A third dimension in assessing economic integration?

Assoc. Prof. Eduard Marinov, Ph.D.

Department "Economics", New Bulgarian University;

Economic Research Institute at the Bulgarian Academy of Sciences

Abstract: The paper aims to examine the relationship between the theory of economic integration and some of the significant structural changes in the global economy from the perspective of the static and the dynamic effects of integration, deriving a typology of integration agreements and a proposing a new model for evaluation of the integration agreements and the motivation for participation and the distribution of their benefits. It puts forth an expanded theoretical framework for economic integration, introducing a novel "three-dimensional" understanding of integration that reflects also participation and engagement in integration processes as a new instrument of international trade policy. In conclusion, the paper raises some questions regarding the necessity of a new geoeconomic paradigm to comprehend and analyze global economic processes.

Key words: international trade, liberalization, protectionism, integration, economic cooperation.

1. Introduction

Integration relations are an objective and logical result of the development of the global economy and international economic relations. With the increase in trade volume and interdependence of national economies, we witness the internationalization of production. The global economy is increasingly being shaped not by closed national economies but by open economies with a high degree of interconnectivity and interdependence in their overall development. Gradually, it becomes a cohesive production system rather than a complex of interconnected national economies.

In the system of international economic relations, we observe several pairs of opposing processes related to institutional and structural changes, which will be examined in the report in terms of their impact on the theory and practice of economic integration. Therefore, the aim of this study is to explore the theory and practice of economic integration from the perspective of real processes in the global economy.

The first part of the study presents these dichotomies: the growth of production and trade flows and their fragmentation, globalization and regionalization of the global economy, the proclaimed desire for trade liberalization and the actual strengthening of protectionism, geopolitics as the basis of trends in global trade, but also geo-economics as the foundation of trends in world politics. Next, a connection is sought between the theory of economic integration and the observed changes in the global economy from the perspective of static and dynamic effects of integration. A typology of integration agreements is derived, and a new model for assessing integration agreements is proposed, considering the motivation for participation and the distribution of benefits. In the final part, a new, expanded theoretical framework of economic integration is suggested, incorporating a new "three-dimensional" understanding of integration that reflects participation and engagement in integration processes as a new instrument of foreign trade policy. In conclusion, some questions are raised regarding the need for a new geo-economic paradigm to understand and analyze processes in the global economy.

2. Structural transformations in global trade

In the contemporary global system of international economic relations, certain changes and trends are observed, influenced by various factors—economic, social, political, security-related, and others. In some cases, these trends are multidirectional, while in others, they have significant economic effects. Since many of these changes are constantly occurring and scientific literature offers diverse opinions regarding their significance and future outcomes, here we will present some of them schematically, which, in our view, are related to the development of our theory and practice of economic integration.

Firstly, in the international trade system, two pairs of opposing processes of institutional changes are observed. The first is associated, on the one hand, with the proclaimed global liberalization of trade in goods: "there are no major trade restrictions left to be eliminated. If in the 1990s the benefits of trade liberalization were significant (amounting to hundreds of billions of dollars), and liberalization contributed to 10% of the world's economic growth, the benefits of liberalization are important and evident but have already been realized" (Krugman, 2016). On the other hand, the introduction of protectionist measures is increasingly observed worldwide—both covertly (in the realm of non-tariff restrictions) and directly (tariffs imposed by Russia, Ukraine, Ecuador; the EU, Brazil, India, Turkey, Vietnam, etc., the trade "war" of the US, and so on). There are many examples indicating that new trade liberalization agreements (e.g., the new trade framework of the EU regarding developing countries—Economic Partnership Agreements with regions in Africa, Free Trade Agreement with ASEAN countries, Latin America, etc.), encompassing many "non-trade" issues (sustainable development, affirmation of democratic values, environmental norms, etc.), actually, despite the declared reciprocity, place developed economies in a more favorable position in the global economy and consolidate the role of developing countries as "resource suppliers" and "production hubs" for large multinational companies, in which capital owners are precisely the developed countries.

The second group of processes, taking place from an institutional perspective in the global trade system, is those of globalization and regionalization. The elimination of spatial and temporal constraints, rapid development of information and communication technologies, new energy sources, automation, biotechnology, knowledge-intensive modern production, etc., are just some of the reasons for the intensification, on a global scale, of interaction and interdependence among economic entities, which binds the entirety of economic activities into a unified whole within the boundaries of the global economy. However, mainly due to the lack of progress in negotiations within the WTO to achieve greater trade benefits, an increasing number of countries choose to participate in various regional free trade initiatives (currently, there are over 60 regional economic communities, with more than 15 of them having some form of a common market), as well as to conclude bilateral or multilateral free trade agreements. Thus, instead of a more integrated global economy and more (cost-effective for consumers) multilateral trade, we are witnessing a deepening divide between the Global North and the Global South, as well as an increasing trend of "closed" regionalization in the globalizing economy.

In third place, some market-driven changes in global trade flows will be briefly highlighted. The emergence of "new players" in world trade is observed, mainly due to the faster development of emerging economies, particularly in comparison to developed ones. On one hand, this, along with the already noted trend of seeking bilateral and multilateral preferential trade agreements, leads to a clearer distinction between the trade interests of developing and developed economies. On the other hand, it creates increasingly fierce competition among global economic powers in accessing new fast-growing markets.

Alongside the concept of the "global village" imposed by information and communication connectivity, the idea of a new trade connectivity is emerging, expressed in the development and increasing attention given to global value chains, the development of a new vision for transnational companies as key players in world trade, and new trends in international capital movement and foreign direct investment. Lastly, but not less importantly, the manifestation of certain cyclical factors should be noted – a decrease in global demand, low commodity prices, a slowdown in growth in China, and so on.

The changing nature of international specialization should also be emphasized. Alongside the growth of trade in consumer goods, over the past decade, trade in intermediate inputs has consistently increased, reflecting the intensified internationalization of production. The purchase of intermediate inputs from foreign countries has increased in supply chains across many industries, thereby reducing domestic value-added in exports. Imports of intermediate inputs account for more than 50% of trade in goods and about 70% of trade in services (Koopman et al., 2010), and in many countries, the growing share of intermediate imports from abroad ends up in the production of consumer goods for export. As a result, the contribution of domestic production factors to exports decreases, especially in smaller (and more open) economies compared to larger or resource-rich ones.

Differences in value-added in exports in different countries reflect the differences in the sectoral composition of their trade. In general, the trend is for greater value creation in services than in manufacturing, which reflects the lower content of foreign intermediate inputs in services compared to actual production. By default, the degree of international fragmentation of production is higher than in services. In fact, the value chain (measured by the number of production stages), especially the foreign part of such a supply chain, is longer in industries such as communication and electronics, motor vehicles, metallurgy, and textiles compared to wholesale and retail trade, and other business services (Panushev, 2020).

Trade can stimulate growth and increase overall welfare in several ways. Firstly, it leads to an optimal allocation of production factors among firms and industries, which results in higher efficiency and effectiveness. At the same time, by increasing competitive pressure, trade reduces inefficiency and stimulates innovation (Aghion & Howitt, 1998). Secondly, it contributes to access to a larger international market, thereby increasing the opportunities for achieving economies of scale and technological spillovers, which support economic growth (Rivera-Batiz & Romer, 1991; Dalum et al., 1999). Thirdly, trade allows countries to specialize, both in terms of production and human capital, in goods and services for which they have a comparative advantage, leading to faster productivity growth through learning and scale effects (Krugman, 1980).

As already evident, the benefits of trade are not evenly distributed, both between countries and within them. Trade encourages countries to specialize, and since different goods and activities are associated with different technological and knowledge capabilities, those countries specializing in dynamic and innovative industries are in a better position to achieve sustainable economic growth (Grossman & Helpman, 1991; Hausmann et al., 2007).

Trade liberalization can occur at the global or regional level. As mentioned, multilateral negotiations between a large number of countries are inherently challenging, while regional trade agreements among a limited group of relatively similar countries allow for the negotiation of rules and commitments that go beyond the possibilities of a broader forum. However, regional integration can also lead to trade discrimination and welfare losses in some countries.

3. Economic integration: cause or consequence of structural transformations?

The term "integration" refers to the restoration of something in its entirety. It is used to characterize a wide range of interdependent relationships and the intertwining of social relations within a group of countries. The concept of "economic integration" is used to describe various aspects of international economic relations and the process of incorporating individual economies for the purpose of achieving free trade. Although some authors justify the differences between the concepts of "regional economic integration," "economic integration," and "regional integration" based on geographical, legal-institutional, or substantive factors, for the purposes of this study, these terms are used interchangeably. In the narrow sense in which it will be discussed here, economic integration refers to the elimination of discriminatory barriers in trade between a certain number of countries and the establishment of elements of cooperation among them. Economic integration also represents an objective process of intertwining the processes in national economies as a result of the development of modern productive forces and achievements in science and technology. As a form of economic influence, it creates more favorable conditions for gaining advantageous positions in the global economy and international relations. In practice, integration develops as economic-political unions based on intergovernmental agreements.

According to most authors, the theory of economic integration goes through two stages of development, each corresponding to the respective political and economic issues of its time. The first stage includes traditional theories of economic integration, which explain the potential benefits of integration in terms of trade and are often referred to as static analysis of integration agreements. The second stage involves new theories of economic integration, which develop under changed economic conditions and trade environments and are often referred to as dynamic analysis of economic integration.

3.1. Static and dynamic effects

Research on trade integration and the theoretical aspects of preferential trade agreements are based on the foundational work of Jacob Viner's "The Customs Union Issue" from 1950 (Viner, 1950). This book is described as the first study of the benefits of economic integration that critically analyzes it from an economic perspective (Catudal, 1951; Salera, 1951).

Viner's research is the first to define specific criteria for distinguishing the benefits and drawbacks of economic integration. His so-called static analysis of economic integration separates its potential effects into already well-known effects of trade creation and trade diversion.

Trade creation occurs when, through the achievement of a trade agreement between two countries, trade shifts from a higher-cost member country to a lower-cost one offering the same product. Trade diversion, on the other hand, takes place when imports shift from a cheaper supplier from a third country not participating in the integration to a more expensive supplier within the community.

In summary, Viner's theory essentially means that countries would have an incentive to integrate if the integration is likely to result in more static benefits than losses, or in other words, more trade creation than trade diversion.

Many authors complement Viner's static analysis by considering different aspects of the effects of integration and adding the concept of "trade expansion" (Panusheff, 2003). Thus, the static effects broadly include:

- Trade creation
- Trade diversion
- Trade expansion

All studies that expand on Viner's analysis conclude that there is no clear answer to whether a customs union enhances global welfare or not. From the perspective of international trade theory, although trade within the community increases, the static effects effectively serve as regional barriers to trade, allowing for the establishment of a new regional protectionism and directing the distribution of integration benefits towards the large, developed economies within the community, at the expense of efficient resource utilization and global welfare improvement.

During the 1960s, it became clear that static analysis of trade creation and diversion was not sufficient. Viner concluded that any non-preferential trade policy (free trade) is superior to a customs union as a means of trade liberalization, implying that the argument of resource allocation as a reason for creating customs unions is no longer applicable. Due to the inability of static analysis to assess the welfare effects accurately, Balassa introduced a new tool for analyzing the effects of economic integration on welfare - dynamic effects. This was aimed at providing better explanations for the reasons and economic motives behind the creation of customs unions and schemes of economic integration in general. The fundamental thesis in international economics is that free trade on competitive markets ensures efficiency in production and consumption worldwide and in each individual country.

Balassa (1961) and Cooper and Massell (1965) were the first to introduce the concept of dynamic effects of economic integration, which brought a new dimension to research in this field. Balassa defined the key dynamic effects of integration as "the gains derived from economies of scale, production rationalization, and increased investment activity far outweigh the static benefits and costs associated with the creation and deviation of trade" (Balassa, 1961). He also focused on the impact of integration on market structure and competition, productivity improvement, risk, and uncertainty. Schiff and Winters provided a broader definition of the dynamic effects of economic integration, including anything that influences the rate of medium-term economic growth of a country (Schiff & Winters, 1998).

Many authors refer to Viner's static analysis and its additions as "old regionalism," while they consider the study of dynamic effects such as increased competition, investment flows, economies of scale, technology transfer, and productivity enhancement as "new regionalism." Some researchers distinguish between primary and secondary regionalism, while others seek to differentiate based on the time period in which the effects manifest: "Short-term static integration effects are related to the initial change in the behavior of economic entities... while the long-term effects of restructuring are associated with improving the functioning conditions and efficiency of firms... and increasing competition" (Panusheff, 2003).

The dynamic analysis of the effects of economic integration arises from the characteristics of today's free economy. Due to its depth, dynamic effects of economic integration have a greater impact on economic processes than static effects. In theory, these effects are expected to lead to more efficient production, increased trade flows, and ultimately, according to the neoclassical trade model, an increase in welfare. However, it is important to examine whether they may also lead to a new form of regional protectionism, economic nationalism, and exacerbation of global divisions (Figure 1).

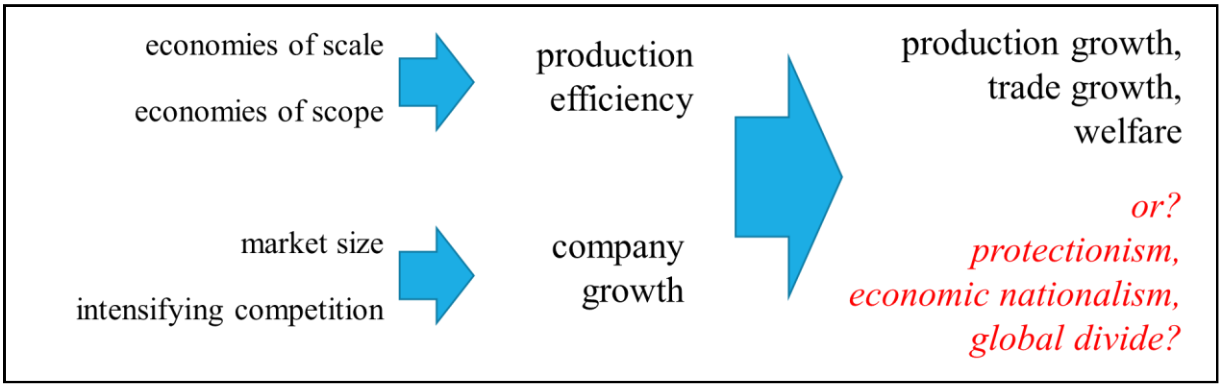

Figure 1. Dynamic effects of integration *(Source: compiled by the author)*

3.2. Forms of economic integration

Economic integration takes on various forms. A significant contribution to understanding this issue is B. Balassa's book "The Theory of Economic Integration" from 1961 (Balassa, 1961), which is widely cited in subsequent research on economic integration, both from a theoretical perspective and in terms of applied policies. According to Balassa, there are four distinct stages of economic integration: a free trade area (FTA), a customs union (CU), a common market (CM), and an economic union (EU).

The forms of economic integration are evolutionary, where each higher-ranking scheme encompasses the characteristics of the lower ones but also introduces new elements that broaden its scope and content. They can be seen as stages in a process that, if desired by participating countries, aims to achieve full integration, including a single currency, social and economic policies, and supranational institutions whose decisions are binding for member states.

Since each successive form of integration involves the relinquishment of more national sovereignty by participating countries, they themselves set their goals in the integration process. "The transition from one stage to another, higher one, implies the expansion of the areas of economic life subject to integration..." (Marinov et al., 2014). Despite the evolutionary nature of the integration process, states that believe it is achievable and aligns with their goals can directly initiate the process at one of the higher levels.

In economic theory, there is no consensus on the exact number and characteristics of the forms (stages) of economic integration. In this study, the author proposes a classification that includes eight stages of integration, mainly based on Balassa's approach to defining their content and differences between them.

The lowest form of economic integration is a preferential trade agreement (PTA). It is an agreement between two or more countries where goods produced within the union are subject to lower trade barriers than those produced outside of it (Panagariya, 2000).

A free trade area (FTA) is a PTA in which member countries do not apply any trade restrictions (zero tariffs) on goods produced within the union. However, they maintain their own customs policies towards third countries. In some cases, this is referred to as trade integration (Hosny, 2013).

A customs union (CU) is an FTA in which member states apply a common external customs tariff to goods imported from third countries. This tariff may vary for different products but not for individual member countries.

A common market (CM) is a CU in which, in addition to goods, there is free movement of other factors of production, such as capital and labor. Moreover, to establish a CM, all non-tariff barriers to trade must be eliminated, and certain economic policies must be coordinated. This stage of the integration process is often referred to as the "integration of factors of production."

An economic union (EU) is a further deepening of integration, where monetary and fiscal policies of individual states are harmonized and even unified. Economic policies in various areas are integrated based on the common market, common approaches are formed, and coordinated financing is established. Eliminating discrimination is linked to a certain degree of coordination of national economic policies to eliminate differences between them. This stage is often referred to as "policy integration."

The ultimate stage of an economic union is an economic and monetary union (EMU). It involves the creation of a common exchange rate mechanism that evolves into the issuance of a common currency functioning in the common market. There is a common monetary policy as well as coordination of macroeconomic policies among member states.

Balassa also discusses another stage of the integration process - full economic integration (FEI), which "implies the unification of monetary, fiscal, social, and countercyclical policies and requires the establishment of supranational authority whose decisions are binding on member states" (Balassa, 1961). Here, both the formulation and implementation of economic policies are the exclusive competence of the institutions of the integration community.

According to some authors, there is another stage of the integration process that is highly political. In this stage, the ultimate political goal of integration is political union (PU), where integration extends to areas that more strongly affect national sovereignty. So far, no integration community has achieved completion in this stage of integration, although the EU makes efforts to deepen political integration in order to become an effective political union by introducing common citizenship and attempting to implement common policies in the areas of foreign affairs, security, justice, and internal affairs.

3.3. Distribution of the benefits of integration

In most cases, theories of economic integration and its benefits – both those concerning dynamic effects and especially those concerning the static effects of integration – are not applicable to weak and developing countries. Balassa (Balassa, 1961) also argues that the theoretical literature on economic integration only considers developed countries. Their problems are related to economic development rather than relative changes in production and consumption characteristics. The theory of economic integration attempts to answer two questions: first, what is its effect on welfare; second, what factors influence the desire of states to participate in integration processes.

In this regard, there is a major problem of distributing the benefits of integration, which leads to different motivations for participation in integration processes and significant disparities depending on whether the participating states are homogeneous or heterogeneous in terms of their economy's size, openness, and level of economic development (small/large, open/closed, developed/developing). This, in turn, leads to different approaches, rates of development, and outcomes of integration processes.

4. Towards a new understanding of economic integration?

Based on the analysis of changes in the global economy and the theory of economic integration, we can derive some changes in the "pure practice" of integration processes and their reflection on our perception of integration. Based on this, we also propose some revisions and additions to the theory of integration:

1. Regarding the unilateral assessment of the effects (static and dynamic) of integration processes, especially in terms of the distribution of benefits and the motivation to participate in such processes, we propose transitioning from a two-dimensional to a three-dimensional assessment of integration processes as genesis, motivation, development, and outcomes (Figure 2).

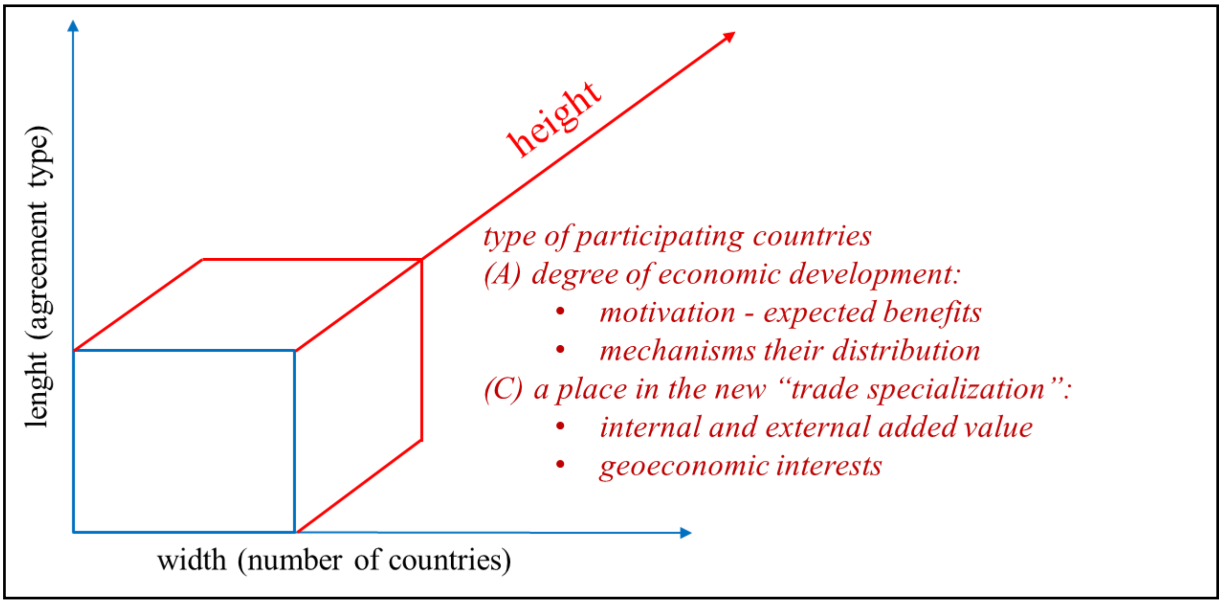

Figure 2. From two to three dimensions in the evaluation of integration processes *(Source: compiled by the author)*

This approach considers, alongside the number of participating states and the form of integration, the type of participating states. This primarily includes their economic size and degree of economic development, allowing us to assess the motivation for participation, expected benefits, and mechanisms for their distribution. Additionally, it considers the participants' position in the new "trade specialization" in terms of internal and external value added of production and trade, as well as the possibility of pursuing and protecting national or regional geo-economic interests.

2. Based on the different forms of economic integration, a more conceptual typology can be derived. By examining the policies and freedoms encompassed by different forms of economic integration, we can distinguish between internal-static integration (involving freedom of movement within the community), external-static integration (related to common external barriers), and dynamic integration (including common economic and other policies) (Figure 3).

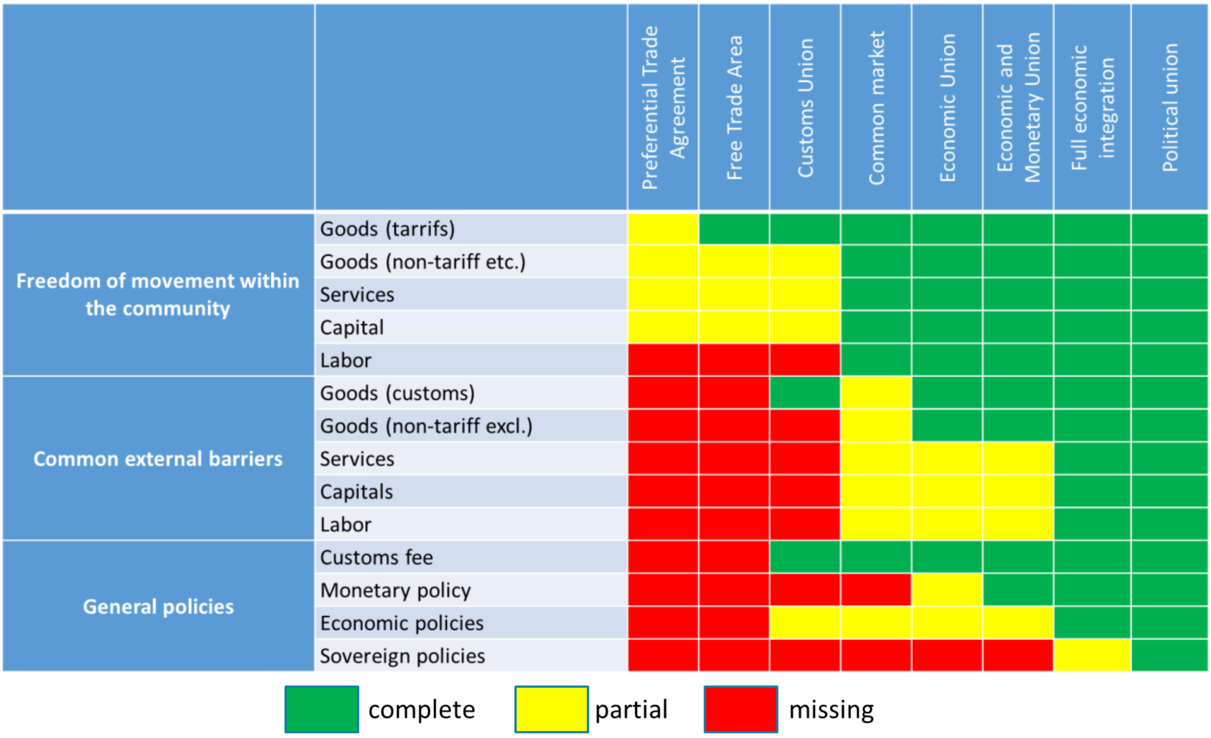

Figure 3. Typology of economic integration agreements *(Source: compiled by the author)*

3. The new understanding of integration and its typology allows us to justify the notion that participation (and engagement) in integration processes is increasingly perceived as a new instrument of active foreign trade policy, especially for small, open, and less-developed economies. Broadly speaking, this involves using participation in integration processes as:

- A means for intra-community import substitution.
- A means to stimulate regional and, consequently, national competitiveness.
- A means to create (preserve) more "internal" value added.

All of this, along with the observed intensification of regional integration processes in recent decades, leads us to conclude that in the contemporary global economy, economic integration is regarded and effectively used as a means of erecting new barriers to free trade - regional protectionism at a global level.

4. Lastly, but not least in importance, the practice of implementing integration building, particularly in the Global South, shows that the staged approach to regional economic integration (e.g., the integration process in Africa) can be considered an alternative path towards continuing global trade liberalization and an opportunity to advance the (stalled) process towards the neoclassical ideal of free trade and multilateral liberalization.

Conclusion

Regional economic integration is one of the main trends in the development of international economic relations in recent decades. There are numerous examples worldwide that demonstrate that this is not an isolated event but a true global phenomenon. Deepening regional integration in various areas is supported by regional initiatives, especially in the field of trade, leading to the creation of geographically and substantively diverse regional agreements and communities. In recent decades, global trade has become increasingly open and less discriminatory, and more countries are joining such binding agreements. Trade agreements themselves are also deepening and expanding, incorporating new policies such as trade in services, foreign investments, intellectual property, and others. The possibilities offered by different forms of economic integration, as well as the ways and methods of harnessing them, are increasing.

An analysis of structural changes in the global economy, including the growth of production and trade flows and their fragmentation, globalization and regionalization of the world economy, the proclaimed desire for trade liberalization and the actual rise of protectionism, geopolitics as the basis of trends in global trade, and geoeconomics as the basis of trends in world politics, through the prism of the theory of economic integration, it becomes clear that economic theory cannot provide us with answers to many important questions or explain what is happening globally. This calls for a reconsideration of the theory of integration, including an assessment of the distribution of benefits from participation in integration processes (based on a three-dimensional examination of these processes), a new understanding of the typology of integration processes and their actual practice, as well as a reassessment of the role of integration as a tool of foreign trade policy.

All of this gives us reason to ask whether the third dimension of integration, in combination with the "new generation" of trade agreements and, more broadly, the proposed new understanding of integration and its relationship to observed structural changes in the global economy, is an attempt to maintain the status quo or to change the system of international economic relations. Only the future will show whether this will lead to a deepening of regional protectionism and a rift between the Global North and the Global South, or whether it will seriously make us consider the need for a new geoeconomic paradigm - both as a new understanding of international political economy from theoretical, practical, and political perspectives, and as a new understanding of the new economic geography, outside the context of neoliberal axioms of "eternal growth" and "inevitable globalization.".

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