

# Integration and Disintegration Effects: Some Examples

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# Introduction

- Free trade and free capital movements within the EU are a key feature of EU membership.
- The EU has expanded and EU members have become more integrated economically.
- The world economy has become considerably more integrated over the last 3 decades (globalisation).
- There are few examples of disintegration, but many of further integration through trade agreements and customs unions (ASEAN, MERCOSUR, NAFTA, GCC, CISFTA, CSME...).

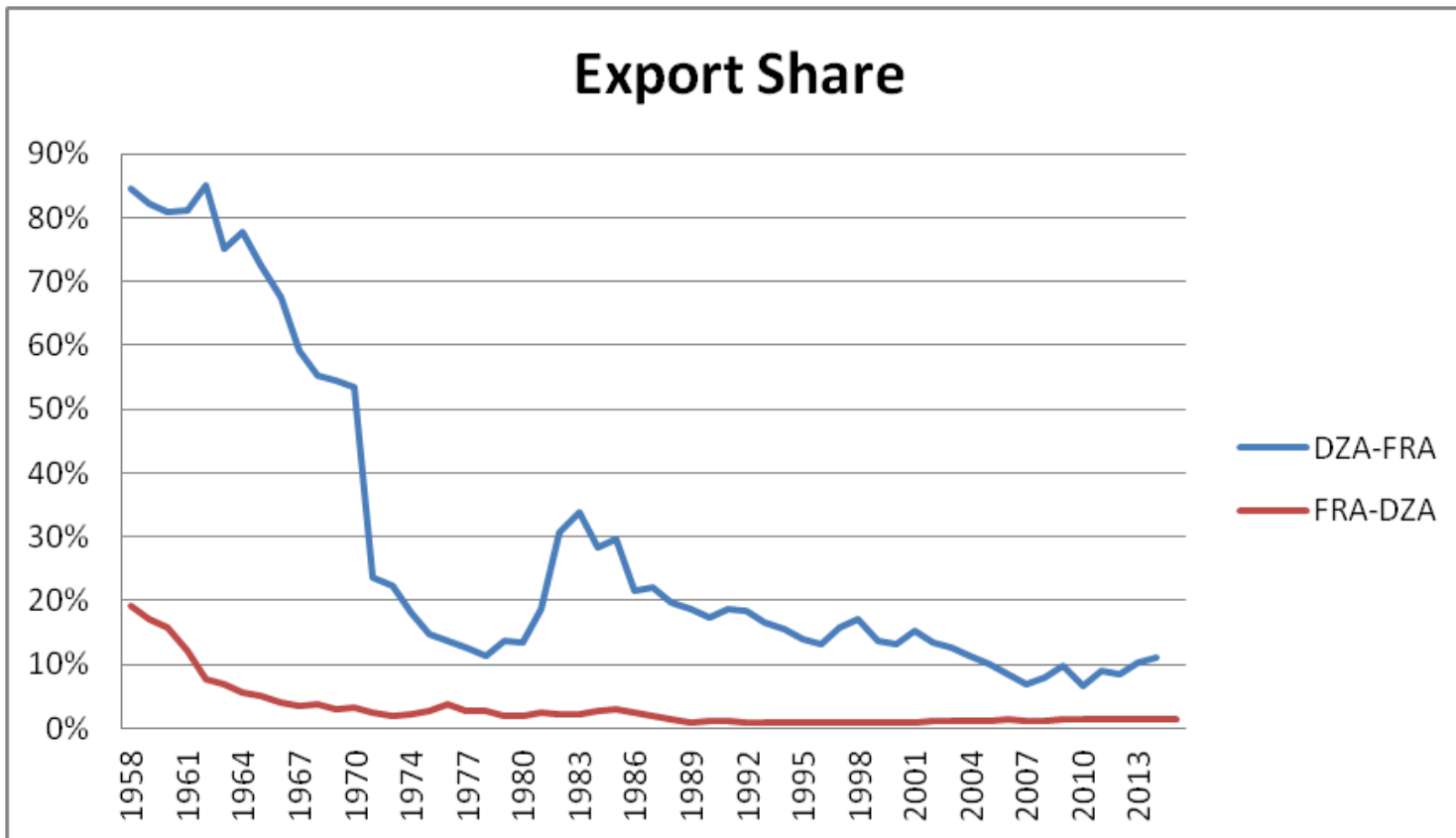
# Introduction

- Ex-ante it is difficult to predict the likely outcome of the UK referendum on EU membership, but a Brexit is quite possible.
- The outcome of the negotiations between the UK and the EU in the event of a Brexit are also difficult to predict.
- An EEA solution is unlikely - de-facto EU membership without a means to shape EU policies is hardly going to be acceptable to Eurosceptics after a vote to leave the EU.
- It is therefore likely that trade relations will be less free than now (remember you can't do better than free trade!)
- This implies that in the event of a Brexit it is likely that there will be changes in the trade relationship between the UK and the EU and there will also be impacts on investment.

# Disintegration Examples

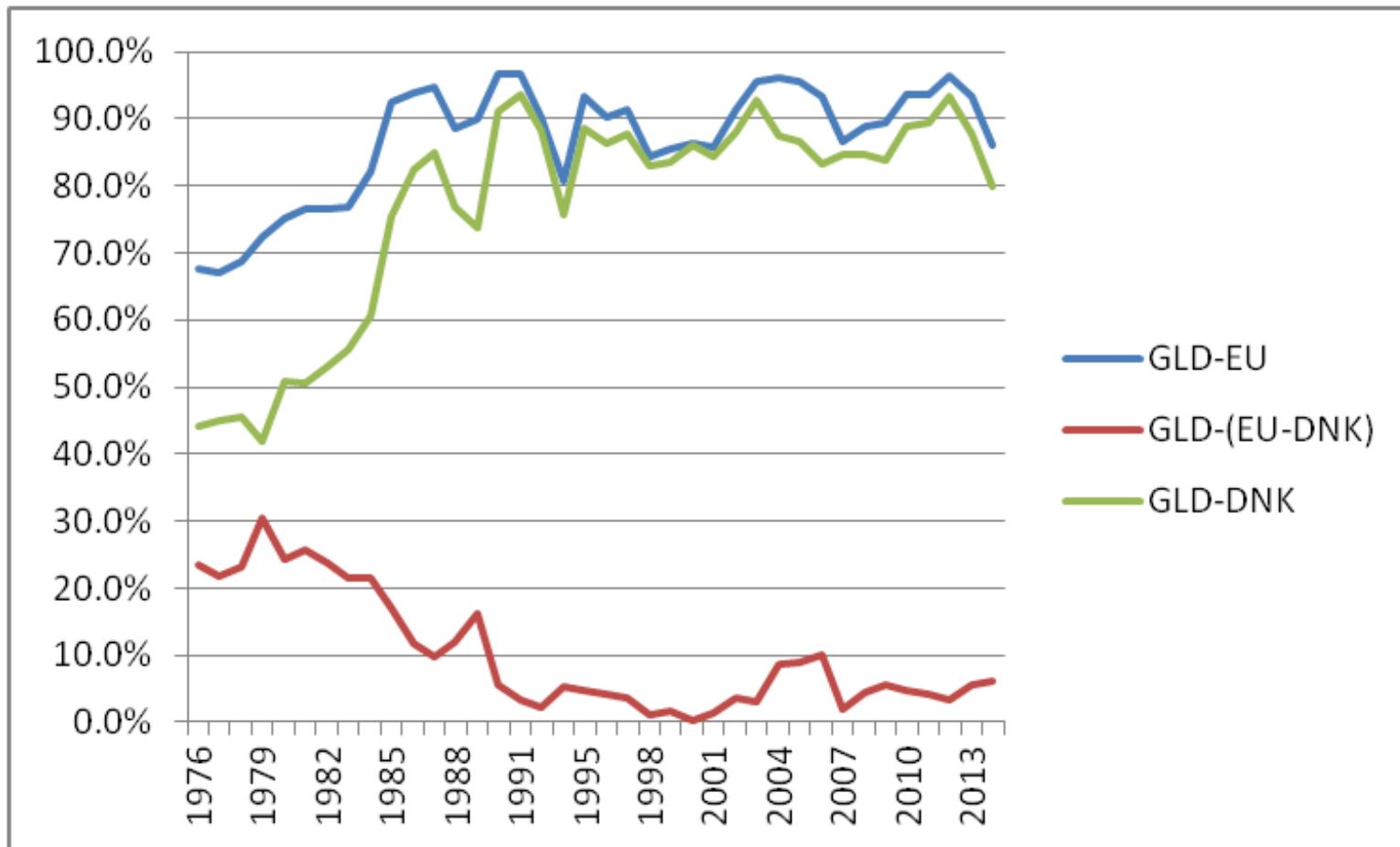
- There are few examples of disintegration, but many of further integration through trade agreements, customs unions and closer.
- Nevertheless, even for the EU there are some previous relevant examples of disintegration – Algeria (gained independence from France in 1962) and Greenland (became an overseas country and territory in 1985, but is still partially integrated into the internal market and applies EU common external tariffs).
- Another relevant example is the breakup of Czechoslovakia.
- These impact on total trade as well as trade patterns (origins/destinations) which can be readily measured as trade shares (trade intensity).

# Trade Intensity between Algeria and France following the breakaway of Algeria



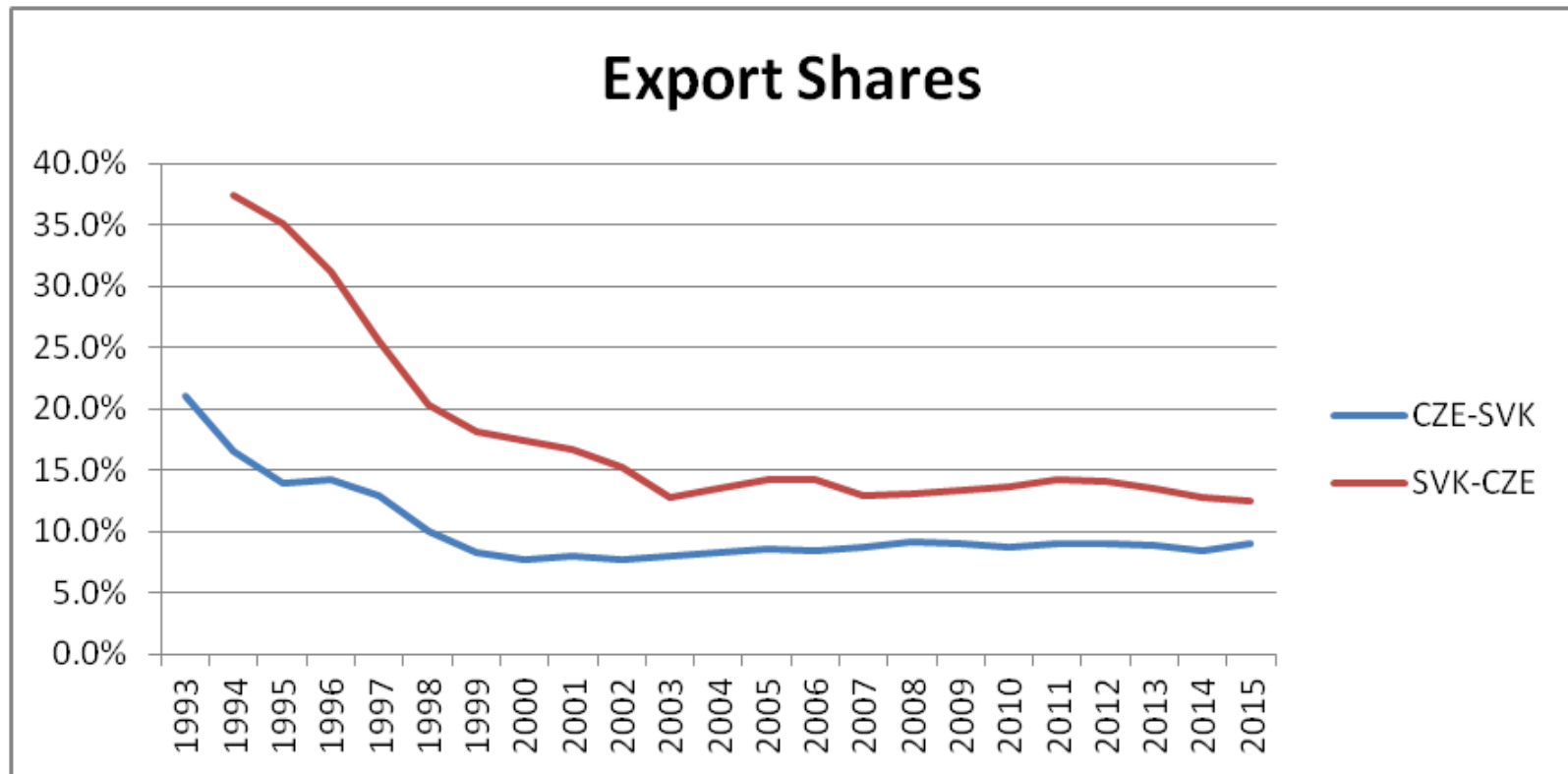
Source: UN Comtrade database

# Trade Intensity between Greenland and the EU



Source: UN Comtrade database

# Trade Intensity between Czech Republic and Slovak Republic after the break-up of Czechoslovakia



Source: UN Comtrade database

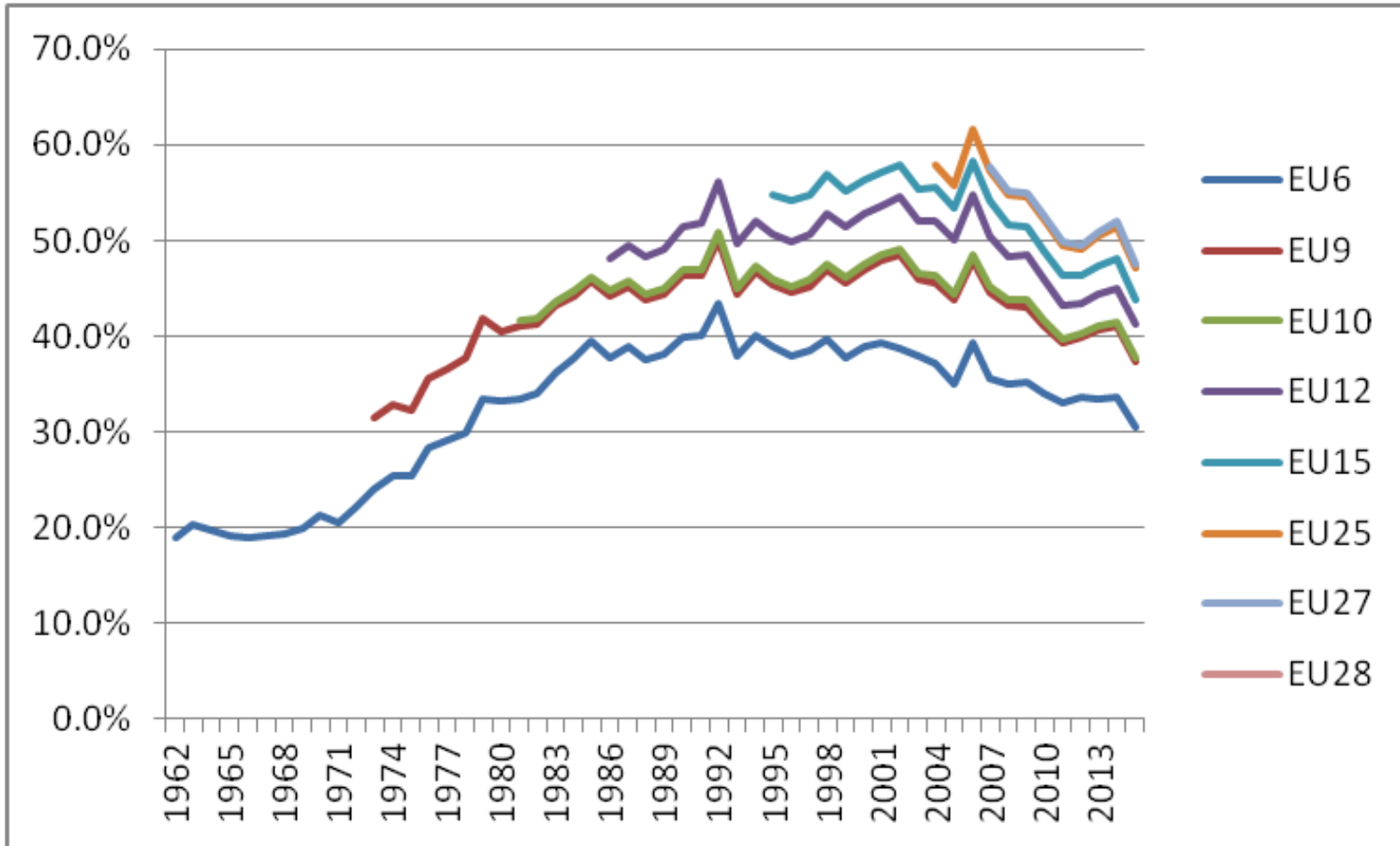
# EU Integration, Expansion and Globalisation



- EU integration e.g. the Single Market should result in increased trade with individual EU Member States.
- Ireland – in 23 out of 27 EU members did the share of trade increase 5 years after membership.
- UK – in 17 out of 27 EU members did the share of trade increase 5 years after membership.
- Germany - in 20 out of 27 EU members did the share of trade increase 5 years after membership.
- EU expansion should lead to increasing trade share with the whole EU (adding more countries).
- However, globalisation should reduce the share of trade with EU members.

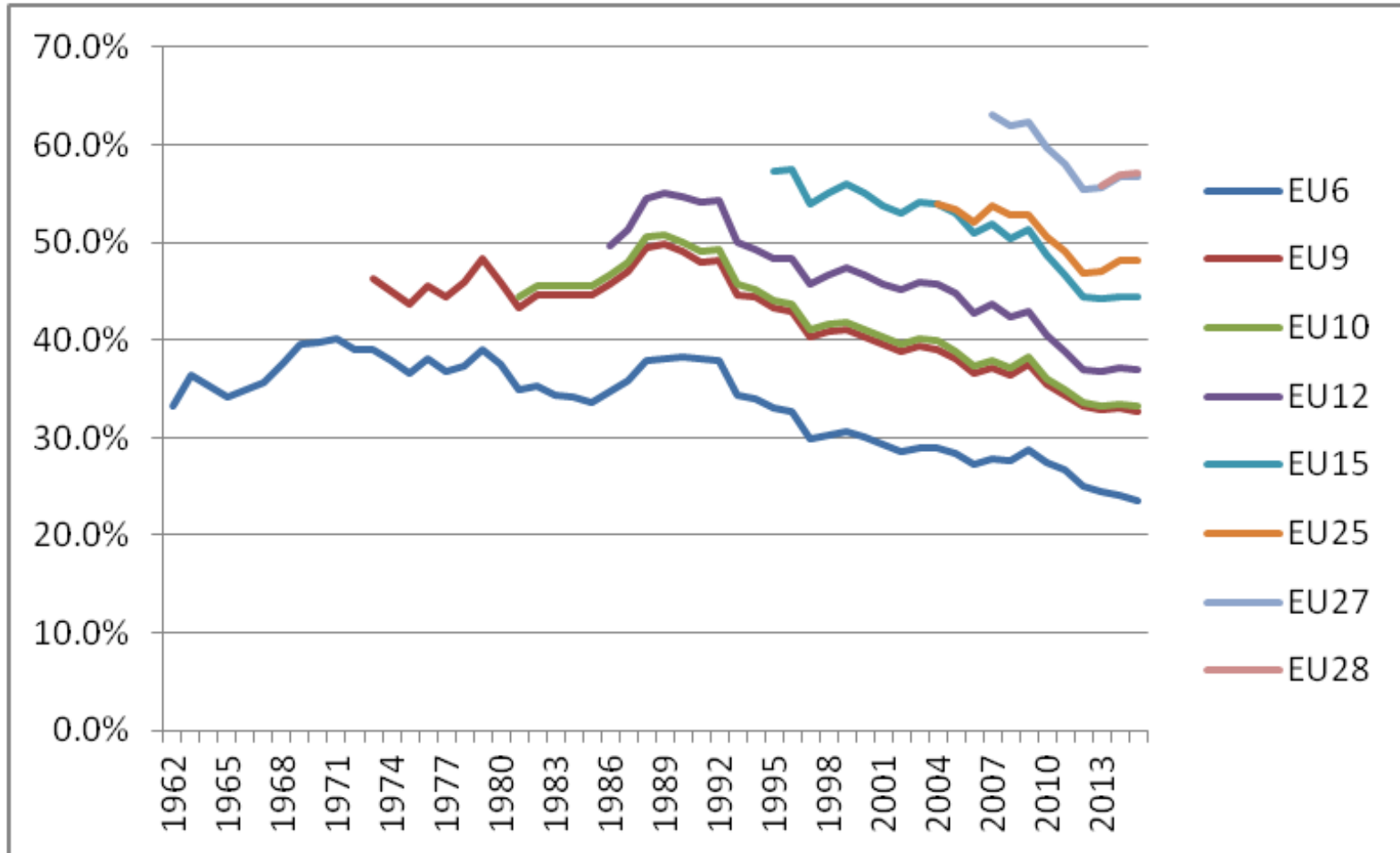


# UK



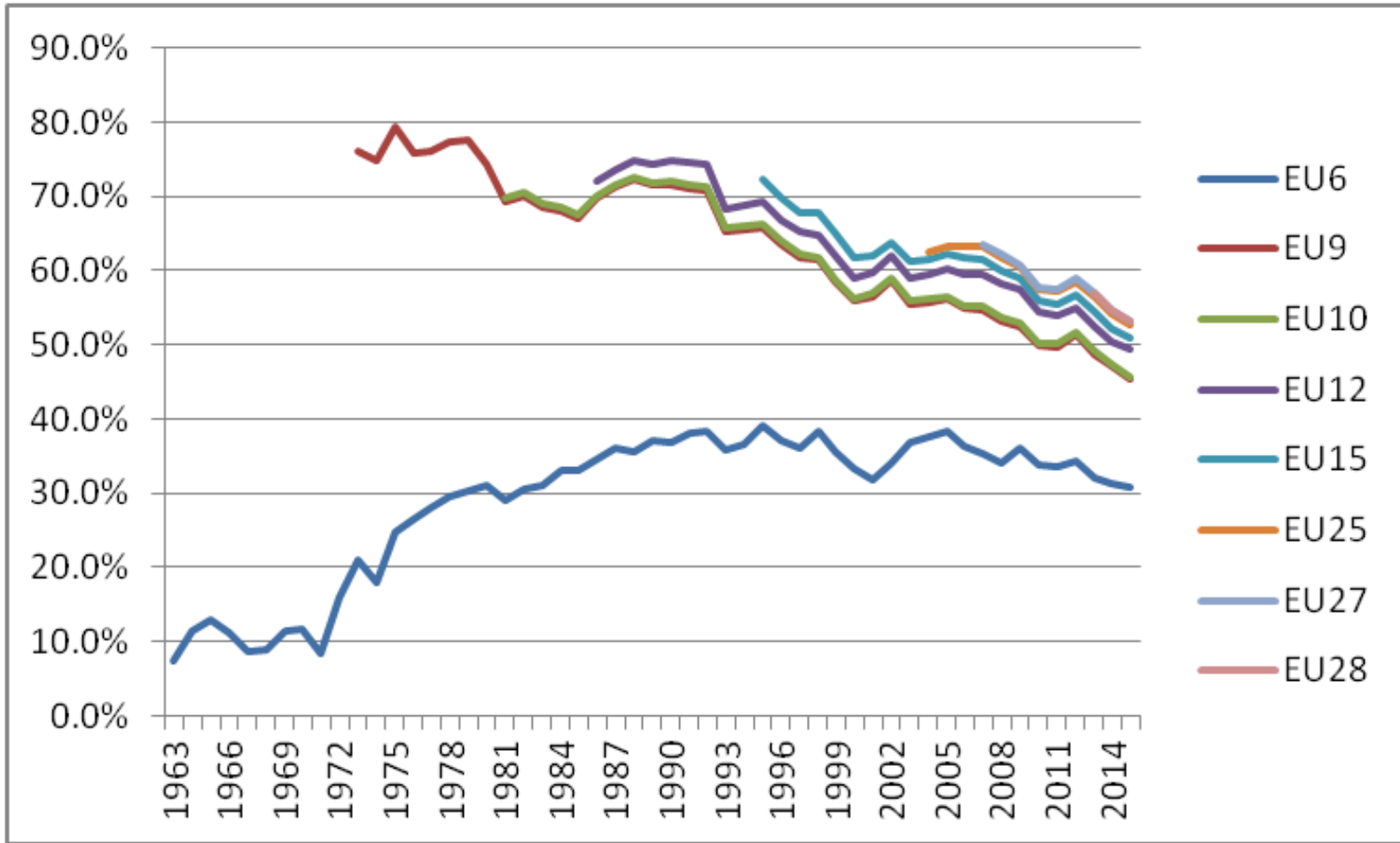
Source: UN Comtrade database

# Germany



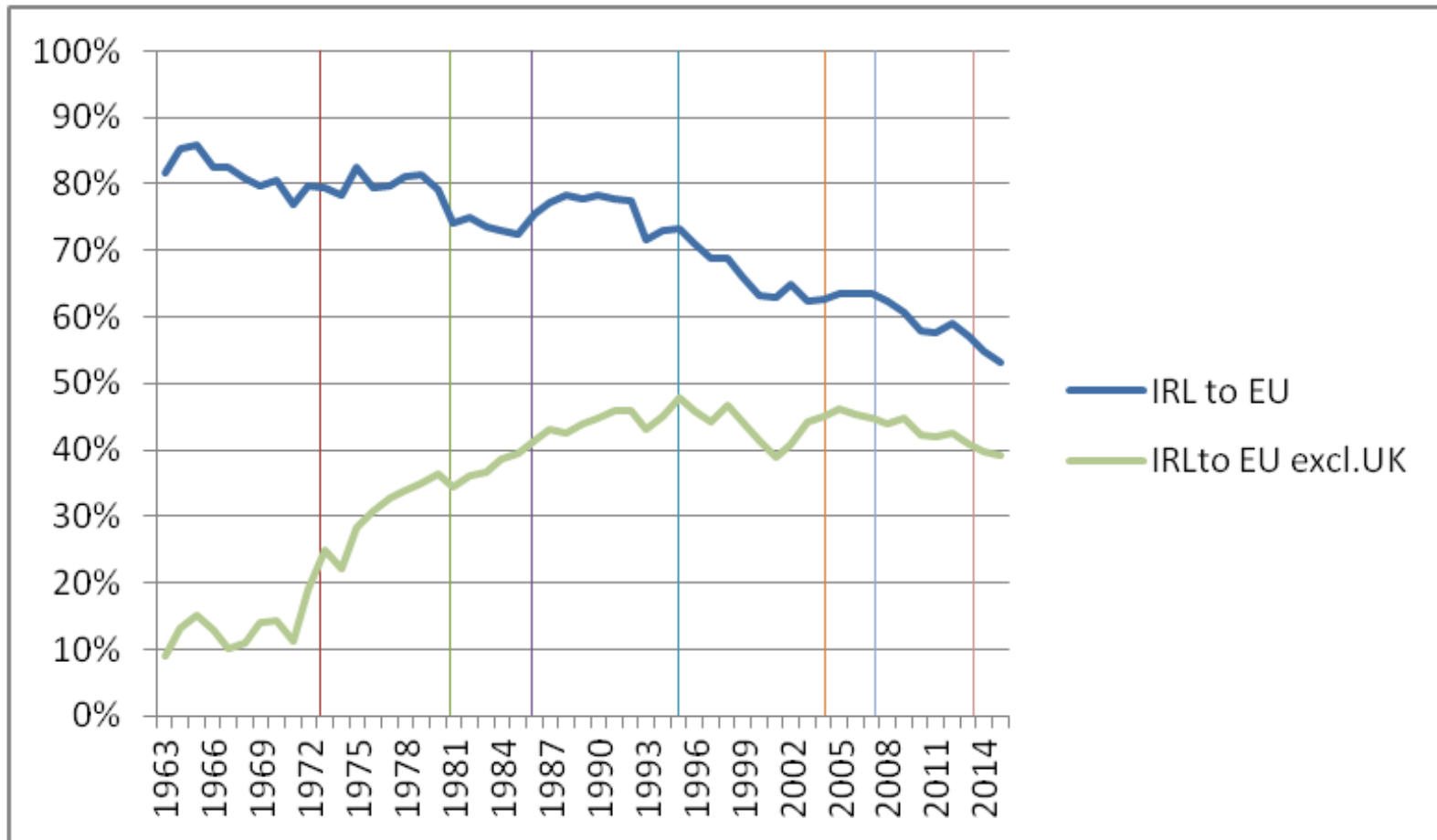
Source: UN Comtrade database

# Ireland



Source: UN Comtrade database

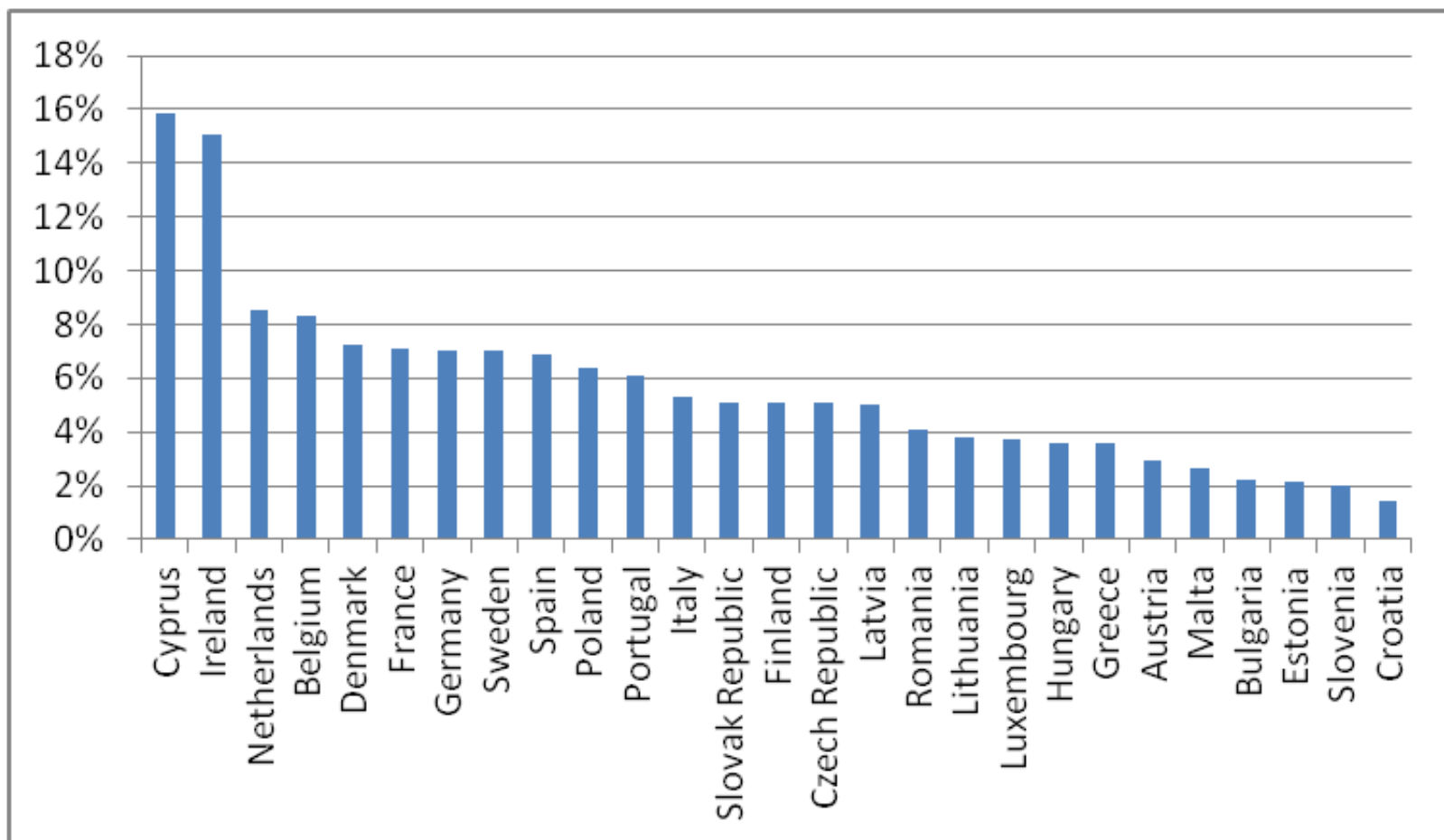
# Ireland



Source: UN Comtrade database

# Merchandise Export Share to the UK

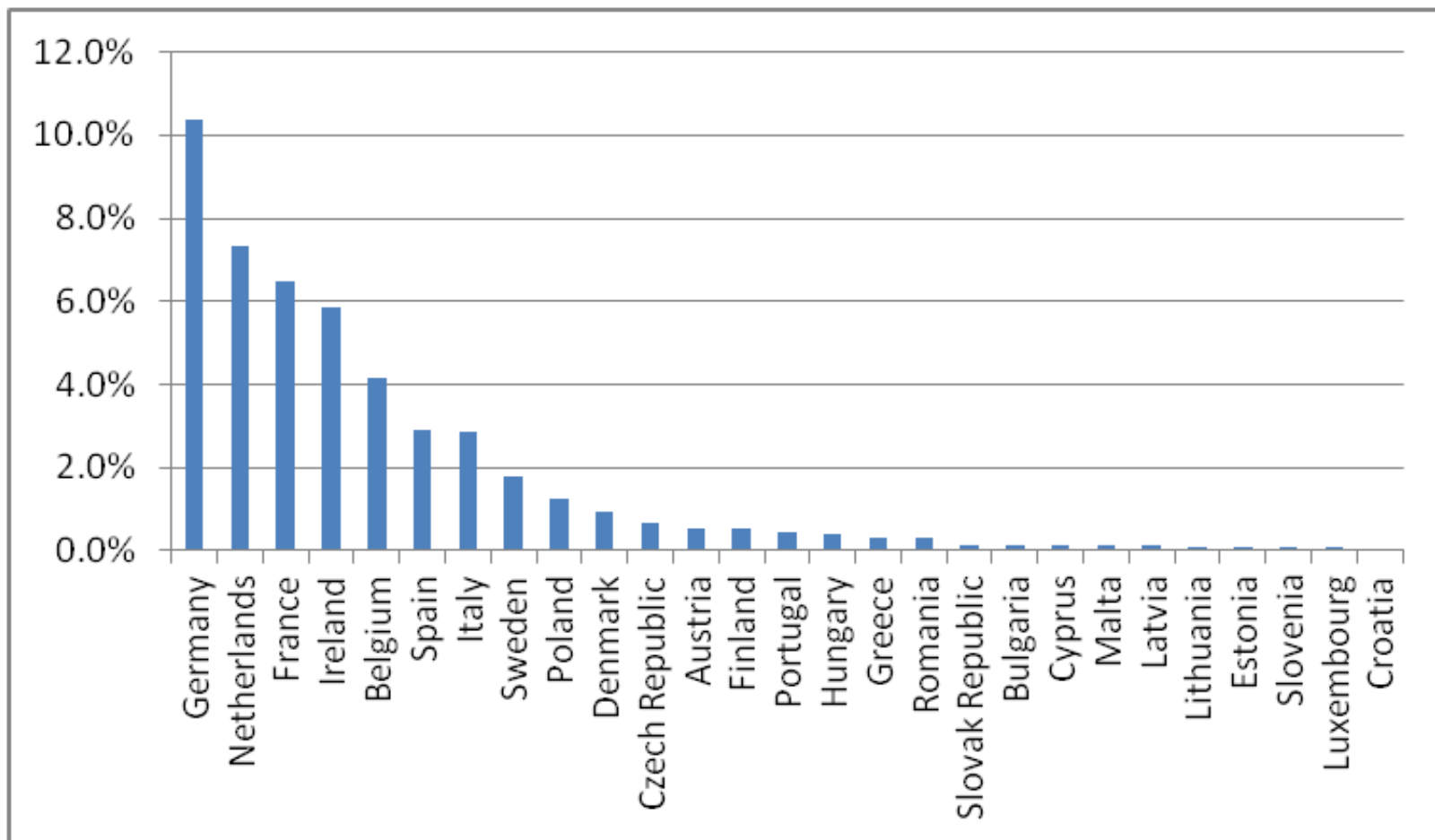
In 2014 just 6.8% of exports from the rest of the EU were to the UK.



Source: UN Comtrade database

# UK Merchandise Export Shares

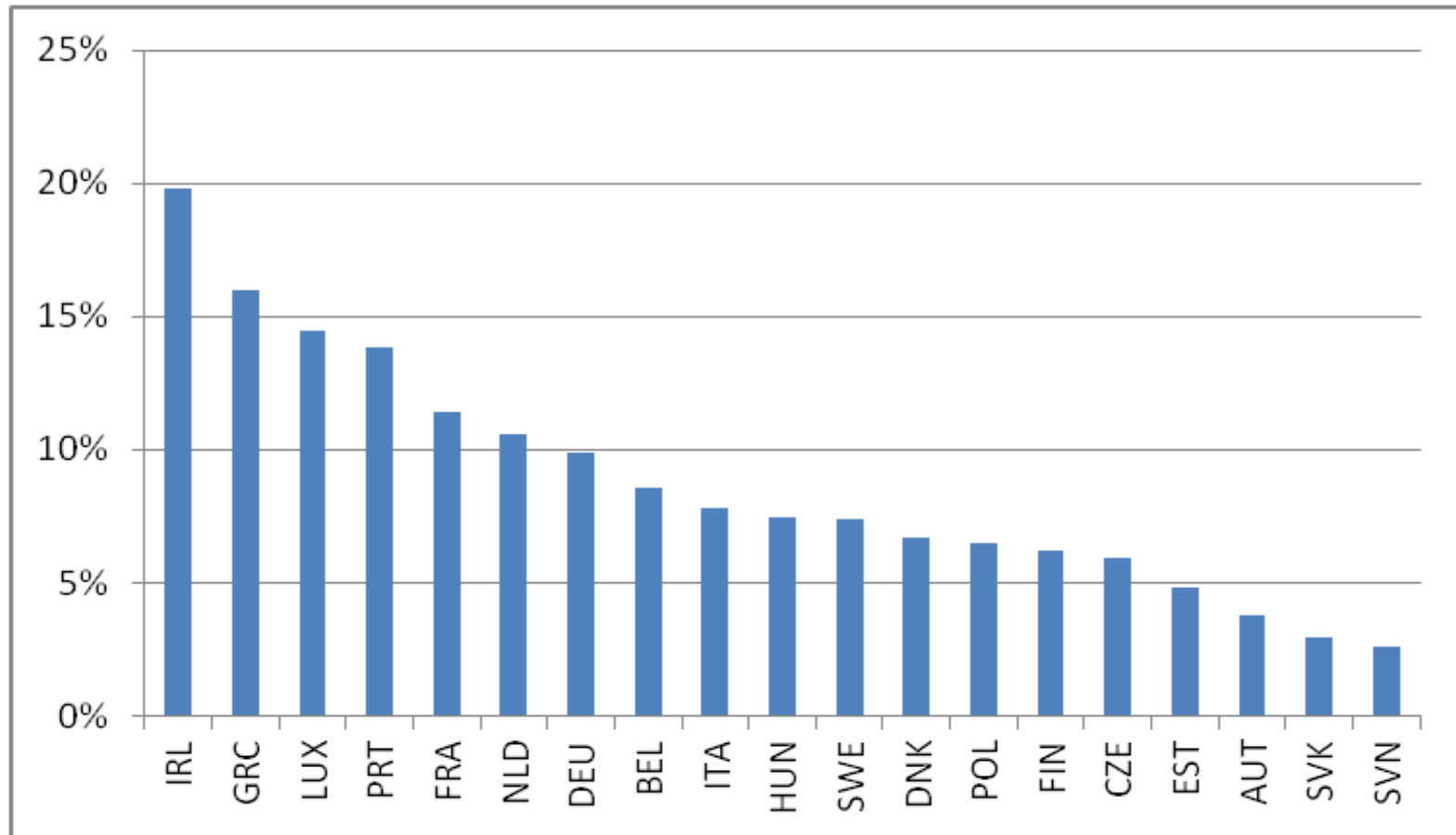
In 2014 48.1% of UK merchandise exports went to the EU.



Source: UN Comtrade database

# Services Export Shares to the UK

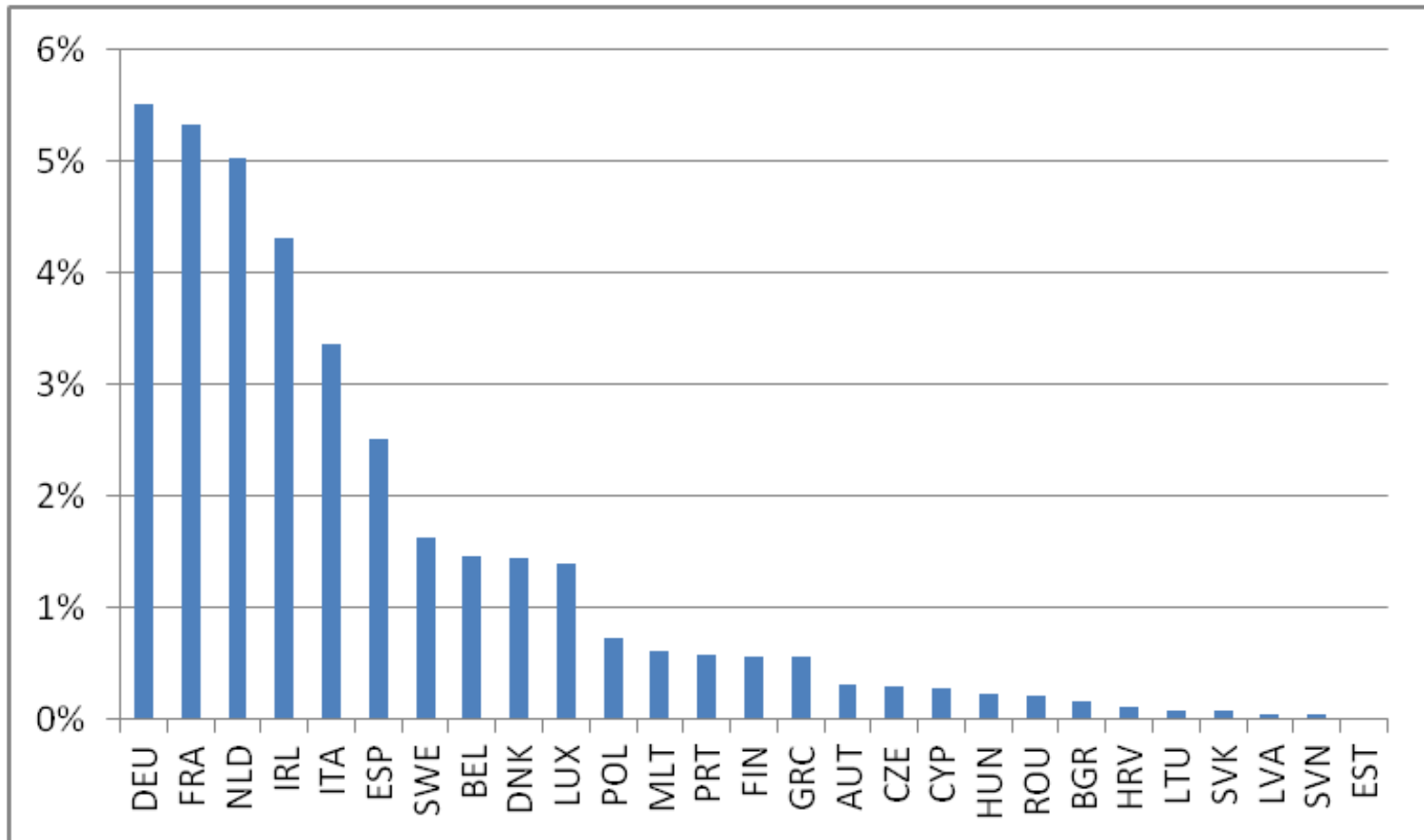
In 2014 just 10.4% of merchandise exports from the rest of the EU were to the UK.



Source: OECD Services Trade Statistics

# Services Exports from the UK

In 2014 just 37.0% of UK service exports were to the EU.



Source: OECD Services Trade Statistics



# Impact of a Brexit

- Numerous studies have shown that EU membership increases trade. One comprehensive study estimated that EU membership increases trade by about 20% compared to a bilateral trade agreement with the EU (Hufbauer and Schott, 2007).
- The UK is considerably more dependent on the EU market than the EU (countries) on the UK market (27 flows versus 1!!) – impact on merchandise would be:
  - UK -9.6% (7.4% for services),
  - Northern Ireland -12%
  - Ireland -3% (4% for services),
  - Germany -1.4%,
  - EU -1.36% (2.1% for services)
- The impact on merchandise trade for the EU is just one 7<sup>th</sup> of the UK impact.

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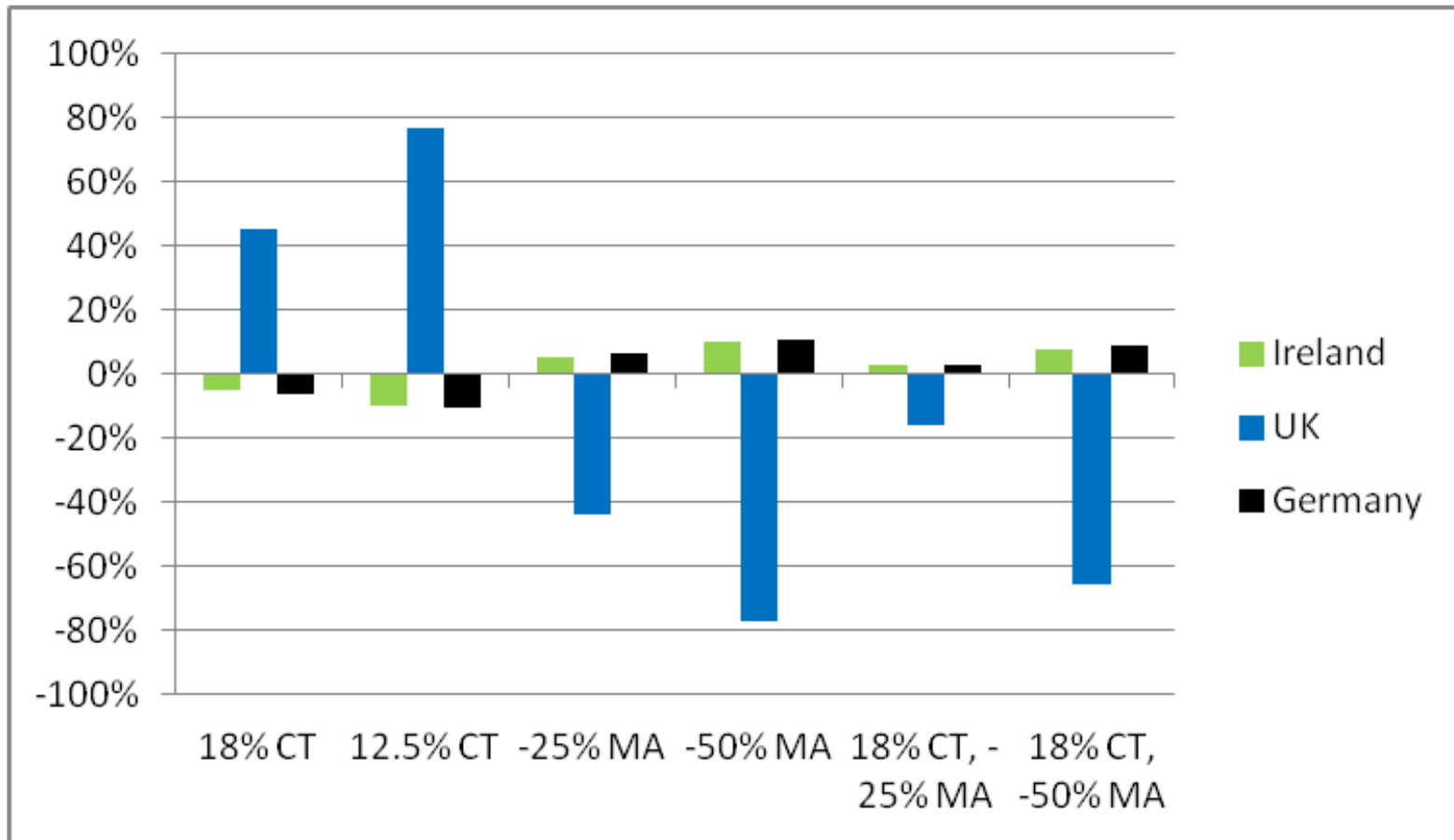
# Foreign Direct Investment

- The UK's inward FDI stock is the largest in Europe, and the second in the world after the US.
- Evidence suggests that EU membership has been a key factor in attracting FDI to the UK and Ireland from outside as well as inside the EU.
- A Brexit would imply a loss of market access of UK based firms to the EU which would imply that some FDI of might divert from the UK to EU members.
- Of course the following a Brexit the UK would also be free to take measures that might attract more investment – a reduction of corporation tax rates to 18% has already been announced – other possible measures would be the relaxation of state aid rules or worker protection.

# Impact of a Brexit on FDI

- Simulations suggests a Brexit would more than undo the positive effect of moving to an 18% corporation tax rate in the UK (Barrett et al. 2015).
- For Northern Ireland the results suggest that the effect of a potential reduction of corporation tax to 12.5% would be reversed by a Brexit (Barrett et al. 2015).
- The available analysis suggests that the expected additional attractiveness of Ireland to new FDI projects is likely to be small (Barrett et al, 2015).
- The aggregate effect has been estimated to amount to a 2% increase in the FDI stock in Ireland (Morgenroth, 2015).
- Considering the sectoral distribution of FDI in the UK and Ireland the actual effect is likely to be slightly larger.

# Change in Location Probabilities of new FDI (Greenfield)



Source: Own calculations based on Barrett et al 2015.

# Summary and Conclusion

- The widening and deepening of the EU has significantly shaped trade patterns.
- However, more recently globalisation has reduced the share of trade with other EU members (there is no evidence that EU membership has hindered this).
- Available example of disintegration show significant impacts on trade patterns.
- In the event of a Brexit UK exports would be considerably worse hit than the EU.
- Loss of market access is also likely to impact on FDI – reducing the stock and flow of new investment (*ceteris paribus*).  
Actions by the UK to attract FDI are likely to be countered by actions of the EU.