Chapter 20

The TTIP and the SCO in the Light of the Success Conditions for Economic Integration

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ABSTRACT

The last global economic crisis has prompted new dynamics in the scope of economic integration: On the one hand, the Transatlantic economy witnessed the formation of the largest economic integration in the human history: the Transatlantic Trade and Investment Partnership (TTIP). On the other hand, Shanghai Cooperation Organization (SCO) recently adopted the economic vision for initiating an economic integration. Since both integration projects were recently launched, this chapter is intended to make a small contribution to the limited scientific resources available to policymakers, academicians, NGOs, etc. In this respect, this chapter first presents a set of political, economic, institutional, and natural conditions suggested in the principal economic integration literature for the success of a regional economic bloc. Second, it aims at evaluating the TTIP and the SCO in the light of these success conditions.

INTRODUCTION

The whole is bigger than the sum of its parts -Aristotle

One of the major dynamics in the international relations is international economic integration. However, though it has a long history dating back to ancient times (colonial empires, merchant associations, religious empires, criminal empires)¹ this dynamics has never shaped the world as powerfully as it does in the modern times. Its evolution and its variation may tell us the story of the international economic integration in last two centuries from the Zollverein to the European Union. Together with the foundation of inter-governmental organizations in the form of regional economic bloc the notion “economic integration” has developed both on theoretical ground and empirical ground.

In modern times, the theoretical basis of the economic integration is, as many economists acknowledged, laid by Viner (1950) which defined trade creation and trade diversion. Questioning Viner’s notion of trade diversion, Meade (1955)
conclude that even though there is trade diversion, a customs union can cause a “trade expansion” under condition of elastic demand. Meade (1955) examined conditions under which trade blocs made member countries better off and conditions under which it did not. He suggested that a customs union may be welfare increasing if the partner countries are actually competitive but potentially complementary, if the initial tariff levels were very high, and if each partner is the principle supplier to the other partner of the traded products. Meade’s general equilibrium model that analyzes the welfare effect of trade blocs from a worldwide perspective is further developed by Lipsey (1957), Balassa (1961), Vanek (1965), McMillan and McCann (1981). Lipsey (1957) tested Viner’s arguments through statistical data. Balassa (1961) argued that the forms of integration other than Customs Union may be possible and produced a model with five steps (free exchange area, customs union, common market, economic union, economic and monetary union) in order to evaluate European Integration. Vanek (1965) proved that setting a common external tariff with the rest of the world and eliminating the barriers to internal trade do not necessarily lead a regional bloc to the situation where trade diversion is greater than trade creation. Vinner’s trade creation-trade diversion approach was challenged by Lipsey (1970) that initially developed the terms of trade-volume of trade approach. This alternative approach stresses on the impacts of a regional economic bloc on individual countries as integration occurs, instead of on world welfare. McMillan and McCann (1981) prove in a three-good model that two partners within the same trade bloc may prefer an intra-union tariff or subsidy to internal free trade to obtain volume-of-trade gains through increased imports from the non-partner country.

On the one hand, the traditional theory of economic integration deals with the issue from the static effect point of view. On the other hand, the new theory of economic integration deals with the issue including dynamic effects into the analysis. Balassa (1961, 1965) added a new dimension by introducing the concept of dynamic effect into the theory of economic integration. Since the trade creation and trade diversion are not solely able to explain the whole potential gain from integration he listed a set of additional effects (larger scale economies, technology transfer, and an increase in competition, investment flows, productivity and growth) that is uneven and obtained over time. Balassa’s argument is developed through partial equilibrium models and empirically tested principally by Corden (1972), Krugman (1979, 1980), Lancaster (1980), Helpman (1981).


Economic integration literature suggests that a bloc may be welfare generating for the cooperating countries depending on some conditions. Various conditions for a successful economic integration have been suggested in different partial equilibrium models or in empirical tests of these models. In this chapter, the suggested conditions in the revised literature will further be dealt with under four subtopics: namely political conditions, economic conditions, institutional conditions, and natural conditions. Subsequently, these success conditions for economic integration, tackled in previous literature, will be used in order to evaluate the potential of the Transatlantic Trade and Investment Partnership (TTIP) and an eventual economic integration project within the Shanghai Cooperation Organization (SCO). Since these two integration projects were recently launched, the concerned policymakers, academicians, NGOs etc. have a very limited scientific resource. This study is intended to make a small contribution to studies in this field.

This chapter is organized as follows: in the next section the theoretical background and
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