

# Market Integration, Regionalism and the Global Economy

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# Contents

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<i>List of figures</i>	page xi
<i>List of tables</i>	xiii
<i>Preface</i>	xv
<i>Acknowledgements</i>	xvii
<i>List of conference participants</i>	xviii
 <b>1 Introduction</b>	 <b>1</b>
<i>Richard Baldwin, Daniel Cohen, André Sapir and Anthony Venables</i>	
 <b>PART ONE: REGIONALISM AND THE GLOBAL ECONOMY</b>	 <b>5</b>
 <b>2 Regionalism vs. multilateralism</b>	 <b>7</b>
<i>L. Alan Winters</i>	
1 Introduction	7
2 Definitions and classifications	8
3 Models of tariff regimes	11
4 What the evidence suggests	34
5 Finale	40
<b>Appendix: and index of multilateralism?</b>	<b>42</b>
<b>Discussion</b>	<b>49</b>
<i>André Sapir</i>	
 <b>3 Preferential agreements and the multilateral trading system</b>	 <b>53</b>
<i>Kyle Bagwell and Robert W. Staiger</i>	
1 Introduction	53
2 Reciprocity	56
3 Reciprocity and non-discrimination	65
4 Preferential agreements	71
5 Enforcement	72

6	Conclusions	76
	<b>Discussion</b>	<b>79</b>
	<i>Raquel Fernández</i>	
<b>4</b>	<b>Politics and trade policy</b>	<b>86</b>
	<i>Elhanan Helpman</i>	
1	Introduction	86
2	Political economy approaches	87
3	Double-edged diplomacy	103
	<b>Discussion</b>	<b>113</b>
	<i>Thierry Verdier</i>	
<b>5</b>	<b>Globalisation and labour, or: if globalisation is a bowl of cherries, why are there so many glum faces around the table?</b>	<b>117</b>
	<i>Dani Rodrik</i>	
1	Introduction	117
2	Trade and wages	120
3	The consequences of increased international mobility by firms for the rent-sharing bargain	124
4	Trade and labour standards	128
5	Quantifying labour standards and their consequences	132
6	Trade, external risk and the role of government	141
7	Conclusions	146
	<b>Discussion</b>	<b>150</b>
	<i>Alasdair Smith</i>	
<b>6</b>	<b>Openness and wage inequality in developing countries: the Latin American challenge to East Asian conventional wisdom</b>	<b>153</b>
	<i>Adrian Wood</i>	
1	Heckscher–Ohlin theory	153
2	Overview of empirical evidence	158
3	Differences between East Asia and Latin America	167
4	Differences between 1960s–1970s and 1980s–1990s	169
5	Summary and conclusions	175
	<b>Discussion</b>	<b>181</b>
	<i>Riccardo Faini</i>	
1	Greater international mobility of capital	182
2	Discriminatory trade liberalisation	183
3	Perverse trade-policy effects	183

**PART TWO: MARKET INTEGRATION AND REGIONALISM 185**

<b>7</b>	<b>Operationalising the theory of optimum currency areas</b>	<b>187</b>
	<i>Tamim Bayoumi and Barry Eichengreen</i>	
1	Introduction	187
2	A review of theory and empirics	188
3	New evidence: German unification and economic integration	198
4	Conclusion	208
	<b>Discussion</b>	<b>216</b>
	<i>Jean Pisani-Ferry</i>	
1	Introduction	216
2	Some shortcomings in the operationalisation of OCA theory	217
3	Dynamic interactions between economic integration and monetary integration: are they already perverse?	222
<b>8</b>	<b>European migrants: an endangered species?</b>	<b>228</b>
	<i>Riccardo Faini</i>	
1	Introduction	228
2	The fall in intra-European mobility	230
3	Migration and migration intentions in Italy and Spain	235
4	Job-search and job-mobility attitudes	243
5	Economic integration and labour mobility	245
6	Conclusions	247
	<b>Discussion</b>	<b>251</b>
	<i>Richard Baldwin</i>	
<b>9</b>	<b>Geography and specialisation: industrial belts on a circular plain</b>	<b>254</b>
	<i>Anthony J. Venables</i>	
1	Introduction	254
2	Overview of the model	256
3	Centre vs. periphery	259
4	Industries differing in trade costs	260
5	Industrial linkages	262
6	Alternative input–output structures	265
7	Implications and conclusions	267
	<b>Appendix: the model</b>	<b>269</b>
	<b>Discussion</b>	<b>273</b>
	<i>Alasdair Smith</i>	
<b>10</b>	<b>Convergence ... an overview</b>	<b>275</b>
	<i>Giuseppe Bertola</i>	
1	Introduction	275

x **Contents**

2	What the data say	276
3	Endogenous vs. exogenous growth theories	278
4	Relaxing neoclassical assumptions	281
5	Economic integration and income distribution	283
6	Conclusions	291
	<b>Discussion</b>	<b>295</b>
	<i>Daniel Cohen</i>	
<b>11</b>	<b>Convergence as distribution dynamics (with or without growth)</b>	<b>298</b>
	<i>Danny T. Quah</i>	
1	Introduction	298
2	Theoretical models	300
3	Empirics	313
4	Conclusions	323
	<b>Discussion</b>	<b>328</b>
	<i>Lucrezia Reichlin</i>	
1	Can we study convergence without addressing the distribution question?	328
2	The proposed empirical framework	329
3	What can we potentially learn?	330
4	Convergence	331
5	Inference	332
6	An alternative framework	333
	<i>Index</i>	337

# Figures

---

2A.1	Iso-multilateralism loci	page 43
3.1	Best-response conditions for good $x$	59
3.2	Nash and efficient iso-net tariff lines	65
D3.1	Trade policies and equilibrium	80
5.1	Incidence in the open economy	122
5.2	Volatility in the open economy	131
5.3	Partial correlation between openness and share of workforce in government employment	145
6.1	Effects of openness on relative wages: two traded goods	155
6.2	Effect of openness on relative wages: many traded goods	157
6.3	Entry of low-income Asia: two traded goods	171
6.4	Entry of low-income Asia: many traded goods	171
6.5	Price of developing-country manufactured exports relative to developed-country exports of machinery, transport equipment and services, 1975–95	172
6.6	Effects of openness and technology transfer	174
D7.1	Correlation of shocks and exchange rate flexibility	220
D7.2	Real exchange rate volatility, 1970–90 and correlation of supply shocks	221
D7.3	Finger index of export structure similarity ( <i>vis-à-vis</i> Germany), 1967–93	224
D7.4	Grubel–Lloyd indicator for intra-EC12 trade, all industries, 1980–94	225
8.1	Migration rates from Southern Europe, 1961–88	230
8.2	Income differentials, 1970–90	231
8.3	Real wage differentials, 1968–95	232
8.4	Unemployment differentials, 1969–92	232
8.5	The role of wage and amenities in the migration choice	234
8.6	Migration from Southern Italy, 1970–90	236
9.1	Centre and periphery	296

## xii **Figures**

9.2	Differing trade costs	261
9.3	Industrial linkages	264
9.4	Upstream–downstream	266
10.1	‘Classical’ approach to convergence	280
11.1	Deterministic neoclassical convergence	303
11.2	Divergence towards non-degenerate steady-state invariant distribution	309
11.3	Stratification, polarisation and convergence clubs	312
11.4	Densities of normalised cross-country productivities: emerging twin peaks	315
11.5	Densities of normalised cross-country productivities: trade conditioning	319
11.6	Densities of normalised cross-country productivities: spatial conditioning	320
11.7	Stochastic kernel, normalised cross-country productivities: trade conditioning	321
11.8	Stochastic kernel, normalised cross-country productivities: spatial conditioning	321



# Tables

---

2.1	The universalist argument: costs and benefits for a single country if the measure passes	<i>page</i> 33
5.1	Increasing instability in labour market outcomes, 1970–87	123
5.2	Correlation matrix	135
5.3	Labour standards and labour costs, 1985–8	136
5.4	Labour standards and comparative advantage	138
5.5	Labour standards and comparative advantage, excluding high- income countries	139
5.6	Labour standards and foreign investment, 1982–9	140
5.7	Openness and size of government, 1985–92	144
6.1	Skill intensity of trade in manufactures, 1966–73	159
6.2	Skill intensity of manufactured exports	160
6.3	Effects of increased openness in five Latin American countries, 1974–95	165
7.1	Correlation matrices of aggregate supply shocks, 1963–93	200
7.2	Correlation matrices of aggregate demand shocks, 1963–93	203
7.3	Coherence of aggregate supply disturbances, 1963–94	205
7.4	Trends in regional specialisation of production for the European Union and the United States, 1972–87	207
D7.1	Average standard deviation of GDP growth rates, 1964–94	223
8.1	Demographic evolution in Southern Europe, 1960–90	233
8.2	Unemployment rates in Italian regions, 1963–94	237
8.3	Mobility attitudes and job search	240
8.4	Econometric determinants of mobility attitudes	242
8.5	Mobility attitudes and job search	244
D11.1	Ergodic distributions	330

# 1 Introduction

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RICHARD BALDWIN, DANIEL COHEN,  
ANDRE SAPIR AND ANTHONY VENABLES

The chapters in this volume are drawn from the final conference of the CEPR's programme of research on 'Market Integration, Regionalism and the Global Economy' (MIRAGE). The objective of this research was to use new techniques of economic analysis to study changes in the global economy in relationship to the process of regional integration, and to draw out the policy implications of such changes. Chapters in this volume are organised in two parts. Part One (chapters 2–6) covers three international trade policy issues: regionalism and multilateralism; the political economy of trade policy; and trade income inequality. Part Two (chapters 7–11) focuses on three 'domestic' problems faced by regional groups: labour migration; exchange rate arrangements; and real convergence.

Chapter 2, by Winters, surveys the burgeoning literature on regionalism vs. multilateralism. Are regional integration schemes good or bad for the multilateral trading system? In the seven years since Krugman's seminal paper (1991) on the subject, the literature has progressed from analysing external tariff setting by symmetric trading blocs, through to looking at the process of bloc formation, the political economy of policy-making and the role of internal institutional arrangements within blocs in determining outcomes. Krugman's original result – that three blocs is the pessimum number from the point of view of world welfare – has been shown to be fragile, but what view of regionalism has taken its place? Winters' answer is that 'we don't know yet'. Political economy analysis suggests that regionalism may be more attractive to producer lobbies than is multilateralism – because they get the benefits from trade diversion. However, effective analysis of these issues requires that more attention be devoted to analysis of institutional arrangements for decision-taking within trading blocs.

Bagwell and Staiger in chapter 3 also look at the relationship between regional integration agreements and multilateral trading. They investigate

the incentives that governments have for pursuing reciprocal agreements rather than unilateral liberalisations, and whether the World Trade Organisation (WTO) serves countries' interests by allowing such agreements to violate the MFN principle.

One of the most important developments in recent policy analysis has been the increased attention now paid to the political process through which policy is formed. Helpman in chapter 4 provides an elegant survey and synthesis of different approaches in this new political economy literature. Authors have taken many different pathways: these include the direct-democracy approach, in which individuals vote directly over policy; the political support function approach, in which government seeks to maximize support from different interest groups; and models of lobbying, in which lobbies' expenditures determine policy outcomes, influence electoral competition, or shape the platforms on which parties stand. Helpman's chapter provides a unifying framework within which the common elements of these approaches, and the key differences which drive their results, are drawn out.

Chapters 5 and 6 are devoted to the interaction between trade and labour markets. Rodrik in chapter 5 reviews arguments as to why labour in developed countries often regards globalisation with hostility. He argues that the main impact of globalisation on the labour market may come not through a downward shift in the labour demand schedule, but through an increase in its elasticity, as it becomes easier for firms to substitute foreign for domestic labour. He then turns to the role of government, arguing that the growth of trade enhances the role of government as a provider of insurance against external risk. This argument is supported by evidence showing that more open economies tend to have relatively larger governments than do less open countries. Globalisation creates a dilemma for this aspect of government activity, however. If globalisation curtails the role of government, this is another reason why labour – in particular immobile, unskilled labour – may feel threatened.

Wood in chapter 6 examines the impact of openness on wage inequality within developing countries, and challenges the conventional wisdom – based largely on East Asian experience in the 1960s and 1970s – that openness narrows the wage gap between skilled and unskilled workers. The experience of Latin America since the mid-1980s indicates that openness has increased wage differentials. Wood argues that the main reason for this lies not in differences between East Asia and Latin America, but instead in the later time period he studies. In particular, the entry of China into the world market, perhaps coupled with the technology bias of new techniques of production, means that a widening

of skilled–unskilled wage gaps is also to be expected in other developing countries.

Whereas chapters 2–6 analyse regional integration in the global context, chapters 7–11 examine issues arising within regional groupings, especially core–periphery differences. Bayoumi and Eichengreen in chapter 7 turn from the design of trade policy and trade institutions to the exchange rate system, and look at empirical work assessing the extent to which the European Union meets the requirements of an optimum currency area. The standard approach is to look at the cross-country correlation of supply and demand disturbances, and research suggests that the European Union divides into a core region (countries with shocks highly correlated with Germany's) and a peripheral region. Bayoumi and Eichengreen extend the data period to include German reunification and find that the core–periphery distinction is still useful, although German disturbances are uncorrelated with other countries in the core from the early 1990s onwards.

As countries experience idiosyncratic shocks, so labour mobility may be an important adjustment mechanism for countries and regions – particularly if they form a monetary union. Faini in chapter 8 analyses migration flows in Europe. Massive pre-war overseas migrations were replaced in the post-war period by large-scale migrations within Europe, but these migration flows have now dropped to a fraction of their previous level. Faini reviews explanations for the decline in European labour mobility, and goes on to analyse the Spanish and Italian experience in greater detail. He argues that improved welfare systems together with family support networks reduce the 'push' factors behind migration, and that these combine with significant obstacles to intra-European labour mobility. He concludes that the prospects for resumption of a high level of labour mobility within Europe are not particularly bright.

Venables in chapter 9 turns from the labour market to investigation of the effects of economic integration on core–periphery differences in industrial structure and income levels. He argues that regions' industrial structures may be determined by their geographical location, and that economic integration may bring significant changes in the pattern of specialisation. Industries that were formerly located in central regions may relocate to the periphery, and regions may become more specialised. Some empirical work in the chapter suggests that a process of increasing regional specialisation is underway in Europe.

The final two chapters in the volume deal with regional and national convergence. Bertola in chapter 10 reviews both the empirical and the theoretical arguments addressing the question: does economic growth

lead to convergence of *per capita* incomes across countries and/or regions? He concludes that the empirical evidence gives a (qualified) negative answer to this question. Theoretical work outlines many mechanisms through which growth will change inequality at all levels – from individual though regional to national. After reviewing this work, Bertola argues that more theoretical work on the relationship between openness and convergence is needed.

Quah in chapter 11 provides an overview of recent research that addresses the question: what determines the dynamics of cross-economy income distributions? He argues that economists should be studying the dynamics of the entire cross-section income distribution, and that standard analyses based on the ‘representative economy’ and the associated convergence regression analysis are quite inappropriate. Analysis of the full distribution dynamics reveals changes in the shapes of the distribution – for example, the ‘twin-peaks’ phenomenon of clustering in the income distribution – and indicates the probabilities that countries can change their relative positions.

In conclusion, this volume offers important analytical and policy insights in changes in the global economy occurring through the process of regional integration. The principal message is that in a world characterised by trade distortions and non-linearities regional integration may or may not foster global integration, and may or may not advance regional or global convergence. The key is good economic policy based on sound economic analysis.

## REFERENCE

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