

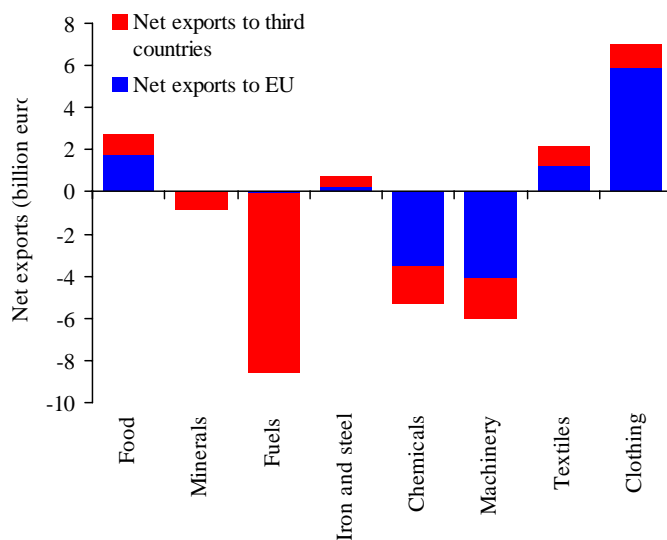
## Chapter 13 Economic Integration

### Question 13.4

Trade integration between the EU and Turkey has a long history. Already in 1963 the Treaty of Ankara envisaged Turkey becoming a full member of the EU. Even though Turkey's application for full membership of the EU in 1987 was rejected, trade liberalisation between the EU and Turkey continued. As a result, on January 1<sup>st</sup> 1996 the EU and Turkey established a Customs Union for *industrial products*.

Figure 1 below shows Turkish net exports for different industries. Most trade consists of industrial products (“iron and steel” to “clothing”), that are included in the Customs Union Decision. For food, minerals and fuels no trade agreement exists (thus they are not affected by the Customs Union).

Figure: Net exports of Turkish industries



Source: S. Togan, H. Nebioglu & S. Dogan (2003)

The following information is given on the three sectors that do not fall under the Customs Union Decision:

*Agriculture* (food sector) is an important part of the Turkish economy. In 2001 it contributed 14 percent to GDP and employed 36 percent of the Turkish labour force. The Turkish agricultural sector is more heavily regulated than its EU counterpart (can you imagine?): more financial support for farmers and higher import-barriers.

Turkey is a net importer of *minerals*. Currently, it imports these minerals from other economies than the EU. In principle however, these imports could also be from the European Union. Assume that Turkey currently applies the same import tariffs on minerals from the EU as from third countries.

Given the limited oil- and gas-resources within the European Union, Turkey has to import *fuels* (gas and oil) from third countries (currently mainly Russia, Libya and Algeria). Assume that at present import restrictions on fuels are stricter in Turkey compared to the EU.

- 13.4A Do you think Turkish welfare increases when the fuel sector becomes part of the customs union?
- 13.4B What about when the mineral sector joins the customs union?
- 13.4C Some European politicians oppose full membership of Turkey because it would form a threat to the Common Agricultural Policy of the European Union. Too much of the funds would be diverted to Turkey. Do you think, based on the information above, that Turkish farmers are in favour of full membership?
- 13.4D Do you think Turkish welfare will increase when the agricultural sector joins the customs union?

### **Question 13.5**

Theoretically it is not clear whether the trade creation or trade diversion effect will dominate when forming regional trade bloc. Economic integration is therefore a fruitful topic for research. Economists analyze every individual trade agreement for its merits and demerits. Below we have listed a number of studies that estimate the trade diversion and trade creation effects for different regional trade agreements. These papers are freely downloadable from the internet. Choose one of the

papers, locate it on the internet and summarize its findings. Does the author of the paper favour the regional trade agreement or not? Of course you can also search the internet yourself for another analysis of maybe another regional trade agreement.

- *European Union*: F. Breuss, “Austria, Finland and Sweden after 10 years in the EU: Expected and achieved integration effects”, Europainstitut Working Paper No. 65, March 2005.
- F. Wilhelmsson, “Trade creation, diversion and displacement of the EU enlargement process”, mimeo Lund University, June 2006.
- *Sub-saharan Africa, Asia and Latin America*: S. Coulibaly, “On the assessment of trade creation and trade diversion effects of developing RTAs”, mimeo University of Lausanne, December 2004.
- R. Clarete, C. Edmonds and J. Wallack, “Asian regionalism and its effects on trade in the 1980s and 1990s”, ADB ERD working paper series No. 30, November 2002.
- *NAFTA*: Congressional Budget Office, “The effects of NAFTA on US-Mexican trade and GDP”, May 2003.

### Question 13.6

The [simulation file of question 13.6](#) offers you the opportunity to experiment with the Krugman regionalism model. In the main text we only dwelled on the effects of different parameter settings on total world welfare. This simulation on top of that also shows the effects on country level. It specifically tells you from which sources a country is earning its income and what this income is worth in welfare terms.

- 13.6A What happens to our specific country when the world moves from ten to nine trading blocs (with the number of countries remaining equally divided among the trading blocs in both regimes)? Explain the changes in total income and welfare of our country.
- 13.6B As the number of trading blocs in the world decreases further, at a certain moment the welfare of our country starts to increase. At which point does this happen and why does

welfare (suddenly) increase after this point?

- 13.6C Increase the tariff to one instead of a half. At which number of trading blocs is the welfare at a minimum level? Why is this minimum level reached at a different number of trading blocs compared to 13.6B?