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"The process of regionalization and free trade areas"

Gilles Van Hamme, IGEAT-ULB, Yann Richard, Université Paris 1 Panthéon-Sorbonne

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The process of regionalization and free trade areas

Introduction

Globalization has been described as the major feature of the contemporary world, at least for the two last decades. If the debate still exists about the newness of processes at stake, it makes no doubt from an empirical point of view that the economic globalization has been accelerating: trade and FDI have increased to reach unprecedented levels; economic actors such as transnational companies or financial investors define more and more their strategy at the global scale; the interdependence between the different parts of the world seem to be higher than ever as illustrated by the recent economic crisis (2007-?).

Many authors insist also on the existence of intermediate levels of organization between the local/national and the global scale, be it from an economic or political point of view. The European Union appears of course as the most advanced in the process of regionalization, notably because the economic integration has been accompanied by a (timid) political process of integration. Yet, many other areas, some of which taking EU as a model, have engaged in a process of regional integration. Here we use the term regionalization to describe the process of economic integration while regionalism is used to characterize the political process that favour the regional integration.

In this context, there has been an intense theoretical debate about whether the regionalization process has accompanied or has been antinomic to globalization. In the latter hypothesis, the regionalization process increases internal integration but slows down the global integration notably through protectionism. In the first hypothesis, on the contrary, it is argued that the regionalization favours global trade.

In this working paper, we will describe the regionalization process across the world, assess its intensity but, most of all, try to assess whether regionalization has been intensifying or slowing down the global economic integration. In this working paper, we will first develop the theoretical conceptions about the regionalization/globalization issue before describing the regionalization process and its relationship to globalization through data of trade in a long term perspective.

1. Theoretical conceptions

In the ideological context of the nineties, the European integration has been perceived by many economic authors as a potential threat (Krugman, 1991; Frankel *et al*., 1995). The basic fear was that internal economic integration would be accompanied economic protectionism, acting as a restraint to economic multilateralism, that is a world free trade area considered as the best way to economic progress (Richard, Zanin, 2008).

However, as soon as the end of the nineties those fears seem to decline and conceptions about free trade area have completely changed. Indeed, several authors demonstrated that internally integrated regions did not lead to economically protected areas (Anselin & O’Loughlin, 1996; Poon, 1997). On the contrary, internal and external trade were both developing at very high rates. Hence, theoretical conceptions about regionalization have progressively changed, while the objective was still the same: increasing liberalization and trade. For some authors, regionalization has thus been considered as a second rank optimum while for others as a necessary transition to a complete liberalization at the global scale (Richard & Zanin, 2009; Bhagwati, 1992; Mashayeki, 2005; Newfarmer *and alii*, 2005). This latter view has certainly been adopted by the World Bank in their famous 2009 World Development report on "Spatial disparities and Development Policy". If the final aim is economic integration to the world, notably for third world countries, regional integration is now perceived as good way to achieve this objective. This is because regional integration might reinforce economic development by benefiting of higher agglomeration economies but also because, for political reasons, liberalization is better accepted in such a context. Briefly said, regionalization is now perceived as a positive process because it favours trade and globalization, and favouring trade is supposed to boost economic development (Van Hamme *et al*., 2010).

But what can be said about the regional economic integration from the regionalization and regionalism perspective? Where does it occur and at what level of intensity? What can be said about regionalization vs. globalization process? What is the position of European Union compared to other regions in this process? These are the questions we will now answer through empirical analyses.

2. Regionalization processes and trade

Nowadays, regional agreements and free trade areas cover most parts of the world (Figure 1). Only Northern Africa, some countries of the Middle East, as well as big economic powers such as China, Japan and South Korea do not belong to any of these multilateral regional agreements despite the latter appear as very open economies, especially China. However, these formal agreements mean very different things in reality: from a formal point of view, the economic integration is more or less achieved (limitations to some products, freedom of investments etc.). For example, CIS is not formally a free trade agreement even if some form of economic integration exists among republics of former USSR. The same is true for many agreements in Subsaharan Africa which only lead to a weak economic integration. On this perspective, only the SACU since 1910, between the Republic of South Africa, Botswana, Lesotho and Swaziland and Namibia, as well as the EAC sine 2001 can be considered as free trade agreements.

In consequence, the effective economic integration between countries taking part of these agreements can be very different, some formal agreements leading to a very weak integration (Figure 1). In general, the most developed areas appear to be the most economically integrated (Vandermotten *et al*., 2010). Typically, least developed countries are oriented toward the developed core countries and have relatively few exchanges among them, notably because they produce primary products manufactured in developed countries or because they are competing for selling the same products. In contrast, developed countries are integrated leading to economic specialization within big integrated areas. As shown by Krugman, in contrast with the classical Ricardian theoretical vision of international trade, trade is more intense among developed countries because agglomeration economies lead to more specialization in manufacturing products European Union is by far the most integrated area, with two third of its trade which takes place within the block, more than 40% of internal trade in comparison to GDP. Yet, the most specific feature of European Union is that economic integration is accompanied by a political integration, something which cannot be found in any of the other free trade areas. NAFTA (1994) also appears as a highly integrated area, with about 45% of intra-block trade. ASEAN groups together south east Asian countries: while the share of internal trade remains below 30%, the ratio between intra-trade and GDP is relatively high around 33%, meaning that the integration is the most advanced among peripheral countries. CIS is to a certain extent the continuation of ex-USSR, and appears as such as still relatively integrated, with most of the countries still oriented toward Russia. However, this integration is rapidly weakening. MERCOSUR (1991) includes Brazil, Paraguay, Uruguay, Argentina and more recently, Venezuela (2006) but is much less integrated than the others free trade areas mentioned, with intra-block trade accounting for 15% of the total trade. The other free trade areas are more marginal in the global trade and moreover very weakly integrated. In such contexts, trade agreements look more as formal agreements than as a driver to economic integration.

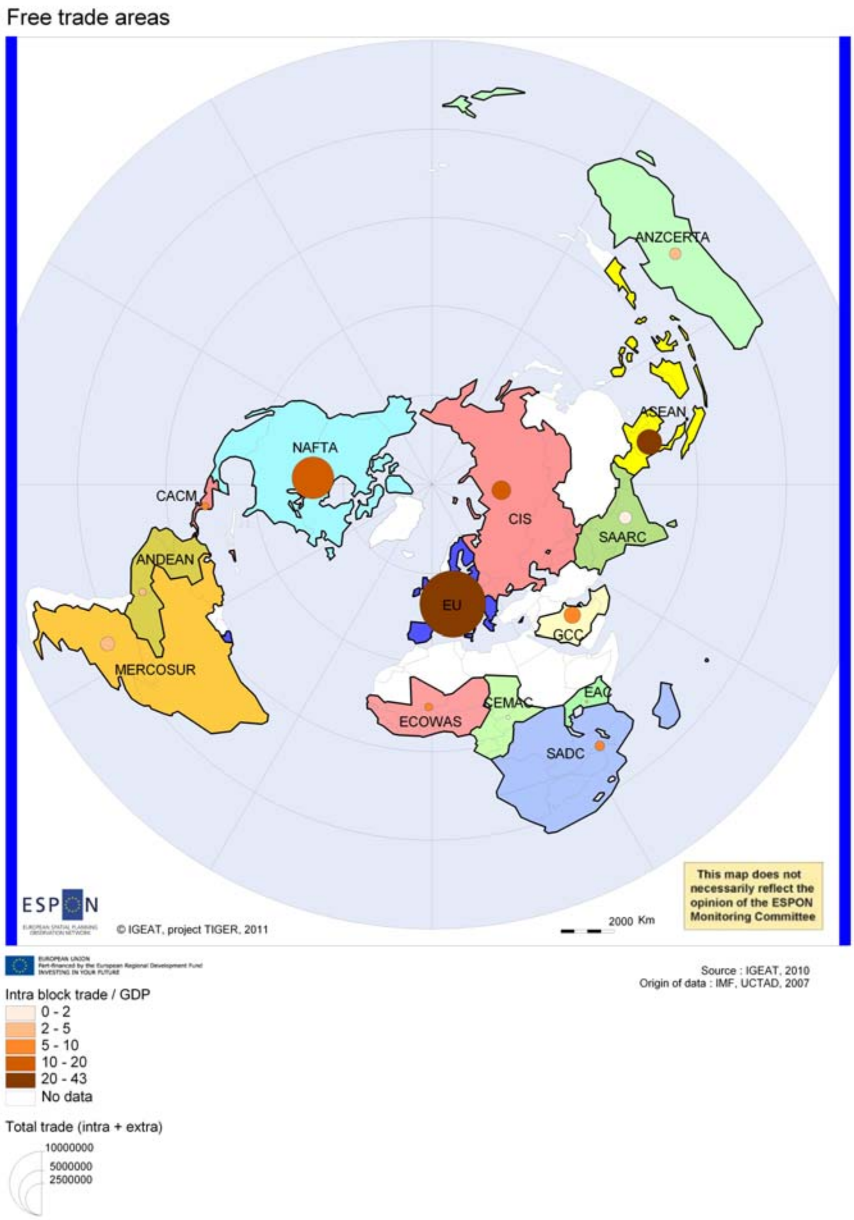

Figure 1. Regional Free trade areas and their level of integration, in 2007

Note: This figure does not include all regional agreements. More importantly, trade integration is very different from one area to another

At the world level, the intra-free trade area trade has increased between 1968 and 1996, and slightly declined afterwards (**Figure 2**). Most of this evolution is due to the European trend, but the same general trend is observed in other free trade areas: the NAFTA area has increased the share of internal trade between 1986 and 1996, in the period when the agreement came into force (1 January 1994); ASEAN and MERCOSUR also became more integrated while with different timing. However, during the 1996-2007 period, extra-block trade has increased more than intra-block trade, resulting in a moderate decline share of internal trade, as observed for EU, NAFTA or MERCOSUR. In contrast with major free trade areas, more marginal trade areas have low and even declining shares of internal trade: this is for example the case of CEMAC, CACM or SAARC.

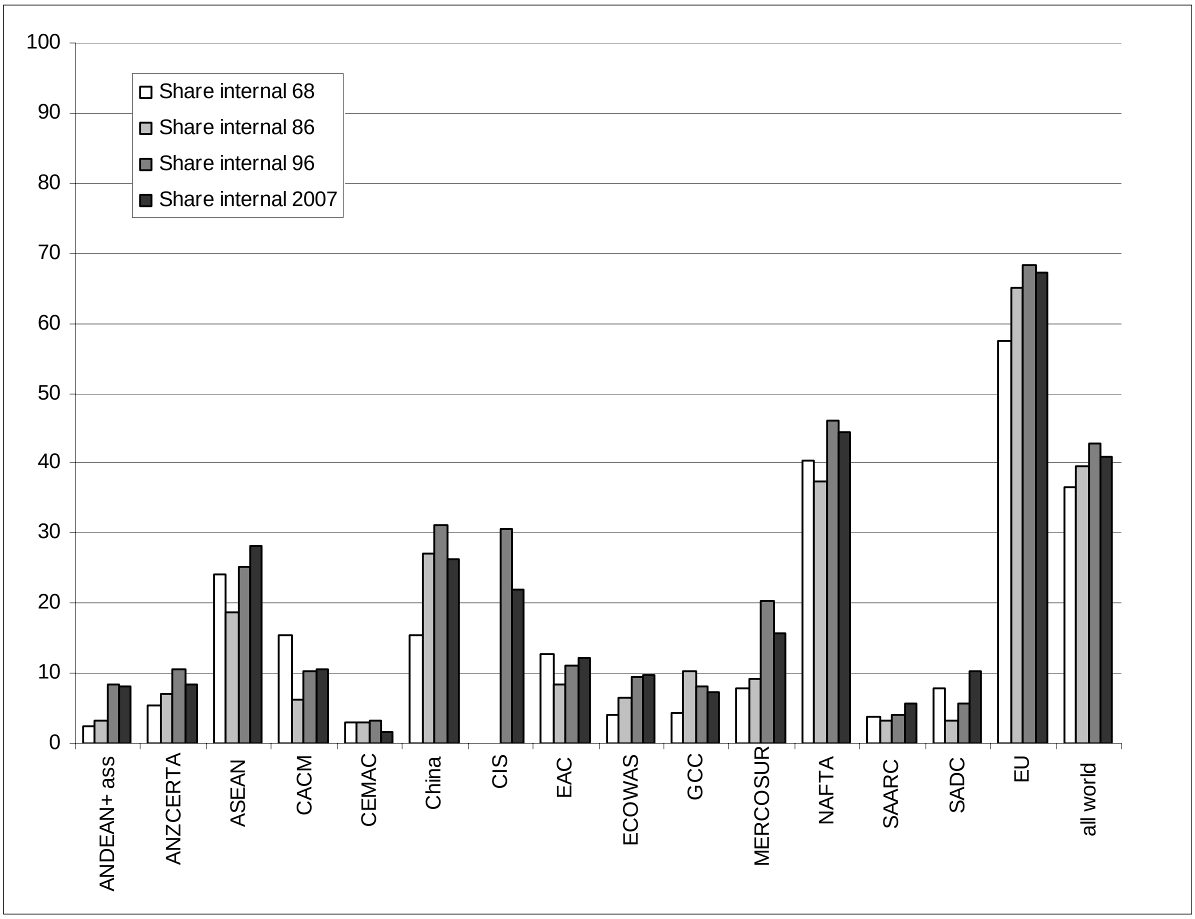

Figure 2. The share of internal trade in the total exchanges of free trade areas, 1968-2007
Source: International Monetary Fund (IMF), personal calculations
Note: China includes Hong-Kong and Macao

However, Figure 3 clearly highlights that regional integration to an increasing share of internal trade has been accompanied by a growing openness to trade, defined as the ratio between external trade (imports + exports) and total regional GDP. At the world level, this opening process has been constant on the whole period, while accelerating in the last decade. While increasing their rate of openness, the biggest free trade areas, namely EU and NAFTA, remain remarkably closed, while weaker free trade areas – because they are smaller and/or less integrated – appear to be much more extroverted: this is the case of CACM or CEMAC. Hence, we cannot argue that for peripheral countries, we find a process of strong integration despite the apparent ideological will to do it. We rather find weakly integrated areas strongly open to the rest of the world. For ASEAN or China, this has certainly been a successful way to develop but nothing proves that other areas are following the same way.

In this process, the European Union distinguishes thus by very high level of integration, with two thirds of internal trade and a relatively closed economy, while much more open than NAFTA for similar total economic size. As a result, the EU is the only area where the rate of internal openness is higher than the one of external openness. It makes also no doubt that the trend is one of growing economic openness to the world.

In conclusion, we may say that regional integration has been a rather slow process if measured by the share of internal trade. But this is because both internal and external trades have been rapid developing until the sixties, with an accelerated rate in the last decade. Hence, globalization trend has resulted in increasing shares of trade on GDP for both internal and external trade.

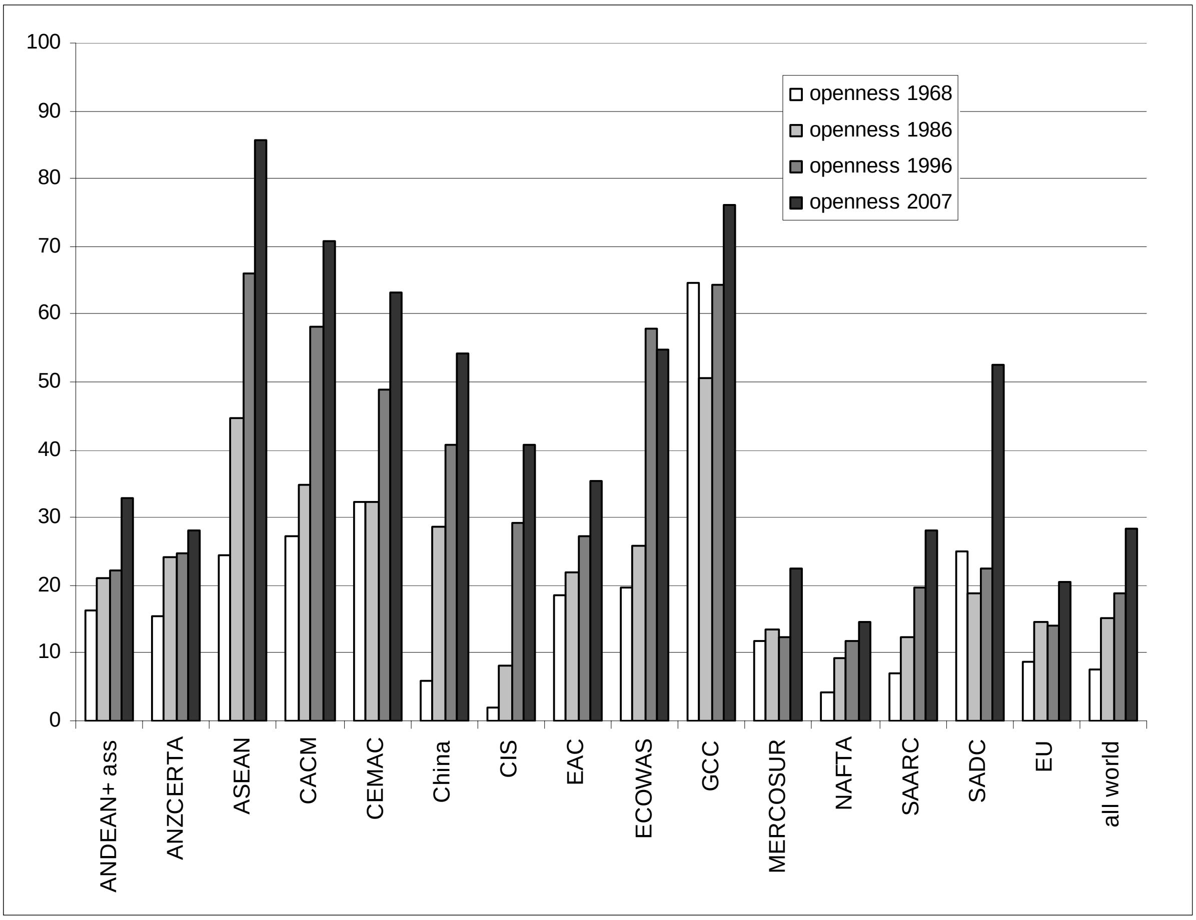

Figure 3. Openness rate (a) to trade in Free trade areas, 1968-2007
Source: Personal calculations on IMF and UNCTAD data.
(a) For each free trade area, the following indicators have been calculated:
Extra-block (Exports + Imports)/ GDP

3. Free trade areas and "natural" economic regions

The concept of natural economic regions can be defined as a range of countries which have intense trade and economic relations among them. In this section, we raise the important question of the relation between "natural economic regions" and free trade areas.

Figure 4 shows the group of countries with intense relative relations in 2007 (see working paper 7b for methodological explanations). It also shows the more important free trade areas across the globe.

Basically, we can identify three major natural trade regions: the Americas, Europe, Eastern Asia. These three regions account for 95% percent of total trade in 2007, with respectively 21, 48 and 28% (Table 1). It is important here to underline that the European region is grouped with former USSR only in the last steps of the process, meaning that both regions have a strong internal cohesion but are nearly separate entities. Apart from these regions, the Middle East and Africa appears as a complex patchwork of small natural economic region (Southern Africa and Gulf countries) and external influence. These different regions also have different levels of internal integration, measured as the share of internal trade: the share of internal trade is 78% for the European group, 60% for Asia, 53% for Americas, but only 12% for Southern Africa and 13% for Gulf countries. This largely reflects the size of the groups but also, their economic extraversion, with more peripheral countries showing low level of internal economic integration. Finally, Table 1 also illustrates that though Europe has severely lost its influence in Africa and the Middle East, it is still the main trade partner, in equal terms with the Asian group.

Finally, when comparing institutional free trade areas with the so defined "natural economic regions", we observe that all free trade areas are included in the same natural economic region, while the reverse is of course not true. Of course, the number of entities explains this for a part, but it also underlines the cohesion of certain trade areas.

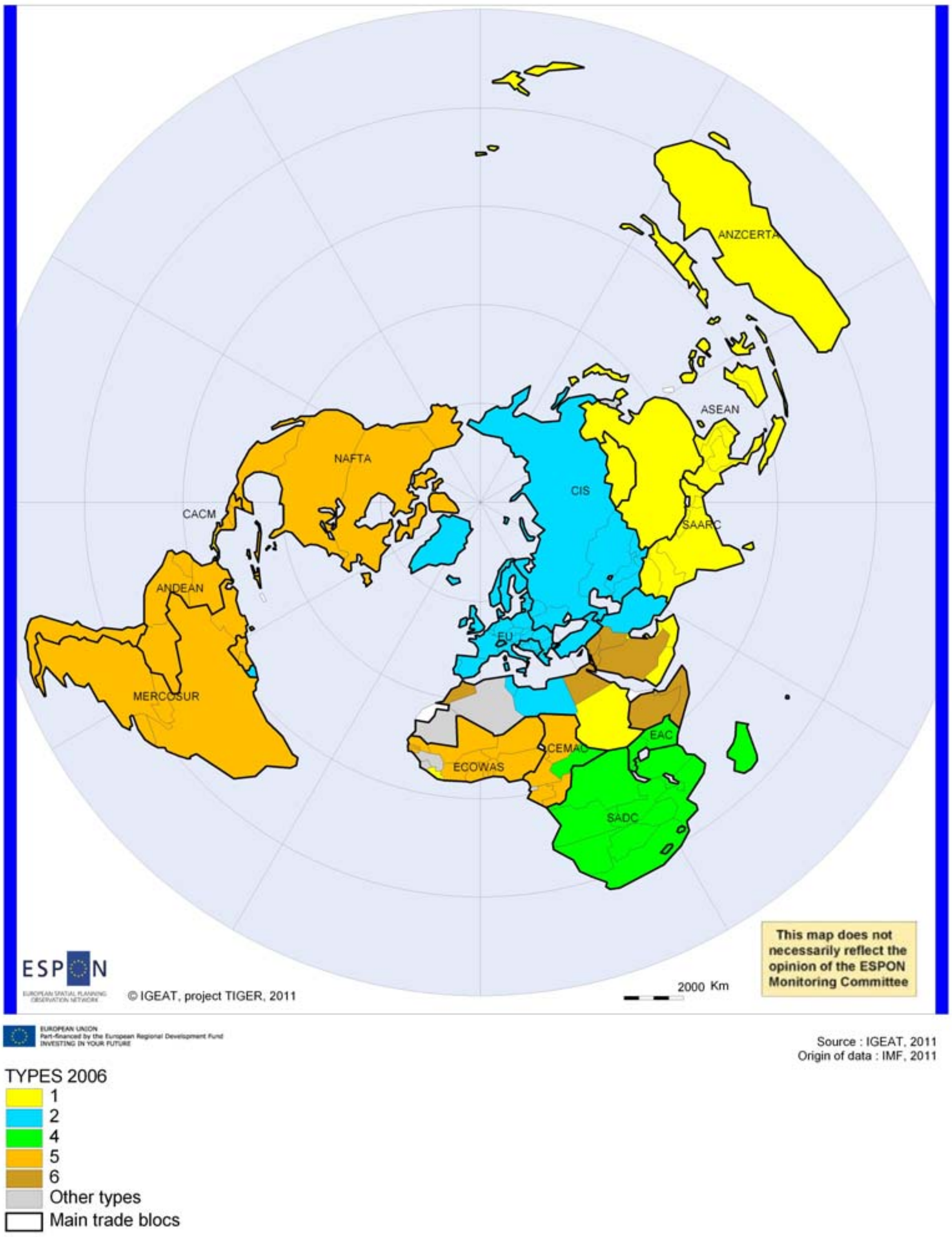

Figure 4. The space of privileged trade relations in 2007 and free trade areas

	Asia (1)	Europe (2)	Southern Africa (3)	Americas (5)	Middle East (6)	Other	Total
Asia (1)	16,8	5,3	0,3	4,9	0,7	0,1	27,9
Europe (2)	5,3	37,3	0,3	4,2	0,6	0,2	48,0
Southern Africa (4)	0,3	0,3	0,1	0,2	0,0	0,0	1,0
Americas (5)	4,9	4,2	0,2	11,0	0,3	0,1	20,8
Middle East (6)	0,7	0,6	0,0	0,3	0,3	0,0	2,0
Other	0,1	0,2	0,0	0,1	0,0	0,0	0,4
Total	27,9	48,0	1,0	20,8	2,0	0,4	100,0

Table 1. Trade flows between major groups of countries, as a share of total trade in 2007.
(1) = type

Conclusion

From a political point of view, the process of regionalization appears to be very advanced across the world, with few countries – but not the least – not making part of any regional trade agreement. However, this regional integration process does not lead to significant integration except in core countries and some emerging areas: EU, NAFTA, MERCOSUR and ASEAN. In the same time, CIS appears as a declining historical heritage. Elsewhere in the world, the economic integration remains very weak, as illustrated in Figure 1.

This process of regional integration has developed in parallel with global economic integration, in contrast with fears of protected regional areas. Indeed, both intra-block and extra-block trade have increased at high rates. More precisely, between 1968 and 1997, the growth of internal trade – that is regional integration – has been more rapid than between block trade while in the 1997-2007 period, the contrary has been true, the share of internal trade having reached a ceiling in NAFTA and EU.

Finally, we find that nearly all free trade areas are included in the same natural economic regions, defined as the groups of countries with privileged trade relations. It means that most free trade areas are cohesive in terms of trade though this can mean very different things in core developed countries, whose most trade is internal, or in developing countries, where most trade is still directed to developed countries.

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