26/Feb/03

Economic Integration in the Americas: European Perspectives

Anthony J. Venables, LSE and CEPR.

L. Alan Winters, University of Sussex and CEPR.

A.J. Venables
Dept of Economics
London School of Economics
Houghton Street
London WC2A 2AE
UK

a.j.venables@lse.ac.uk
44 (0) 20 7955 7522

L. Alan Winters
School of Social Sciences University of Sussex
Falmer
Brighton BN1 9SN
UK

l.a.winters@sussex.ac.uk
44 (0) 1273 877 272

1. Introduction

Europe's integration project has now been running for half a century, a period spanning the postwar birth of economic cooperation and the more recent enlargements and deepening of the union. The project has been enormously successful in both political and economic terms, although there have been frequent tensions and undoubted failures.

This paper draws out some of the main messages from the European experience of integration. We look at both the political and institutional development of the European Union, and at its economic development. What have been the driving forces behind the integration process? What institutions have developed to manage integration? What has been the impact of integration on trade flows and income levels across European countries?

We then endeavour to draw out the parallels between Europe and the Americas and the lessons from European experience for the FTAA. Evidently, the two continents are very different in both political and economic terms. On the economic side, integration has had a large impact on European trade and incomes, but one might argue that the Americas offer an even greater potential for trade creation and for using integration as a competitive force to drive economic development. Relatedly, however, America may well suffer greater economic divergence as a result of integration than has Europe, its initial differences in size and income levels being so much larger.

On the political level, European experience suggests that achieving the economic gains requires continuing and far reaching policy measures. These, in turn, require a deep political commitment to integration and the existence of institutions to promote integration and protect it from the inevitable inter-member frictions and preoccupations with national goals. In

Europe progress has been driven largely by the Franco-German partnership and by the Brussels institutions. It is hard to see what their equivalents in the Americas might be.

The remainder of the paper comprises five sections. Section 2 explores the political economy of European integration, considering the history of and commitment to integration among its members, the roles of the institutions that it has created and the particular nature of its inter-member relations. In each case it explores the parallels with and lessons for the FTAA, frequently arguing that these are rather weak. Section 3 deals with trade and production, arguing that Europe has seen both trade creation and trade diversion, that integration has generally been a force for increasing competition, and that specialisation in member countries has tended to increase slowly. It discusses the importance of foreign direct investment and of (the relatively weak constraints on) national policies. It concludes that, on the whole, the evolution of the European economies has been in line with comparative advantage and efficiency. With its greater diversity between members, the FTAA may generate greater trade creation, investment flows and competitive pressures than did European integration, but possibly at the expense of greater divergence between members. Reaping such benefits, however, will require ongoing integration, gradually rolling back the various barriers and frictions on interregional trade.

Section 4 contrasts labour markets and migratory flows between Europe and America: despite the former's greater commitment to labour mobility *de jure*, it is the latter that will have the more mobility *de facto*. Section 5 considers the experience of income convergence in Europe and again argues that America cannot be entirely confident that it will achieve similarly benign outcomes. This is especially so if the FTAA does not pursue a deeply integrationist agenda including a degree of redistribution.

2. Political economy

This section reviews the history of European integration and institutions to see what lessons they contain for the FTAA. It will be come plain that the two exercises are fundamentally different and that the casual drawing of parallels could be very misleading.

2.1 The EU as an Institution

A Grand Vision

European integration is an ancient aspiration, although its current manifestation arises from the geo-politics of the mid-twentieth century: the desperate need, following World War II, to find a way of preventing future Franco-German conflict, coupled with a strong sense of internationalism that saw the future in terms of institutionalised co-operation between countries[1]. Perhaps the most important factor in understanding the history of post-war European integration is to see that it was essentially a political-ideological phenomenon. It was not driven by the careful calculation of economic costs and benefits, still less by trade negotiators, but by a grand vision which had fortunate economic side effects.

This fact has had fundamental effects on Europe's evolution, for the grand vision helps to move internal debates beyond mercantilism and the calculation of benefits issue-by-issue. It induces a generalised reciprocity, whereby every party gains in the end, but where every one recognises the value of the system as a whole and is prepared to accept losses on some deals. The day-to-day compromises necessary to achieve co-operative outcomes become easier to make, or, which is basically the same thing, easier to sell at home.

Grand vision is not completely absent from the FTAA, but at least for the major partners, it is not very obvious. Thus, great political will-power will be required to prevent the FTAA process from being held to ransom by powerful interests in powerful countries. Moreover, that will-power should not be created by too exclusive a focus on hemi-spheric issues - that would be bad both for the Americas and the rest of the world.

Political Institutions

The first major step in modern European integration was the European Coal and Steel Community (ECSC), whose origins illustrate the political motivation for integration. Its purpose was to stimulate the recovery of heavy industries in (West) Germany while making it impossible for their output ever to be used to wage war again. The proposal - due to Jean Monnet and Robert Schuman - was that, by establishing a truly common European market in coal, iron and steel, countries would become so interdependent that war would be not only 'unthinkable, but materially impossible'. The customs union was supplemented by a 'High Authority', which had the power to dictate national output quotas, establish maximum and minimum prices, and enforce competition. The High Authority was an administrative body, controlled in policy but not day-to-day matters by a Council of the Community on which the separate governments were represented, and also by a European Parliament. A Court of Justice was established to oversee the legal aspects of the Community.

Following the ECSC, attempts were made to establish both a defence community (the EDC) and a political community (the EPC). Both failed, so the 'integrationists' were thrown back onto economic integration in the form of the European Economic Community (EEC), and the atomic energy community (Euratom), which were created in the Treaties of Rome in 1957. At first, the EEC and Euratom existed separately but parallel to the ECSC, but in 1967 the three bodies were merged, to from the European Communities (EC) with one Commission (successor to the High Authority), one Council, one Parliament and one Court.

---

[1] The same internationalism that produced the UN, IMF, World Bank and the GATT.

These institutions of integration have evolved and expanded, but the basic structures remain as they always were. Thus although the EU now has a common currency and (limited) powers to make common political and foreign policies, it is in essence just a continuation of the old EEC, with institutions designed primarily for deep micro-economic integration. Its governance is shared between a Commission, a Council, a Parliament and a Court.

The *Commission* comprises 20 commissioners appointed by member states for four-year terms, two from each of the larger members and one from the others. It initiates Union policy and executes it, but it cannot actually make policy — that falls to the *Council.* The Commission is explicitly supranational, and is charged with preserving and promoting the European ideal.

The *Council* formally comprises the foreign ministers of all member states, although much business is conducted by ministers concerned with specific issues (e.g., agriculture ministers discuss the Common Agricultural Policy (CAP).[2] The Council shares executive power with the Commission. It may adopt the latter's policy proposals, in which case they become law, but it may not generally amend them. Decisions are theoretically taken by qualified majority vote, requiring 62 out of 87 votes, where votes are allocated to member states according to size. Until the 1990s, however, all countries informally had a right of veto on issues of alleged fundamental national interest (under the "Luxembourg Compromise"). As a result decisions had to be reached by trading compromises (often on unrelated issues) to obtain a unanimously acceptable package. Recently strong efforts have been made to re-establish majority voting in most spheres (but not, for example, fiscal policy and various 'pet areas'

[2] The meeting of heads of government is known as the European Council. It has regular bi-annual meetings.

such as audio-visual policy) and there is hope that this will reduce the horse-trading. Nonetheless, the tradition of consensus remains strong within the EU.

As a direct consequence of its relatively consensual nature, policy making in the EU is patchy, inconsistent and ragged. Compromise and pragmatism have been the watch-words, rather than efficiency and elegance, with particular members being granted derogations from some measures and the enforcement of others relying heavily on turning a blind eye. One might regret this, but it is notable that despite a number of shocks, European integration has avoided serious set-backs for half a century.

The FTAA's ambitions are less than those of the EU, but nonetheless they will strike at some pretty fundamental beliefs and values in some member countries. Without the institutional depth or the political motivations of the EU there is a serious danger of stalemates arising. The issue will be particularly pressing in the USA, which has least to gain from the FTAA and probably the most confrontational attitude towards trade negotiation.

The *Court of Justice* interprets Union law. Its findings are binding even on member governments. The judges are appointed by member states, but they are required to be quite independent of national interests and cannot be removed by member governments. The dispute settlement procedure for the FTAA is not settled yet, but, following traditions in American regional blocs to date, it will presumably be intergovernmental and without direct effect in national law (i.e. it requires domestic legislation to become effective).

The *European Parliament* has a small but growing role in the Union. It must be consulted by the Commission and the Council before they decide many issues, and it has some power over the Union budget. Its greatest power is to dismiss the Commission *en masse,* although this is such an unwieldy weapon that it is of little practical use. The FTAA proposes no popular legislature at all.

These institutions form a constitutional structure just as complex and delicately balanced as the US Constitution, but without, of course, its democratic legitimacy. Like the latter, they have to balance "states' rights" against the centre and rely on powerful legal bodies for enforcement. Arguably such balances are necessary to create the confidence that allows member governments to proceed with deeper aspects of integration that impinge directly on issues of sovereignty and internal distributions of income.

Although it is fashionable, and to some measure warranted, to decry Brussels' bureaucracy and interventionism, one should not lose sight either of its origins or of its role in the integration process. The institutions stem from a period when there was much greater faith in governments than now, when governments were much more heavily involved in economic management than now, and when the essential task was political. Arguably, the subsequent difficulties were not due to the original structures *per se*, but their inability to evolve as circumstances changed. Such flexibility is another lesson for today's would-be integrators.

Inflexibility is similarly the problem with agriculture. The CAP stems from a period when agriculture provided a substantial part of employment in all six original members, and was strongly protected. The error should be seen less in the original policies, which were thought to make sense at the time, but in the danger of giving particular sectors special constitutional standing (agriculture is singled out in the Treaty of Rome) and/or their own bureaucracies. Each makes reform very difficult when circumstances change. As the FTAA is put together, it is important to avoid institutionalising the special cases that are bound to arise. Recognise them as explicit failures and exceptions so that they can be addressed later.

Redistribution

The original 'Six' EEC members were fairly homogenous in terms of income levels, but later enlargements began to introduce a wider spread, especially the 'Southern Enlargement' to Greece (1981), Spain and Portugal (1986). Their accession raised serious issues of intra-EEC distribution, not only in helping the new poorer members to catch up, but also within existing members. The so-called 'Structural Funds' for poorer regions were greatly strengthened with the Southern enlargement as a way of assuaging fears, especially in Britain, that poorer non-agricultural regions would suffer. In fact, distribution is a major factor in much EU decision making, and the existence of institutions to address it helps to prevent it from becoming a barrier to progress and an impediment to efficiency enhancing decisions. The transfer mechanism - small as it is compared with those in federal and unitary states - has been essential to the running of the EU since the southern accession.

Guardians of the Vision

European integration has always been a rather 'on and off' affair with periods of enthusiasm and rapid advance followed by periods of doubt and retrenchment. The former are, understandably, associated with economic booms and the latter with recessions. Thus the early 1980s found the EU very much down in the dumps. After the severe anti-inflationary policies at the beginning of the decade, the US and Japanese economies began to recover, but those of the EU seemed firmly stuck in the mire. Moreover, the rapid increase in intra-EU trade that had characterised the early stages of integration seemed to have halted or even gone into reverse. The cry was frequently heard that 'the steam had gone out of integration' and doubts were expressed about the viability of the EU as an institution, let alone any further progress.

During such 'depressions', the Commission's role as the guardian and champion of the European ideal has been vital to the goal of integration. While member governments, and thus the Council of Ministers, are focusing on their local problems, the Commission is constitutionally required to take a broader, longer, and more European view. In the mid-1980s its response to the lethargy of the European economy was dramatic and imaginative. It had long been recognised that the actual integration of the EU economies fell short of the aspirations of the Treaty of Rome. Recalling the stimulus that the initial creation of the EEC had induced, and following the prevailing intellectual trend towards economic liberalism, the Commission proposed a bold step towards complete economic integration with the launch in 1986 of the Single Market Initiative.

Similarly, the Commission was the driving force behind the Maastricht Treaty of 1992, which formally created the EU and extended the competences of the Union to foreign affairs and justice. This was far from popular, being rejected by a referendum in Denmark and very nearly so in France. It illustrates a further cycle in the dynamics between the Commission and the states: flushed with one success (in this case the Single Market), the Commission attempts to follow it by further deep integration and centralization, only to find it rejected by governments and electorates. These rejections, however, do not threaten the basic fabric of the common market: tribute to its deep foundation in European perceptions, and to its pragmatic and non-confrontational mode of progress.

2.2 Intra-bloc Relations

As noted already, the EU and the FTAA have different objectives for the degree and style of their integration. Behind this lie fundamental differences in their structures and intra-bloc relationships, which further complicate the drawing of parallels between the two groups.

The balance of power

The preceding section showed the importance to EU development of political will, and following from that, institutional depth. A key driver of both has been, and continues to be, the Franco-German relationship.

It is at this fundamental level that the FTAA looks most different from the EU. Not only is the post-war political imperative absent, but so too is the balance of power that obtains within the EU. Table 1 gives income shares of countries in the Americas and in the EU. The motive force in Europe has been the need for two roughly equal-sized powers to co-operate and create something new that is different from either of them. The third power, the UK, is large enough to be taken seriously but not to derail the whole enterprise. As table 1 shows, France, Germany and the UK accounted for 19.7%, 26.6% and 14.1% of EEC output in 1973. The American predicament, on the other hand, is that, while without the USA the FTAA is nothing, the USA has only relatively mild incentives to co-operate. Thus with 78.8% of total American output in 2000, the USA clearly has a veto over the current conception of the FTAA – and probably over any other, for it is difficult to see it blessing (or even tolerating) a regional market of which it is not part. Overall, the different size distributions of members in the FTAA and the EEC make it difficult to perceive strong parallels in the two groups' political dynamics.

Alternative Visions

A recurrent theme of European integration has been the UK's reluctance to commit to the integrationist goal combined with its efforts to give market economics a central role in the European edifice. Indeed, more or less throughout the post-war period Britain has sought open markets but no, or very limited, political integration.

The USA's attitude towards the FTAA is similarly market-based, anti-bureaucratic, and Anglo-Saxon pragmatic, but its position is utterly different. The issue in the FTAA is not one of accommodating a significant player's doubts, but of trying to bring the critical player far enough on board to make the game worthwhile. One might see stronger parallels between the UK and Mexico (4.8% of output) and Brazil (4.7%), But even here the circumstances are different. Mexico may wish the FTAA would go away – in order to keep her preferred status with the USA – but would not wish to exacerbate the latter's dilution by remaining outside if the FTAA goes ahead. (Just as applied with Canada and NAFTA). Brazil also has clear reservations about the FTAA, including that it would constrain interventionary policies too much. She would almost certainly be prepared to stay outside if she could build her own minor trading arrangement with some neighbours. This would look a little like the EEC/EFTA divide of the 1960s, and like in that decade, may well see the dominant economy in the minor grouping experiencing irresistible pressure to defect.

Numbers

Numberically, and in terms of size distribution, the creation of the FTAA (35 countries) parallels the enlargement of the EU from a "core" of 15 members to 27. However, the events they seek to bring about are different. The USA is not inviting 34 new states to join its existing structure, but to create an intergovernmental body separate from itself. The EU, on the other hand, is absorbing members and therefore changing its nature. Enlargement is more concerned with transfers than is the FTAA and is less reversible. (It is virtually impossible to leave the EU, let alone be ejected from it. The FTAA can contemplate exit and entry purely because it is not so 'deep').

3. Trade and production

Since the FTAA is primarily a trade agreement, as opposed to an attempt at deeper political integration, we now turn to the economics of integration. The EU is far from being a perfect parallel, being more compact geographically, more homogenous in income levels, more intent on deeper integration and of an earlier era than the FTAA, but it provides our best view of the long-run effects of regionalism on trade patterns. The European trade regimes of the late 1950s were about as restrictive as are current regimes in Latin America, thus the internal trade liberalisation foreseen in the FTAA is probably about the same size as that of the EEC's original members, with many countries having initial tariffs of around 15% (see table 2).

As well as experiencing internal integration, the EU also adopted a common external trade policy and liberalised its external trade significantly and we have yet to see if FTAA members do similarly.[3] Nonetheless, EU experience probably provides an upper bound on the prospects for trade re-orientation following the FTAA. For example, its greater compactness and homogeneity will have allowed greater growth in intra-industry trade than the FTAA will see; it has certainly been more hostile to internal barriers to trade than the FTAA will be - for example, it eliminated contingent protection internally and made little use of Rules of Origin.

European integration had a dramatic effect on the geographical patterns of members trade. Every member has seen a strong re-orientation of its trade towards other members following accession or the formation of the EEC. Moreover this is as true of manufacturing (and probably services) as of the grotesquely distorted agricultural trade. Figure 1 plots the shares of three EU members' imports coming from the original EC-6. As an original member, Germany experienced increasing integration with the remaining five from 1957, with duty-

[3] Tariffs converged to an EEC average Common External Tariff (CET) of 10.4% in 1968 and

free and quota-free access from 1968. The UK acceded on January 1st 1973 and Spain on January 1st 1986. The pattern is very clear: starting slightly before the formal date of the integration, the trade share starts to rise. It rises for 10-12 years and then stabilises. For Spain the growth is still continuing at the end of the period. Freund and McLaren (1999) have explored the dynamics of regionalism more formally using both trade shares and trade intensity indices[4]. For the latter - the more appropriate measure analytically - they find some evidence of anticipation effects - starting on average 2½ years before formal integration - followed by 9½ years of higher growth before achieving a new steady-state[5]. On average EU countries increased their intra-bloc trade intensity by 53 percentage points over this process.

Much of the growth in trade in Europe has been intra- rather than inter-industry trade. Table 3 reports levels of intra-industry trade for various EU member countries' intra-EU trade. They are high and growing, and far in excess of anything observed among American countries.

The economic effects of these changes in trade flows can be divided into two main sorts. First, trade permits industrial specialisation, although the real income effects of this depend on whether or not countries are specialising according to their comparative advantage – the trade creation – trade diversion issue. Second, within industries, trade promotes competition and enables more efficient firms to expand and benefit from economies of scale. We look at the European experience under each of these headings.

3.1 Industrial specialization, trade creation and trade diversion

The benefits of changing inter-industry trade flows arise as each country's production

6.6% following the Kennedy Round.

[4] The trade intensity index for i's trade with j is $(T_{ij}/T_{iw})/[(T_{wj}-T_{ij})/T_{ww}]$, where T represents trade in both directions and where subscript w represents the world.

structure reorganises to exploit comparative advantage and possible benefits from spatial clustering of sectors.

Sectoral specialization

There is evidence that EU integration has been associated with a rather modest increase in manufacturing specialisation. Measures of the difference between the industrial structures of EU countries have been computed (at the level of 36 industrial sectors, Midelfart-Knarvik et al 1999). All EU countries except the Netherlands have, since the late 1970s, seen their industrial structure becoming more dissimilar from that of other EU countries. Figure 2 reports these measures averaged over groups of countries according to the date of their accession to the EU. The different heights of the curves essentially reflect different country sizes (large countries tend to have similar industrial structures, so EC1 is relatively low because of the predominance of Germany, France and Italy). More interesting, are the different patterns of change. For the initial entrants there is a more or less steady increase throughout the period, indicating industrial structures becoming more dissimilar. The 1973 and 1980s entrants (EC2 and EC3) exhibit an increase from the early 1980s. The last wave (EC4) shows increasing specialisation from around 1992 onwards.

Econometric analysis of these changing patterns of specialization indicates that it is largely in line with intra-union comparative advantage. For example, skilled labor intensive activities have tended to relocate towards skilled labor abundant countries, and R&D intensive activities have relocated towards scientist abundant countries (Midelfart-Knarvik and Overman 2002). However, reallocations in line with intra-union comparative advantage are not necessarily welfare increasing, as they could be accompanied by trade diversion.

[5] Anticipation effects have been noted previously - e.g. in Winters (1983) for the UK.

Analysis at the level of countries and 36 industrial sectors likely understates the degree of specialisation that is occurring. At the level of quite narrow sectors there is evidence of increasing clustering of activity, and specialisation is increasing at the sub-national as well as the national level. However, despite this, EU countries and regions remain very much less specialised than comparable size geographical units in the US. So far at least, integration has not caused specialization and clustering of activity to go as far as the US experience suggests would be expected in a single country.

Trade creation and trade diversion

Increased intra-bloc trade is frequently taken as indicating successful economic integration, especially in popular debate, but, of course, it shows no such thing. The traditional economic question hinges around whether the share increases as a result of trade creation or trade diversion. There is no doubt that European integration has been accompanied by a good deal of trade creation, both internally as well as so-called external trade creation, in which imports from outside the bloc displace members' domestic production and/or expand consumption. Thus, Truman's (1975) decomposition of apparent consumption of manufactures into shares due to imports from partners, imports from non-partners and domestic supplies, shows both sources of imports growing strongly at the expense of the domestic share. Truman finds that out of 53 country-sector combinations observed over 1960-68, 31 display such 'double trade creation' while a further 13 display internal creation and external diversion. Over 1975-82 Jacquemin and Sapir (1989) find roughly similar proportions of 'double trade creation' and less evidence of trade diversion, while Sapir (1992) finds 'double creation' for aggregate EC-9 trade over 1980-91.

The predominant pattern of 'double trade creation' does not imply absence of trade diversion, as external trade should be compared with what it would have been in the absence of integration. There is an unavoidable need to specify the *anti-monde* when estimating integration effects. The simple before and after comparisons implicit above and in figure 1 implicitly assume that in the absence of integration the shares would not have changed. That is manifestly flawed when different parts of the world economy have been growing at such different rates, and general levels of protection have been falling. Two approaches exist to modelling the *anti-monde* more explicitly. First, one can model trade flows in terms of prices and incomes and explicitly allow for the different tariffs faced by different suppliers. This requires considerable information and some effort to model the determinants of trade flows through time in a theoretically coherent fashion. Winters (1983) takes this approach to UK manufacturing trade following its accession to the EEC in 1973. He finds relatively little trade diversion, but certainly some evidence of it.

The second approach is to use a gravity model, which essentially uses trade between other (unrelated) countries to identify the *anti-monde* for partners' trade. Gravity models typically (and correctly) refer to total trade rather than just manufactures. Hence for Europe, they would be expected to display greater diversion, and this is, indeed, evident from the more careful gravity-model studies extant.

The gravity model explains trade between two countries in terms of their incomes, populations, location and geographical characteristics, plus at least two sets of dummy variables to capture the effects of each regional arrangement: one on intra-bloc trade and one on trade between partners and non-partners. The coefficients on such dummy variables reflect a huge variety of effects and can be highly significantly different from zero at any point in time. Hence to measure integration effects one needs to observe not their levels but their changes over periods when regional integration has occurred.

Within Europe, Bayoumi and Eichengreen (1997) find strong signs of EEC-EFTA trade falling below expected values as the EEC was formed, and some evidence of the acceding countries' trade with non-members similarly falling below par as they joined.[6] Sapir (1998) similarly finds EU-EFTA trade penalised by EEC formation and enlargement. Soloaga and Winters (2001) use a much wider range of countries than just Europe to define their *anti-monde*, but at the expense of considering only the period 1980-96. They use three dummies to capture trade effects, breaking the extra-bloc trade effect into an export and an import effect. Figure 3 reports Soloaga and Winters' results for the EU. In 1980 the EU shows unusually strong trade with non-partners and lower than expected trade within the bloc. (This is a common result in gravity models based on large samples of countries.) As integration deepens and Iberia enters the Union, however, these effects decline absolutely - that is, intra-trade grows relative to expected and extra-trade falls. Moreover, Soloaga and Winters show that these changes are statistically significant, suggesting the presence of trade diversion.

The 1980s and 1990s are an interesting period for observing the effects of EU integration, for deepening and enlargement were not accompanied by major external liberalisations - only the Tokyo Round. Thus these results are perhaps a good indicator of the effects of the FTAA if members do not adjust their current levels of trade barriers against the outside world. Under these circumstances, trade diversion *is* a significant threat.

Specialization, trade creation and trade diversion in the Americas

Does the European experience hold any messages for the possible effects of integration in the Americas? The European experience indicates that trade diversion can and does occur.

[6] Just as with the apparent consumption exercise, these exercises are coloured by the reduction in the accedants' tariffs on other countries as they adopted the common external tariff. In this case, however, the external trade changes may reasonably be attributed to integration.

There are however reasons for thinking that this might be less in the Americas than in the EU. In a North-North regional integration scheme all member countries' comparative advantages are 'on the same side' of the world average. These are precisely the circumstances in which trade diversion is likely, as trade is diverted in line with intra-union comparative advantage rather than world comparative advantage. For example, labor intensive imports may be diverted from low income non-member countries to middle income members. Integration in the Americas includes countries with a wider range of comparative advantage, so countries' intra-FTAA comparative advantage are more likely to coincide with their full world comparative advantage. There is then less likelihood of trade diversion occurring (Venables 2003).

Gains from specialisation according to comparative advantage are increasingly achieved through the development of production networks and trade in parts and components, as well as through trade in final products. However, such trade crosses borders multiple times, and is vulnerable to disruption and small trade frictions. Simply eliminating tariffs may be necessary, but is probably not sufficient for the promotion of such trade, suggesting the need for deep integration. Furthermore, comparative advantage is determined by factor prices and factor productivity. Technology transfer – for example by multinational firms – is necessary if factor endowment based comparative advantage is to be fully exploited.

3.2 Competition, scale, and market integration

Gains from trade liberalization derive not just from specialization and clustering of activity, but also from within industry reorganization. Small, national, segmented markets are liable to be dominated by a few national producers, possibly operating at sub-national scale and exploiting considerable monopoly power. Market integration should remove this segmentation, allowing firms to compete more effectively in other national markets and permitting expansion of relatively efficient firms. It permits firms to be larger *and* markets to be more competitive. EU experience has indicated that, in some sectors at least, achieving these gains can be quite difficult. Even when tariffs have been eliminated, markets appear to remain segmented, with substantial price differentials between countries, and borders still having a strongly negative effect on trade flows. These observations were amongst the motivations for the Single Market Initiative, launched in 1986.

The Single Market Initiative (SMI) was launched in 1986 for completion in 1992, with the objective of eliminating market segmentation and 'completing the internal market'. The economic policy measures introduced fall into four main categories. The simplification or removal of frontier formalities, facilitating and speeding the flow of goods across borders. The simplification of product standards, in particular the adoption of the 'mutual recognition principle', whereby goods approved for sale in any member state are deemed acceptable in all. The deregulation of transport sectors, allowing for improved efficiency in the internal distribution of goods. And the opening up of public procurement to supply from all member states.

Although individually small, these measures were estimated collectively to reduce the costs of trade across borders by an amount equal to several percent of the value of goods traded. More importantly, their indirect effects were predicted to lead to gains equivalent to several percent of EU GDP, as markets became more competitive *and* firms reorganised, increasing their scale to that of the larger integrated market. Evidence on actual gains is patchy. The SMP was accompanied by a burst of merger activity, and there is some evidence of further trade creation (Pelkmans 2001). Griffith (2001) in a study of UK manufacturing finds a significant increase in both labour productivity and total factor productivity in establishments in sectors that were particularly affected the SMI. Increased scales of operation have been attributed to the SMI, particularly in sectors where liberalization of public procurement was important, although the size of firms in the EU remains generally smaller than their US counterparts.

What messages come from this experience for FTAA? First, the potential gains from scale and competition effects will depend heavily on country characteristics. The industrial sectors of many developing and middle-income countries are characterised by low levels of competition, so the pro-competitive effects of trade might be particularly large. However, countries at different stages of development have relatively low levels of intra-industry trade. In sectors where there is no comparative advantage and local firms are weak, the response to opening is likely to be loss of firms, rather than reorganisation into larger and more efficient firms able to export to Northern markets.

Second, to realise the gains, the European experience points to the importance of 'deep integration'. The pro-competitive and scale economy gains of market integration can be impeded by frontier frictions that individually appear quite minor, but collectively allow firms to retain dominant positions in their home markets. The list of such frictions is long. A free trade area, as opposed to a customs union is bound to retain border formalities as well as rules of origin. Contingent protection has been widely used both by the US and within Mercosur, and its 'trade chilling' effects are well known. Meeting national product standards is costly, and harmonisation of standards almost impossible. Europe took the mutual recognition route, but this involves a level of acceptance of foreign standards and a willingness to delegate product approval to foreign institutions that is inconceivable in the FTAA.

Finally, intra-industry trade can occur for quite distinct reasons. Implicit in the discussion so far is the idea that this trade is primarily horizontal, i.e. cross hauling goods at the same stage of production. However, some intra-industry trade is vertical - trading inputs or parts and components within a sector.[7] It is possible to envisage strong growth in this sort of trade (for example, along the lines suggested by Ethier (1998) in his celebration of regionalism), as has already occurred between the US and Mexico. But in this context too, small border frictions present significant trade barriers. Timely delivery is extremely important, and parts and components may cross borders many times, embodied in different stages of production. Deep integration is important in promoting this trade too.

3.3 Foreign direct investment

Accompanying the rapid growth of trade in the EU there has been expansion of foreign direct investment (FDI). World FDI stocks have grown faster than both income and trade in recent decades, and the EU-15 holds around one-third of the stock of inwards FDI. This share surged to over 40% at the time of the Single Market Initiative driven by a cross-border merger wave. The importance of FDI for EU economies is illustrated by the fact that 47% of Irish manufacturing employment is in foreign owned firms, and even for large countries the numbers are substantial (France 26%, UK 16%, OECD 1999).

Much of the growth of FDI within the EU has been intra-EU investments, which accounts for a majority of the total. Investments from outside the region have also been important as economic integration has allowed outside firms to supply the entire European market from a single plant. Indeed, for many suppliers FDI is a much more important means of reaching the European market than is foreign trade. For manufacturing as a whole, sales of goods by US

[7] Fontagne, Freudenberg and Peridy (1997) show that there is a strong degree of vertical IIT within Europe, although the definition they use - an absolute difference of over 15% in the unit value - is pretty generous towards finding vertical IIT.

subsidiaries in the EU were, in 1998, 3.75 times larger than EU manufacturing imports from the US. There is also considerable evidence that some of the inwards Japanese investments of the 1980s was driven largely by EU tariff and non-tariff barriers.

These investments are perceived to have important positive effects. Productivity is generally higher in firms that are multinational than in firms that supply only the domestic market (Martin, R. and C. Criscuolo 2001). Particular importance attaches to FDI in services, as this may be the only means through which foreign competition can enter the domestic market. Consequently both the entrenched interests of incumbent firms and the potential economic gains from liberalisation are large. Opening up of service sectors to competition was one of the objectives of the Single Market Programme, imposing on member states the obligation to abolish restrictions on the free movement of services and extend mutual recognition to professional qualifications. However, progress remains slow, with differing legal standards and regulatory regimes still impeding cross border investments and competition.

What lessons does the EU experience hold for the Americas? It is useful to distinguish between horizontal and vertical investments. The former are made mainly in order to serve the local market, and involve making investments that duplicate investments in the home country, as when an assembly plant is built in each market. The latter are made to minimise production costs, and involve moving stages of the production process to lowest cost locations, such as the relocation of unskilled labour intensive stages of production to low wage economies. Theory predicts that horizontal inwards investments will tend to be greater the larger the market, and the higher are trade barriers to reaching the market. Vertical investments are driven by factor price differentials and by low trade barriers, as output from the project is exported for further processing in other locations.

Although it is not always possible to empirically identify one type of investment from the other, the evidence suggests that inwards investment in the EU is overwhelmingly horizontal rather than vertical. Almost all sales of US affiliates in the EU are to the EU market, and only 4% re-exported to the US. This contrasts with re-export rates of 40% for Mexico, (see Shatz and Venables 2001).

There is scope for expansion of both types of investment within the Americas. Easier intra-regional trade means that market-serving investments can serve a wider area, so raising their profitability. This may attract inwards investment from outside the region as well as within the region. The far greater range of wages across the FTAA region create the scope for much more extensive vertical FDI.

The EU experience also suggests that inwards investments are extremely prone to cluster in a few selected locations – eg Ireland. This may be partly due to underlying characteristics of the location (such as the English language), but also becomes self-reinforcing, both because of demonstration effects, and because of the development of pools of suitably skilled labour and inter-firm linkages.

3.4 National policy incentives

Economic integration changes the policy environment within which national governments operate. Activity may become more 'footloose' within an integrating region, changing governments' incentives to use alternative policy instruments. The effects of this can cut in different directions for different policies.

Once free market access is assured, it becomes much more difficult and expensive for governments to pursue a number of distortionary policies because they can be undermined by international trade. Thus, for example, if imports can move into the domestic market, a government finds it much harder to justify shackling its own firms by excessive regulation.

This is perhaps encouraging for the FTAA, which is, after all, mainly concerned with market access. However, implicit in it is the tendency for greater market access to increase pressures for other harmonisation. If they cannot be addressed one may find progress on market access slowing or even reversing. Think, for example, of the calls to link market access to labour standards. An FTAA with no institutional foundation will face serious challenges in addressing these problems. The simplest solution is the hegemonic one whereby the dominant power decides and the others follow, as, for example, in SACU (South Africa) or Closer Economic Relations agreement between Australia and New Zealand. This seems more or less impossible for the FTAA for political reasons and because of the very wide range of incomes.

While increased mobility of firms can reduce the incentives to use burdensome regulation, it can also increase incentives to use distortionary subsidy policies, and this has been an issue in the EU. National interventions can take many different forms. At one extreme are direct state aids to industry, which amounted to some 4% of EU manufacturing value added in 1986-88, a figure that had declined to below 3% by the late 1990s. The bulk of this goes to R&D support and to meet regional policy objectives. Of the part that goes to specific industries, aid is highly concentrated on a few sectors, particularly shipbuilding and steel. Other national policies include general infrastructure and training schemes and use of corporate taxation; low corporate taxes in Ireland have been viewed as highly effective in attracting mobile FDI projects to Ireland from other potential locations in the EU.

Aware of the possible distortions to competition that would arise if countries were free to subsidise industry, articles 92 and 93 of the Treaty of Rome explicitly prohibit such subsidies.

These articles are policed by active monitoring and intervention. For example, between 1998 and 2000 more than 1500 cases were reviewed by the Commission and in 7% of these cases negative decisions were reached requiring recovery of aid (European Commission, 2001). As for corporate taxation, Ireland has had several instances of conflict with the EU. Negotiations with the Commission led to termination of a complete corporate tax holiday on profits related to export sales and to an increase of the basic rate of corporate income tax from 10% to 12.5%. The weakness of these policies lies in the number of loopholes. For example, state aids are allowed in order to reduce regional disparities, and can take the form of regional incentives to enterprises in selected (but large) regions. Total expenditures to an enterprise are capped, and aids to new investments are preferred to ongoing subsidies.

While policy in these areas is still developing, the broad conclusion of the research literature is that these policies have done little to distort the location of industry. Midelfart-Knarvik and Overman (2002) show that specialisation is taking place according to comparative advantage, despite the use of state aids. Braunerhjelm et al (2000) conclude that competition for activity generally takes the form of measures that count as good economic management, rather than wasteful tax or subsidy competition. Perhaps this is an area in which the FTAA need not regret its lack of institutional depth. On the other hand, if subsidies are the precursor to stiff countervailing duties or if they swamp the dispute settlement procedures with intractable cases, they could undermine the FTAA's market access momentum. The real need is the need for internal disciplines on subsidies among FTAA members. It seems very unlikely that the FTAA could impose discipline where governments seriously wished otherwise.

4. Labour Markets

One of the starkest differences between Europe and the FTAA is that the former legally has almost unlimited labour mobility between members, whereas the latter intends to do nothing to enhance mobility at all. In fact the difference is probably much less extreme, for Europe has seen rather little intra-bloc mobility while the members of the FTAA have seen, de facto, quite a lot.

Table 4 shows the number of foreign workers in the EC-6 in the early years as internal mobility was gradually introduced; it suggests that flows were indeed quite significant. However, fewer than half the migrants were from other EC members. The table also shows the peak in 1973: after that date, at least until very recently, immigration to Europe became much more difficult for workers from outside the member states. But at around the same time, internal migration also appeared to decline in the EU, the stock of migrants from other EC-states falling from 3.2% of the workforce in 1973 to 1.9% in 1985 (Molle 1994).

Braunerhjelm et al (2000) also document the decline in European migration over the period since 1960, even from the traditional poorer sending countries. Thus, for Greece, emigration rates per thousand of population peaked at about 10 in 1964 and 1970 but have been below 5 since 1973. Those for Portugal reached 20 in 1970 but have never exceeded 5 since 1975, while for Spain the peak was about 4 in 1970, and they have been less than one since 1975. Moreover, even internal migration within the EU members states has been low by world standards, and falling.

Braunerhjelm et al attribute Europeans' low propensities to migrate to distortions in labour and housing markets; inappropriate industrial and regional policies, high levels of unemployment in Europe since 1973 and 'home bias' in location decisions. In other words, despite large continuing differences in real wages around Europe, migration is far from inevitable. Moreover, the entirely permissive legal regime for internal migration has done virtually nothing to boost migration flows. Despite the oft-expressed fears that new poorer members will swamp Northern European labour markets, nothing of the kind has happened.

The contrast with the new world is striking. Here migratory flows are large and buoyant especially if one includes illegal migration. Much is from outside the FTAA area (especially from Asia into the USA and Canada), but much is also from within. The FTAA will not formally inhibit migration and so as we contemplate the future of the FTAA, the likelihood appears to be one of more buoyant migratory flows than Europe has ever experienced since 1970. This is particularly true in the light of research that shows that in relatively poor countries increasing incomes boost emigration by relaxing liquidity constraints. The FTAA may not seek to encourage mobility, but de facto, it may do so by increasing contact between member states and boosting incomes.

5. Income convergence

The most important economic questions concern the effects of regional integration on growth. Is regional integration likely to be good for growth in the region as a whole, and for poorer countries in particular?

The EU has experienced significant, although by no means steady convergence of per capita income across member states. The outstanding features are the rapid catch up of Ireland, Spain and Portugal, and at the same time the continuing poor performance of Greece. The overall experience of convergence has been analysed by many authors and can be summarised in many different ways. Summary measures of the cross-country dispersion of per capita income in the EU indicate significant convergence through the 1960s and 1970s, although no further aggregate change during the 1980s. There was some resumption of convergence across countries from the late 1980s, although this was accompanied by divergence at the sub-national level (Puga 2002).

Standard neo-classical trade theory gives the presumption that integration should lead to convergence of factor prices and incomes – with the limit being factor price equalisation. However, a number of qualifications need to made to this benchmark case. Even if integration brings convergence of per-capita income, it need not bring steady convergence of all factor prices. Feenstra and Hanson (1997) show how the relocation of production activities to low wage countries can reduce wages of unskilled labour in these countries. The argument is that the activity that relocates may be unskilled labour intensive relative to other activities in the high-wage country, but skilled labour intensive relative to activities in the low-wage host country. In a more general model in which comparative advantage stems both from endowments and from location (with remote regions having a comparative disadvantage in high transport costs goods), reducing trade barriers brings peripheral countries into the trading system and raises their real incomes. However, changes in the prices of individual factors can go either way, depending on both the location and the endowments of individual countries (Venables and Limao 2002).

Some analyses of wage differences across European have focussed less on factor endowment differences across countries, and more on the relationship between locations with good market access (the center) relative to those with worse access (the periphery). Empirically, European cross-country wage differentials follow a strong 'center-periphery' wage gradient, and there has been concern about the possibility that integration might draw activity out of peripheral regions and into the centre. Theory suggests that this gives rise to a U shaped relationship between the ratio of wages in the periphery to those in the center as the degree of integration changes (Krugman and Venables 1990). When trade barriers are high local manufacturing is protected, allowing higher wages to be maintained; at the other extreme, perfectly free trade brings factor price equalisation. It is at intermediate levels of trade barriers that firms are drawn into 'central' regions which offer large markets and from which they can supply the periphery. Peripheral regions are poor locations for manufacturing, and as a consequence have lower wages in equilibrium.

In the European context it has generally been argued that barriers are low enough that countries are on the upward sloping section of the U. Further reductions in trade barriers cause firms to relocate to lower wage peripheral regions, this flattening wage gradients. Empirically, the evidence on convergence suggests that this has – to a limited extent – happened.

However, the effect is much less obvious in the FTAA context. As trade barriers are reduced firms with the benefits of large domestic markets (the US) may benefit more than those with smaller markets. The models then predict that peripheral firms survive only if there is a widening of wage gaps between center and periphery. These wage gaps can be amplified if there are clustering forces (Fujita, Krugman and Venables 1999). A productive area for future research may be the application of these modelling frameworks, developed largely in the European context, to the Americas.

The persistence of regional disparities within the EU has motivated an active policy of regional transfers. Table 5 gives the net budgetary position of EU member states (contributions to the EU budget minus receipts) as a percentage of national GDP. It indicates that these transfers are substantial, amounting to more than 4% of Irish and Greek GDP. The common agricultural policy is the largest element underlying these transfers, but the second largest element of the EU budget is regional policy. The main instruments of regional policy are the 'Structural Funds' of around €30bn pa, articulated around three 'objectives'. 70%

goes to objective 1, ‘to promote the development and structural adjustment of regions whose development is lagging behind’, eligible regions being those with per capita income below 75% of the EU average. In addition, Greece, Ireland, Portugal and Spain are eligible for ‘Cohesion Funds’ of a further €3bn pa.

The bulk of expenditure from the Structural Funds and Cohesion Funds go on infrastructure projects and training and education, with some direct grants going to firms. The value of these expenditures can be assessed in both economic and political terms. Economically, the direct transfers have been very substantial. The extent to which they have promoted regional growth over and above their direct effect remains moot. Alogoskoufis (1995) argues that transfers to Greece have been anti-growth – they permitted the continuation of poor macro economic policies longer than would otherwise have been possible.

6. Conclusions

The refrain throughout this paper is that European integration has been successful because it has been a continuing process of steps to achieve deeper integration, going far beyond the removal of tariffs. The size and heterogeneity of the Americas offers large potential gains from integration, but there will be undoubted stresses arising from tensions over particular policies and perceived unevenness in the distribution of the benefits. The EU experience shows how these stresses can be handled and points to the importance of deep integration in achieving the full potential of a regional agreement. However, the EU performance is grounded in the deep political commitment of its members and in the creation of a political and institutional framework that can pursue integration and regional reform independently of national governments. It is in these dimensions that the Americas are most fundamentally different from the European Union, and the possibility of following the European model is most limited.

References

Alogoskoufis, G. (1995) 'The Two Faces of Janus: Institutions, Policy Regimes and Macroeconomic Performance in Greece', *EconomicPolicy: A European Forum*. April no. 20, pp. 147-84.

Baldwin, R. E. and A.J. Venables (1997), "International Economic Integration," in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics, vol. 3*. Amsterdam: North Holland.

Bayoumi, T. and B. Eichengreen (1997), "Is Regionalism Simply a Diversion: Evidence from the Evolution of the EC and EFTA", in Ito, T. and Krueger, A. O. NBER East Asia Seminar on Economics, vol. 6, *Regionalism versus Multilateral Trade Arrangements*, Chicago, The University of Chicago Press.

Braunerhjelm P. et al (2000) 'Integration and the regions of Europe: how the right policies can prevent polarization', Centre for Economic Policy Research, London.

European Commission, (2001) State Aid Scorecard, Brussels, http://europa.eu.int/eur-lex/en/com/rpt/2001/com2001_0782en01.pdf).

Feenstra, R. and G. Hanson (1997), "Foreign Direct Investment and Relative Wages: Evidence from Mexico's Maquiladoras", *Journal of International Economics*, 42, 371-93.

Fontagne, L., M.Freudenberg and N Peridy (1997) 'Intra-Industry Trade and the Single Market: Quality Matters' CEPR Discussion Paper 1959, London

Freund, C. and J. McLaren (1999) 'On the dynamics of trade diversion; evidence from four trade blocks', International Finance discussion paper no 637, Board of Governors of the Federal Reserve System, Washington D.C.

Fujita, M., P. Krugman and A.J. Venables (1999), *The Spatial Economy: Cities, Regions, and*

International Trade, MIT press, Cambridge MA.

Griffith, R. (2001) 'Product market competition, efficiency and agency costs: an empirical analysis' working paper 01/12. Institute for Fiscal Studies, London.

Jacquemin, A. and A. Sapir (1988) "International Trade and Integration of the European Community: An Econometric Analysis", *The European internal market: Trade and competition Selected readings.* Oxford; New York; Toronto and Melbourne: Oxford University Press 1989; 202-12

Krugman, P. and A.J. Venables, (1990) 'Integration and the competitiveness of peripheral industry' in C. Bliss and J. de Macedo, (es) *Unity with diversity in the European Community*, CUP, Cambridge.

Martin, R. and C. Criscuolo (2001) 'A note on ownership and productivity in UK businesses', mimeo Centre for Economic Performance, LSE.

Midelfart-Knarvik, K-H., H.G. Overman, S. Redding and A.J. Venables (1999), "The location of industry in Europe", CEPR, London.

Midelfart-Knarvik, K-H. and H.G. Overman, (2002) 'Delocation and European integration; is structural spending justified?' *Economic Policy*, 35, 321-359.

Molle, W. (1994) *The economics of European Integration; theory, practise and policy*, Second Edition, Dartmouth, Aldershot.

Ocampo J A and Bustillo I (2003), this volume

OECD (1999) *Measuring Globalisation*, OECD, Paris.

Pelkmans, J. (2001), *European Integration: methods and economic analysis*, Pearson, London.

Political and Economic Planning, (1962), '*Atlantic Tariffs and trade*' Chatham House, London.

Puga, D. (2002) 'European regional policy in the light of recent location theories, *Journal of Economic Geography* 2(4), 372-406.

Sapir, A. (1992) 'Regional integration in Europe', *Economic Journal*, 102, 1491-1506

Sapir, A. (1998) 'The political economy of EC regionalism', *European Economic Review*, 42, 717-32.

Shatz, H. and A.J. Venables (2001) 'The geography of international investment' in *The Oxford Handbook of Economic Geography*, eds G.L. Clark, M.P. Feldman and M.S. Gertler, OUP, Oxford.

Soloaga, I. and L. A. Winters (2001), "Regionalism in the Nineties: What Effect on Trade?", Centre for Economic Policy Research, Discussion Paper Series, no. 2183.

Truman, E.M. (1975) 'The effects of European economic integration on the production and trade of manufactured products' in B. Balassa (ed) *European Economic Integration* North Holland, Amsterdam.

Venables, A.J, (2003) "Gainers and losers from regional integration agreements', *Economic Journal*, forthcoming.

Venables, A.J, and N.Limao (2002) "Geographical disadvantage: a Heckscher-Ohlin-von Thunen model of international specialisation', *Journal of International Economics,* 58, 239-263.

Winters, L.A. (1983) "British Imports of Manufactures and the Common Market", *Oxford Economic Papers*, vol. 36, 1983, pp. 103-118

Table 1: GDP Shares, the Americas and Europe

Americas		**Europe (EU15)**			
	2000		1958	1973	1998
US	78.8	Germany	20.1	26.6	25.1
Canada	5.7	France	21.2	19.7	17
Mexico	4.8	UK	23.2	14.1	16.7
Brazil	4.7	Italy	11	12.9	14
Other South America	5.2	Other EU	7.3	11.7	27.2
Central America and Caribbean	0.8	Other Non-EU	17.2	15	0

Source: World Development Indicators, World Bank

Table 2: Tariff rates, the Americas and Europe

Americas		**Europe**	
	2001		1957
US	4.1	Germany	8.3
Canada	4.1	France	17.2
Mexico	15.9	BeNeLux	11
Brazil	13.2	Italy	17.5
Other South America*	11.7		
Central America and Caribbean*	11.5		

Sources: Political and Economic Planning (1962), Ocampo J A and Bustillo I (2003).

* Simple average

Table 3: Share of Intra-Industry Trade in Intra-EC Trade (as percentage of total intra-EC trade)

Country	1958*	1963*	1970*	1970**	1980**	1987**
Belgium-Luxembourg	0.54	0.60	0.66	0.69	0.70	0.77
Denmark	-	-	-	0.41	0.52	0.57
France	0.61	0.68	0.73	0.76	0.83	0.83
Germany	0.47	0.57	0.67	0.74	0.78	0.76
Greece	-	-	-	0.22	0.24	0.31
Ireland	-	-	-	0.36	0.61	0.62
Italy	0.42	0.48	0.59	0.63	0.55	0.57
Netherlands	0.50	0.57	0.64	0.67	0.73	0.76
Portugal	-	-	-	0.23	0.32	0.37
Spain	-	-	-	0.35	0.57	0.64
United Kingdom	-	-	-	0.74	0.81	0.77

* Computed with EC-6 trade data.
**Computed with EC-12 trade data.

Source: Sapir (1992)

Table 4: Estimates of the number of foreign workers in EC member states, 1960-1980

	Thousands				As percentage of host labour force			
	1960[a]	1970[a]	1973[b]	1980[b]	1960[a]	1970[a]	1973[b]	1980[b]
Germany	461	1727	2519	2072	2	6	11	9
France	1294	1584	1900	1643	6	8	11	9
Netherlands	47	134	121	194	1	3	3	4
Belgium	170	257	211	333	5	7	7	11
Luxemburg	20	27	43	51	16	21	35	37
Italy	20	30	55	57	-	-	-	-
EC6	2012	3759	4849	4350	3	5	7	6

[a] Labour force
[b] Dependent workers

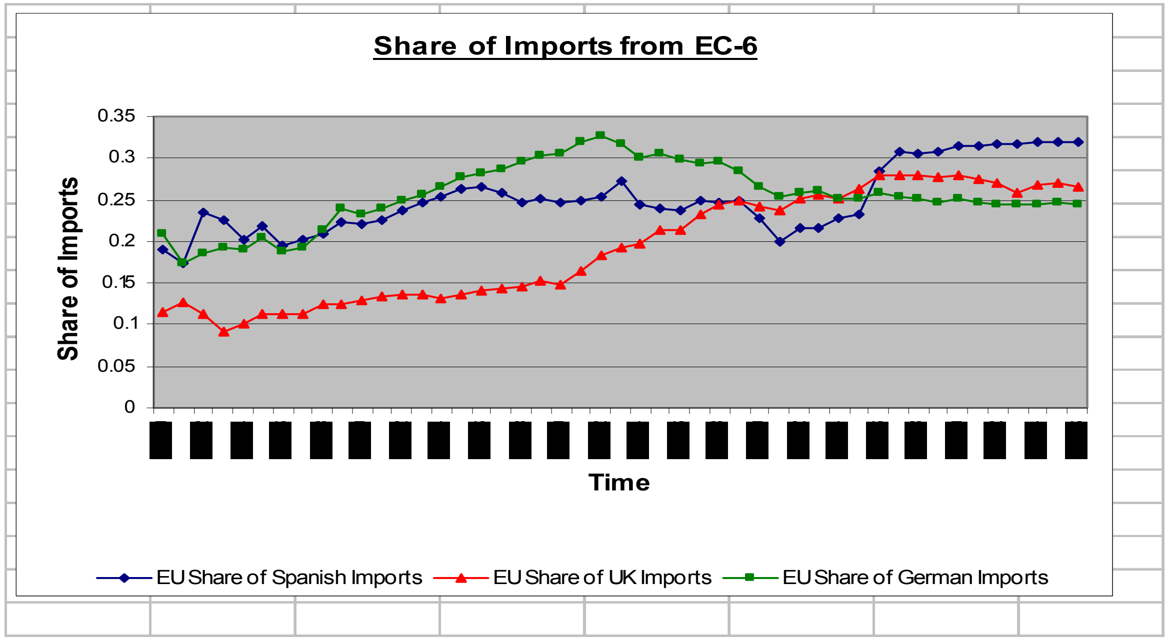
Source: Molle (1990)

Table 5: Net contributions to the EU Budget (% GNP)

	1992	1993	1994	1995	1996	1997
B	-0.16	-0.25	-0.47	-0.18	-0.30	-0.52
DK	0.27	0.30	0.18	0.25	0.16	0.03
D	-0.62	-0.72	-0.78	-0.72	-0.58	-0.60
GR	4.65	5.16	4.61	3.98	4.19	4.12
E	0.60	0.73	0.78	1.69	1.34	1.27
F	-0.14	-0.11	-0.23	-0.14	-0.03	-0.08
IRL	5.84	6.54	4.42	4.45	4.84	4.82
I	-0.03	-0.14	-0.29	-0.09	-0.13	-0.02
L	-0.59	-0.74	-0.52	-0.43	-0.26	-0.35
NL	-0.34	-0.49	-0.63	-0.65	-0.76	-0.73
A	-	-	-	-0.49	-0.12	-0.41
P	2.91	3.42	2.48	3.06	3.40	3.11
FIN	-	-	-	-0.15	0.08	0.04
S	-	-	-	-0.53	-0.35	-0.59
UK	-0.29	-0.38	-0.13	-0.56	-0.24	-0.17

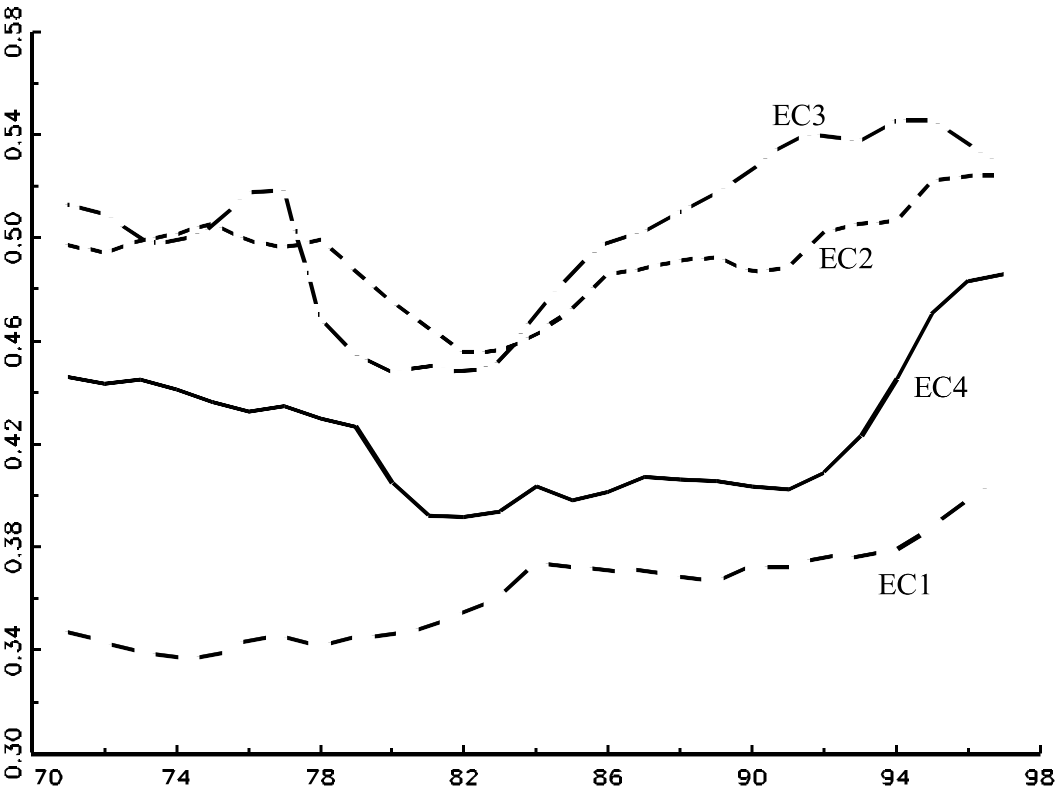
Source: European Commission

Figure 1. Shares of Members' Imports coming from EC-6, 1950-1996



Source: European Commission

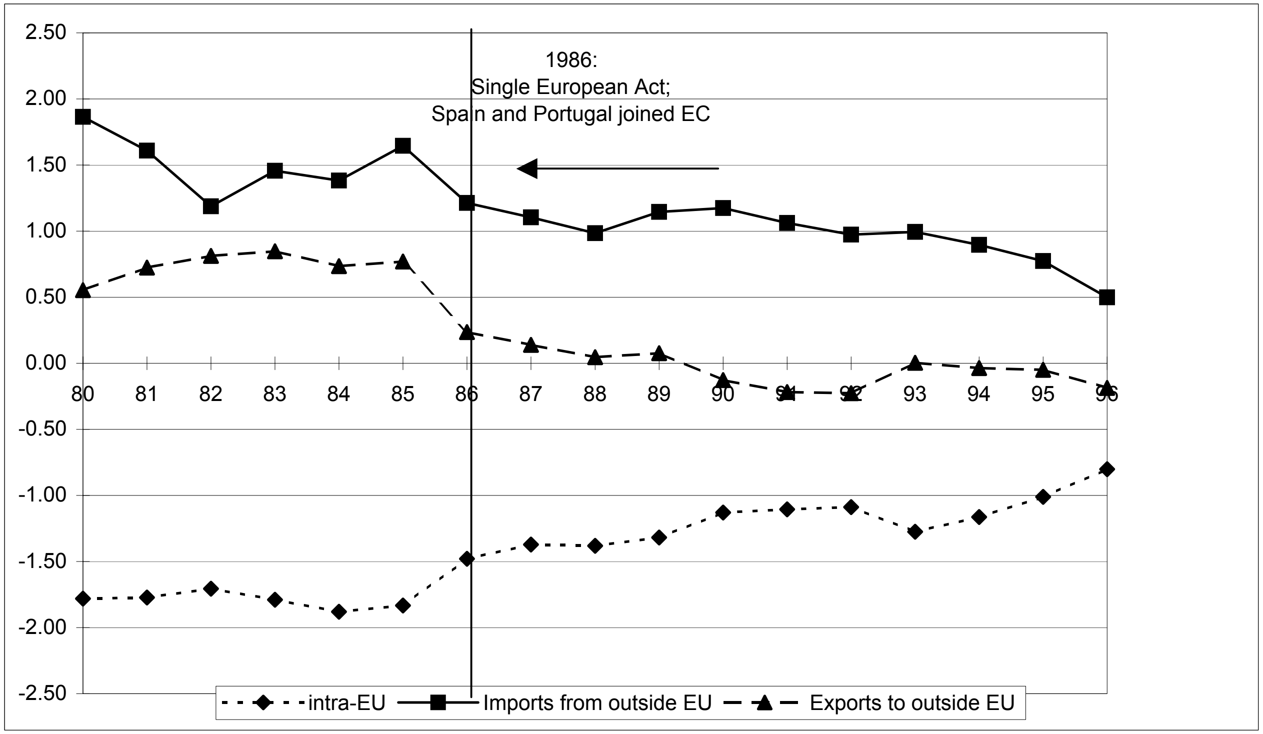
Figure 2: Krugman specialization indices



EC1: Belgium, France, Germany, Italy, and the Netherlands
EC2: Denmark, Ireland, and the UK
EC3: Greece, Spain and Portugal
EC4: Austria, Finland, and Sweden

Source: Midelfart-Knarvik et al 1999

Figure 3: Internal and external trade effects from a gravity model



Source: Soloaga and Winters 1999