and counting!

Sixty years ago, the post-Second World War leaders formed a consensus to reduce the very high tariff barriers that emerged during the 1930s. The signing of the General Agreement on Tariffs and Trade (GATT) in the late 1940s signalled a ‘multilateral’ approach towards liberalisation in reducing post-war protectionism among the industrialised countries. However, just a decade after the GATT was signed, the oldest and arguably most successful EIA was signed: the Treaty of Rome – signed in 1957 – laid the key legal foundations for today’s European Union. While most free-traders would argue that multilateral free trade in goods and services and barrier-free foreign direct investment is optimal for the world, the reality is that *regionalism* has developed hand-in-hand alongside multilateral liberalisations promulgated under the GATT.

The spaghetti-bowl analogy, of course, conjures up the notion that such agreements have surfaced in a seemingly *ad hoc* fashion; many, of course, would challenge this notion. One of the dominant features of most EIAs is their regional nature; the vast bulk of EIAs are among countries on the same continent. A second aspect of such agreements is that they tend to be among countries that are economically large and similar in many respects: GDP similarity, per capita income similarity, degree of democratic governance, etc. Third, the vast bulk of EIAs tend to be free trade agreements (FTAs) – as opposed to preferential trade agreements (PTAs), customs unions (CUs), common markets (CMs) or economic unions (EUs), although all such types of agreements exist. This raises questions as to which economic, political and institutional fundamentals should play a role

in determining which countries should form such agreements, when should such agreements emerge, and what form should such agreements take.

In light of the continuing proliferation of EIAs worldwide, it would seem that policy makers, businesses and consumers would all benefit from a better map guiding the *sequencing* of EIAs, a map that better addresses the choice of EIA partners, the breadth of agreements, the depth of integration, etc. With few exceptions, there is a virtual dearth of analyses of the sequencing of economic integration agreements.¹ The 50-year anniversary of the most successful EIA in world history provides an opportune moment to consider lessons to be learned as other continents – the Americas, Asia and Africa – move forward with their own economic integration agendas.

This special issue of *The World Economy* includes seven papers that were presented at a symposium, ‘The Sequencing of Regional Economic Integration: Issues in the Depth and Breadth of Economic Integration in the Americas’, which was held at the Kellogg Institute for International Studies at the University of Notre Dame on 9–10 September 2005, sponsored by the Coca-Cola Company, the Inter-American Development Bank, and the Kellogg Institute and Mendoza College of Business at the University of Notre Dame. The conference was co-organised by Jeffrey H. Bergstrand, Antoni Estevadeordal and Simon J. Evenett.

The first paper, by Richard E. Baldwin, addresses directly the conference’s main topic, ‘Sequencing and Depth of Regional Economic Integration: Lessons for the Americas from Europe’. After first reviewing the political economy forces governing Europe’s experience with regional integration, Baldwin discusses how economic integration in Europe was driven by a ‘domino-based’ geographic dispersion. Building on his earlier ‘domino-theory’ work, Baldwin details carefully how the evolution of European economic integration provides empirical support for his theory. On depth, his paper argues that the path of European integration – from completion of the customs union, to the Single Market programme, to the Maastricht Treaty and monetary union – was also driven by a political economy ‘dynamo’, but established in unique features of the Treaty of Rome. Baldwin’s paper provides insights from European integration for other regions on the breadth of economic integration by carefully analysing EU–EFTA developments, but offers cautionary lessons from Europe on sequencing the depth of EIAs.

The second paper, by Simon J. Evenett and Michael Meier, examines the process of sequencing that has emerged in recent years in the United States. Evenett and Meier argue that the current Bush Administration’s ‘process’ towards sequencing EIAs can be characterised as a policy of ‘competitive liberalisation’. This policy has entailed a series of mutually-reinforcing and sequential steps to open markets abroad to US companies, to strengthen market-oriented laws and

¹ One of the few exceptions is Evenett et al. (2004).

regulations overseas, and to place the United States at the centre of the world trading system. Foreign and security policy considerations have influenced US trade policy making. In addition to characterising the policy in detail, Evenett and Meier assess the logic of the approach and cast doubt on whether the US policy of competitive liberalisation has begun to fulfil its promises.

The third paper, by Edward D. Mansfield, Helen V. Milner, and Jon C. Pevehouse, examines how domestic political factors influence the type of economic integration agreement that countries form. The authors argue that the type of agreement – PTA, FTA, CU, CM or EU – that pairs of countries choose is influenced strongly by the number of ‘veto players’ that exist within the countries’ institutions. Democracies are more likely to form an EIA than non-democratic countries, a tendency that becomes more pronounced as the degree of proposed integration increases. Yet all democracies are not the same; as the number of ‘veto players’ rises, the likelihood of a democracy entering an EIA *falls*. A statistical analysis supports the authors’ arguments.

The fourth paper, by Eric W. Bond, focuses on the role of ‘adjustment costs’ in determining the optimal sequencing of an EIA when there are multiple industries to liberalise, such as manufactures vs banking. Indeed, the EEC’s Treaty of Rome actually *anticipated* these issues by including a discussion of further sequencing (‘ever closer union’). If EIAs are self-enforcing contracts, members will follow through on obligations if the payoff from following the agreement exceeds that from violation of it. Adjustment costs to liberalisation of industries might influence the timing of liberalisation (simultaneous vs sequential), with the analysis bearing similarity to why tariff reductions tend to be phased in over time. Bond argues that when two industries have no ‘spillover effects’, EIAs with sequential liberalisation will be easier to sustain. However, if the liberalisation of one industry influences permanently the flow of benefits from liberalising the other industry, simultaneous liberalisation may be easier to sustain.

The fifth paper, by Antoni Esteveordeordal and Kati Suominen, provides an analysis of the relationships between numerous types of international ‘cooperation’ agreements and EIAs, and potential sequencing between both types. Theoretical and empirical analysis of the relationships between agreements forged in different ‘domains of cooperation’ remains nascent. The authors first describe a new and extensive dataset of more than 12,000 international agreements formed between 1808 and 2005 spanning 23 conceptually different domains of cooperation (e.g. trade, energy, infrastructure, financial assistance, etc.). Next, the authors describe how sequencing of such agreements can be used potentially to obtain higher ‘payoffs’ from cooperation. Third, they provide empirical evidence that trade-integration agreements, in particular, can be an important catalyst for further cooperation agreements.

The sixth paper, by James E. Anderson, addresses another entirely novel issue to the debate on sequencing: how the lowering or elimination of one trade cost

– say, tariffs – due to forming an EIA endogenously (and sequentially) influences another trade cost – ‘insecurity’. Anderson himself has moved the issue of ‘trade costs’ to centre stage in the analysis of the volumes and patterns of international trade flows and prices.² However, while the issue of trade costs has demanded increased attention in international economics in recent years, such costs are generally treated in trade models as *exogenous*. In this paper, Anderson moves trade costs even further to centre stage by making non-tariff trade costs endogenous. In a world with ‘traders’ and ‘robbers’ surfacing from the same labour pool, Anderson shows that an EIA can lead to greater enforcement or weaker enforcement, and enforcement’s response can differ between regional EIAs vs multilateral liberalisation. Moreover, deeper integration surfaces endogenously in his framework as two countries’ ‘merchants’ respond with private initiatives. However, governments can also respond endogenously. In fact, he finds that private provision of enforcement may undercut the benefits of trade liberalisation more for poor countries than rich ones, suggesting that poorer nations may benefit relatively more from endogenous government provision of ‘security’.

The seventh paper, by Andrew Moravcsik, addresses an issue in the depth of integration that even the European Union has not yet surmounted: European unification. In this paper, the author returns us to the pilot (post-war) case for regional economic integration, Europe, and discusses the ultimate stage of ‘deep integration’: the European Constitution. Moravcsik argues first that a synthesis of the theories of endogenous policy formation, non-coercive interstate bargaining theory, and international regime theory provides a plausible account of the path of European integration, with little role for explanations stressing geopolitical or ideological factors, international mediation, or political entrepreneurship. Moreover, these theories – which embrace economic fundamentals as driving factors – help explain the ‘sequencing’ of the European Union, especially in regard to successive enlargements. However, he concludes that the process of European integration appears to have reached – what he terms – an ‘institutional plateau’, for which a ‘constitutional compromise’ appears to be the only plausible equilibrium.

REFERENCES

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- Evenett, S. J., A. J. Venables and L. Alan Winters (2004), ‘The Sequencing of Regional Trade Initiatives in Europe and East Asia’, report prepared for the Economic and Financial Affairs Directorate General of the European Commission, February.

² See Anderson and van Wincoop (2004).