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THE ECONOMICS AND POLITICS OF REGIONAL INTEGRATION AND THE CHOICE TO INTEGRATE

by Pier Carlo Padoan

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1. Introduction

Regional integration is very much a political as it is an economic issue, and the case of the Middle East represents no exception. Recent peace developments make of the Middle East a very interesting case study of a possible start up of an integration process. In this paper we will review some of the arguments discussed in the literature on the economics and on the political economy of integration and we will develop a conceptual framework so as to consider under which conditions will a country decide to join an integration agreement. The paper is organized as follows. Paragraph 2 reviews some of the economic arguments for economic integration. Paragraph 3 and 4 consider the political and collective action arguments for integration. Paragraphs 5, 6, 7 present a conceptual framework for the analysis of the decision to integrate. Paragraph 8 applies the results to the case of the Middle East. Paragraph 9 concludes.

2. The economics of integration

The economics of integration involves two, interrelated, aspects: the microeconomics and the macroeconomics of integration.

The microeconomics of integration looks at the reasons why it is beneficial for a country to join an integration agreement and it rests on international trade theory. As it is well known, short of full unilateral liberalization, which - according to neoclassical theory represents the first best policy to maximize national welfare - partial opening up of barriers following integration will improve the allocation of resources and hence welfare. Although this improvement might be partially curtailed by trade diversion, which could offset gains from trade creation, reallocation of resources generated by the integration process allows for the exploitation of national comparative advantages. Differences in national resource endowments will lead to a deepening of specialization patterns which will benefit all countries involved in the integration process. Factors of production within each country would be allocated in sectors where the country enjoys a comparative advantage while other sectors would have to be closed down. Such a process will, of corse, involve adjustment costs and temporary unemployment, the severity and duration of which could be alleviated by appropriate financial support (a topic which will be taken up later). Note that the benefits of integration, in such a framework, could be equally obtained by the reallocation of factors among countries, i.e. by migration and/or capital movements. Once reallocation is completed the region will witness an increase in inter-industry trade, i.e. trade of goods belonging to different sectors (like e.g. textiles and food products).

Economists heve recently pointed at another possible source of gains from integration, deriving from the exploitation of (static and dynamic) gains from trade. The larger market generated by integration would allow (oligopolistic) firms to exploit increasing returns. This would lead to further specialization within the same sectors as competition would rest on both lower costs

deriving from expanded production and from product (quality) differentiation. Intra-industry trade, i.e. trade of similar goods between countries would be generated.

Welfare gains from integration would ensue from lower costs and broader quality range as well as the exploitation of dynamic returns to scale generated by the learning process following the introduction of new technologies.

In this case too costs from integration could emerge. In addition to the standard adjustment costs economies of scale could generate agglomeration effects as factors, both capital and labour, would concentrate in specific regions only, leading to undesirable core-periphery effects within the region. Employment opportunities would concentrate in some areas exacerbating the asymmetrical distribution of net benefits. (Krugman 1992)

In general trade integration would increase both inter and intra industry trade and, in both cases, adjustment costs would activate pressures to resist adjustment and or demand compensatory measures on the part of countries and areas most severly hit by the asymmetric distribution of net benefits.

Economic theory not only predicts that trade integratuiion will rise welfare of integrationg economies but also suggests which countries are likely to form integration agreements. The so called "gravity models" ( ) predict that countries are most likely to form integration agreements, and to develop their bilateral trade, the shorter is the geographical distance (or higher geographical proximity) as this minimizes trasportation costs, and the closer are the income levels, as this generates similar consumption patterns and favours the development of intra industry trade and the exploitation of economies of scale.

This is a relevant point in the case of the Middle East as the substantial divergence of per capita incomes between Israel and the Arab countries is seen by many as a severe obstacle to the development of deeper regional integration.

This takes us to the macroeconomic aspects of integration. Two points should be considered under his topic: one deals with the coordination of macroeconomic policies and will not be considered here; the other deals with the macroeconomic conditions that must be fulfilled for an integration process to be succesfull.

As we have said trade and industrial integration imply adjustment costs. These are better sustained, both from an economic and from a political point of view, under conditions of high growth. High growth is also necessary to close per capita income differences which, as mentioned above, may represent an obstacle to integration. Finally, redistribution effects are better sustained when the absolute amount of wealth each countryobtains is large even if it may be unsatisfctory from a relative point of view.

Growth may be slowed down if a country, pursuing a strategy of opening up, is constrained by its balance of payments performance. It is resonable to expect that during the early stages of integration a country will have to import proportionally more than it is able to export. This, in turn requires that appropriate external financing is obtained, i.e. that international markets, foreign governments, and international organizations are willing to trasfer funds to the country in question.

External financing can be obtained on purely political grounds, i.e. when donor countries value the position of the recipient country as vital to their strategic interests, and therefore are willing to sustain her financing needs irrespective of the recipient's ability to repay her debt. In a process of integration, however, while political factors may be highly relevant - as we shall see below - market forces will come to play an increasingly relevant role, both directly and indirectly. Directly because if a country wishes to attract foreign capital it must offer minimun credibility conditions both about her growth prospects and her ability to repay her debt; in a word a country must be creditworthy. Indirectly, because creditworthiness can be obtained through the scrutiny of international lending organizations which, if positive, would convince international markets of the opportunity of investing in the country.

From this point of view one of the macroeconomic benefits of integration is indeed the acquisition of international credibility as partecipation into an international agreement requires structural adjustment in the integrationmg economy. (1)

Creditworthiness brings further adjustment costs, in addition to those generated by the opening of trade, as it usually requires that the macroeconomic policy of the recipient country be set on a course consistent with international standards. This requires, in other words, the the government of the recipient country is willing to change her macroeconomic priorites. As it will discussed below this implies political as well as economic costs and benefits to be evaluated.

To summarize, economic theory suggests that integration is benficial because -in the case of trade integration- it allows to reach a more efficient resource allocations and, also because it allows the country to obtain -in the case of macroeconomic integration-credibility benefits.

3. The politics of integration

Political choices related to the integration strategies have already been mentioned. Insofar as the integration process requires adjustment costs these will bring political costs and benefits considerations on the foreground. A governemnt will have to consider both economic and political costs and benefits deriving from the decision to integrate and confront them with the political costs and benefits of the other option, i.e. not to integrate and keep pursuing an isolationist policy. The ways in which these interact will be discussed in more detail below when we present a conceptual framework where these elements are combined and interrelated. Before we do this, however, other factors explaining the opportunity to join an integration agreement, related to political aspects, must be considered.

As it has been recently reiterated (Gowa 1994) trade integration, which may be considered the production of a partially excludable public good (a club good), generates another benefit to integration countries, security, as increasing trade ties decrease the incentives to recur to hostile behaviour. Conversely, the production of security, itself a public good, leads to develop trade among military allies rather than with (potential) enemies. It follows that trade agreements and military alliances tend to reinforce each other.

This implies that membership in a trade agreement is more valuable in presence of a possible outside threat. This may be a genuine military threat as Gowa and Mansfield (1993) have argued. According to these authors trade agreements are more likely among countries which are also members of the same military alliance. Their argument can be most fruitfully applied

to a cold war (bipolar) world rather than to a multipolar situation. The present global environment, characterized by a drive towards trade regionalism (De Melo and Panagarya, 1992) may present other forms of threat i.e. those deriving from the formation of regional and aggressive trade blocs. In such a case the incentive for joining a trade agreement, does not lie so much in the trade creation and factor allocation benefits as in the "insurance" that membership in a regional agreement provides against the harm that a trade bloc war could produce to small isolated countries (Whalley and Perroni 1994, see also Baldwin 1993).

4. Regional integration and collective action

The economics and the politics of integration explain why it may be beneficial to form integration agreements. The existance of such incentives, however, does not guarantee that a process of integration will actually take place. Suppose that all countries which would benefit from a such an agreement are pursuing nationalistic and isolationalistic strategies, suppose, in other words that they are in a situation of mutual non-cooperation. In such a case, as it is well known from the theory of international cooperation, (Guerrieri and Padoan 1988) the conditions for the production of the collective good repsresented by the agreement may fail to materialize. If, however, a process of integration is started a cumulative process may take off which will induce initially reluctant countries to join in the agreement (Padoan 1994). In other words when considering the possibility of integration one should distinguish between the potential benefits, as discussed above, and the conditions of the actual process of integration.

It is well known from the theory of international cooperation that the probability of forming an international agreement, producing an international public good, raises with the presence of a leader country, a regional hegemon. (2) In such a case the leader can start a process of integration, e.g. by offering unilateral liberalization measures so as to induce other countries to liberalize as well. In terms of the theory of collective action the leader will be willing to bear more than proportionally the costs of providing the collective good while smaller countries will, partially or totally, free ride.

The leadership function, however, need not necessarely be covered by a single country, nor this has to be a country within the region. As Shelling (1960) has shown (See also Lake 1993) the leadership function can be provided by a k-group, a (relatively) small group of countries that jointly produce the collective good. Seen in a slighltly different perspective (see e.g Witt 1989) a k-group supplies the "critical mass" that is needed to start off the integration process.

Again, the leadership function need not be provided by a country or group of countries within the integrating region. Such a function can be provided by actors whcih are not necesarely members of the emerging agreement. To understand the point consider the case of regional integration agreements that charaterize thye present state of international trade relations. The current wave of regionalism, which seems to be rather solid and promises to be long lasting (Panagaraya and De Melo 1992) is different from the one that started in the mid sixties. That experience eventually failed mainly because countries seeking to form regional agreements pursued inward oriented policies as regional integration was seen as an alternative to a policy of opening up to international markets and was characterized by a strategy of import-substitution rather than one of export promotion.

The current wave of regional trade formation is, on the contrary, outward oriented. Countries seeking to join regional trade agreements are also pursuing polices of opening up. More

precisely they are seeking access to regional markets as a precondition for or a complement to external opening tout-court. Notable examples are EFTA and Central Euroepan countries seeking European Union membership, Latin american countries seeking NAFTA membership, Asian countries pursuing initiatives such as Apec. It is clear that such a storming wave of regionalism is possible because the major industrialized countries, such as the US, or group of countries, such as the EU, are favouring the process, i.e. they are providing a leadership function.

Note that provision of a leadership function by a country, or group of countries which do not belong to the integrating region implies that two integration processes are at work. One is related to the integration of peripheral countries with the central region, the other deals with the integration process among the peripheral countries. These two processes need not proceed along the same lines and, in some cases, they are seen as alternatives rather than as complementary strategies. Indeed as several examples show (3) peripheral countries would rather join the core region directly without forming a (local) regional agreement with their neighbours, which may even be regarded as adversaries rather than allies or partners. In such a case, which is certainly the case of the Middle East, a crucial role in fostering regional integration can be played by the leader(s) country, e.g. by accepting to provide access to regional integration, international collective goods, only if the local regional agreements develops.

In the case of the Middle East if industrialized countries or international organizations believe that a condition for stable peace in the Middle East -which is in their interest to obtain- is economic integration in the region then they will try to speed up such a process both through pressure politics and by offering economic benefits, such as financial assistance and market access conditional upon progress in local regional integration.

What we are mainly interested in this paper, however, is not the behaviour of leader countries such as industrialized nations vis-a-vis the Middle East, but the behaviour of countries belonging to the region in deciding whether joining a local integration process is beneficial or not. In what follows we will provide a framework to describe such a decision process.

5. An isolated economy

Let us start by considering an isolated economy and consider the policy problem faced by the government. While there are several ways to consider and model the goals of an isolated economy (See e.g. Frey 1994) one may start by assuming that a government faces two problems: a domestic problem, which may be represented by saying that it wishes to maximize the probability of staying in power, and an external problem which may be represented by saying that it wishes to maximize her (external) security. In order to obtain these two goals the government will use public expenditure -her only policy tool in our simplified framework. Using a simple notation we will say that the government will use X, the public expenditure share over GNP to maximixe P, the government's popularity, to which the probability of staying in power is positively related. We also assume that there is a minimum level of popularity P* which is required to stay in power for a given institutional and political setting. The way in which X influences P reflects the social and institutional characteristics of the country. The amount of X necessary to obtain a given amount of P will increase with the degree of social sclerosis in Olson's (1965) sense, the number and strength of interest groups, the degree of fragmentation of the society, the size of the state bureaucracy (Mueller 1988). Obviously a

minimum level of popularity implies a minimum level of X, -X*-. Figure 1 represents the relationship between X and P with two different hypothesis about the nature of state relatioships. A strong state (S), where the dgree of social sclerosis is low, will obtain a higher amount of P out of a given amount of X than a weak state (W) where the degree of social sclerosis is high.

Let us now consider the other aspect, security. One, albeit indirect, way of increasing security of a country is to maximize the production of wealth, i.e. the rate of growth of output. A high rate of growth increases both available resources and the welfare of the population, so it is reasonable to assume that, ceteris paribus, a government will try to maximize the rate of growth of the economy Y. To this end the government will use her policy variable X.

The relationship between government's expenditure and growth is far from uncontroversial. Theoretical arguments and empirical evidence exist to support both views, i.e. that a larger share of public expenditure lowers growth and that it stimulates it. The relationship between growth and public expenditure, in addition, involves qualitative as well as quantitative aspects which may be captured only with severe semplifictions. It is more convenient to consider growth benefits (Yb) and growth costs (Yc) of government's expenditure. The first derive from the improvement in the country's infrastructure, research efforts, human capital etc., all factors which improve a country's productivity. The second derive from the negative effects on the economy's allocative mechanisms as a consequence of the distortions introduced by the government. This implies that what matters is not just the gross size of the government - as measured by her expenditure- but also her composition, i.e. given the overall amount of X the results in terms of Yband Ycwill depend on the composition of X. A higher share of expenditure in e.g. education, R&D etc. will raise Yb, a higher share of e.g subsidies , but also military expenditure insofar as it implies imports from abroad and does not stimulate a national industry, raise Yc.

The relationships between X and Yband Ycare represented in figure 2. They are both increasing but at different rates. The case drawn suggests that there is a range of values of X for which benefits are larger than costs but that, once X passes a critical value (X2 in fig. 2) costs become higher than benefits.

The positions of the curves reflect the compositon of X. So that, e.g, a higher share of R&D expenditure in X will shift Ybto the right and e.g. a higher share of military expenditure in X will shift Ycto the right.

Other things equal the government will choose X so as to maximize the difference between Yband Yc.

We are now able to illustrate the policy choice of an isolated government with the help of figure 3. In the left hand quadrant the government chooses X so as to satisfy the popularity constraint P*. I.e. X cannot be lower than X*. Given this lower bound X will be set so as to maximize net growth benefits.

As drawn, figure 3 leads to one prediction of the model. Domestically strong states will obtain larger growth benefits than weak states because they can reach P* with a lower value of X. Also, strong states can afford, ceteris paribus, a larger share of military expenditure -because they will suffer a lower loss in terms of growth benefits. In other words, strong states and states where governments expenditure is more efficient and the economic system is more able to

transform public resources in growth outcomes are more able to pursue isolationistic policies. insofar as they are able to obtain higher growth, and hence security, benefits from public intervention.

6. Costs and benefits of integration

As it has been made clear in the previous paragraphs economic integration delivers benefits and costs, both economic and political, to the integrating countries. Drawing on the literature of economic integration we can assume that costs of integration -Ic- are decreasing, and benefits of integration -Ib- are increasing with the degree of integration, i.e. with the degree of liberalization of the economy. Costs derive from the adjustment an economy has to undergo in the reallocation process that integration requires. Such costs are initially high as one can assume that the production structure of a closed or isolated economy is initially quite distant from the one that is optimal in an integration equilibrium. Hence the resource reallocation process may be quite painful, in terms of sectors that must be closed down and in terms of the political resistance to change. Ceteris paribus we can assume that integration costs will be larger the higher is the degree of protection and the larger is the share of the economy that is not exposed to international competition, i.e. the non tradable sector.

Benefits are increasing with the degree of integration as beneficial effects of international competition spread over a larger part of the economy. Considering the non economic aspects of integration benefits will be larger if members of the integrating region are also part of an alliance, if there is an outside threat, and if the region includes a leader able and willing to provide collective goods to the the other countries.

Figure 4 describes these elements. The position of the Icand of the Ibcurves, respectively, depend on the share of the non tradable sectors (a larger non tradable sector shifts the Iccurve upwards), and on the presence of an alliance, an outside threat, a regional leader, all elements that would shift Ib upwards.

As it is shown, there is a critical level of integration -T*- beyond which benefits are larger than costs, hence it is convenient to pursue the integration option.

Trade and industry liberalization, however, is not enough to start and pursue a strategy of integration. The adjustment entailed in the process of integration implies a macroeconomic dimension. Funds must be made available to the economy to finance the adjustment and macroeconomic stabilization must be implemented to obtain the dual objective of making the potential benefits of integration effective and obtaining the international credibility that is necessary to attract funds from abroad, both from official institutions and from private investors (See Wilson 1994). In short, the macroeconomic dimension of integration implies an additional cost, that of obtaining the creditworthiness necessary to gain access to international capital markets.

We can assume that the cost of creditworthiness (R) is increasing with the degree of liberalization (integration) as a larger amount of funds will be needed the larger the dimension of the transformation process due to integration. A political element is also involved with respect to the kind of government ruling the country. As it has been argued (Rauscher 1993) democratic regimes will obtain easier access to international lending than authoritarian regimes

as both international organizations and private investors will attach a larger risk premium to investments in the latter.

Matching up the two elements of the integration process produces a new threshold in the choice process, illustrated in figure 5. As the cost of reputation R increases with the amount of integration T the critical value T* determines a critical value -R* - of reputation which must be reached in order to gain access to international finance. The value of R* is larger the less democratic is the political regime of the integrating country.

International reputation can be obtained by engineering a macroeconomic adjustment program, which in our framework, can be, very simply, represented by an inverse relationship between R an X the policy variable controlled by the government. This implies that a minimum level of R requires a maximum level of X.

At this stage the framework is fully described and ready to be used for its purpose, i.e. to answer the question: under which circumstances will a country find it desirable to join an integration agreement?

To sum, up the incentive to integrate requires that a miminum level of integration is reached. Such a level is smaller: the more market oriented is the economy, the stronger is the integration process already in place, the stronger is the outside threat (e.g regional blocs worldwide), the stronger are the political and military ties with neighbouring countries, the more efficient is the provision of regional collective goods by leader countries.

The minimum level of integration implies a minimum level of international creditworthiness (reputation) to be obtained in international markets. As the minimum level of integration and the critical level of reputation are directly linked, case in which the incentives to integrate are strong also entail a relatively small reputation cost so that a positive, cumulative mechanism is set in place. Given the political dimemsion attached to reputation building one prediction of the model is that market oriented democracies will face stronger incentives to integrate than closed-economy, authoritarian countries.

Changes in the outside environment can alter national incentives to integrate. These will rise with increasing conflictuality in global trade relations, the perception of outside threats, the active role of leader countries, which may not necessarely be members of the region. The funding policy of international organizations may influence the incentive to integrate by lowering the reputation cost.

7. The Choice to Integrate

While the model described above may appear unnecessarely complex it really boils down to one choice. The government mayset the amount of X, her policy variable, at a value that is consistent with the integration option. It will do so if this option brings forward net benefits that are larger than those associated with the isolation choice.

Figure 6 brings together the elements introduced above in the case the option to integrate is a preferred one. Let us start from quadrant 2. The intersection beteween benefits and costs from integration determines a minimum level of integration -T*- . This leads, in quadrant 3, to a minimum level of reputation R* to obtain the necessary financing in international markets.

Quadrant 4 brings together the reputation function and the popularity function, both determined, although in an opposite relationship, by the level of the domestic policy variable X. To use Putnnam's (1988) terminology (see also Guerrieri and Padoan 1990) the upper and lower bounds to X, established respectively by the reputation -X(R*)- and the popularity - X(P*) - constraints, determine a "win set", i.e a set of feasible policies that are consistent with both domestic and international policy goals.

The case described in figure 6 shows that, given the win set, the govermnent will set the policy variable to X+ so as to maximize the net benefits from growth (the segment A-B in quadrant 1). As a consequence total benefits obtained by the government from the integration choice will be (A-B)+(D-E), growth benefits plus integration benefits.

The case just described is fortunate but also not very interesting. In such a case if an integration opportunity arises it will be convenient for the government to exploit it at no additional cost as benefits from domestic and international policy choices will simply add up. As we have discussed in paragraph 1, however, integration usually brings about adjustment processess that change the incentive set faced by a government. Two cases are worth considering.

1) The reputation constraint is more binding that the popularity constraint: $X(R^*)<X(P^*)$. In such a case a win set does not exist. The emergence of an integration option, however, may be exploited by the government to force an adjustment on the domestic economy by lowering the popularity constraint below the reputation costraint. This is the familiar case where international politics is used as a leverage to impose change in the domestic political and economic arena. This option will be more attractive the larger are the benefits promised by the integration process. Without developing too much the point one can imagine that this option will be more easily pursued the more powerful are the domestic interest groups that will benefit from integration (whose relative position and size determines the relative position of the Iband Icschedules).

2) The reputation constraint is less binding than the popularity constraint, however it doeas not allow the country to maximize the benefits of growth as the appropriate value of X, X+, cannot be reached: $X(P^*)<X(R^*)<X+$. In such a case the option to be chosen must confront the benefits of isolation, (Yb-Yc)' and the benefits of integration, which include the benefits of growth in the case of integration, which are obviously lower, i.e. (Yb-Yc)"<(Yb-Yc)', plus the benefits from integration (Ib-Ic). Integration will be pursued if (Ib-Ic)+(Yb-Yc)">(Yb-Yc)'.

In sum, the government will accept to pursue a domestic adjustment if, even with a lower level of X than the one obtained in the isolation case, the condition above is satisfied. If that happens countries partecipating in the integration process will exhibit a lower level of X. The level of X chosen will be such as to maximize (Ib-Ic)+(Yb-Yc)" with the constraint of $X>X(P^*)$. If the latter cannot be met, again the country will face an incentive to pursue a domestic political adjustment so as to lower the value of $X(P^*)$.

8. Implications for integration in the Middle East

What can the model described tell us about the process of integration in the Middle East? To look at this issue it is useful to distinguish between two integration episodes in the region. One dates back to the seventies, when integration among Arab states was fostered by two factors:

the political cohesion against Israel and the large availability of funding from oil exporting countries. The second is the possible current phase of integration.

The first episode did not produce any substantial integration in trade an industry. As external financing was not subject to economic conditionality or reputation to obtain creditworthiness, Arab countries were not faced by a true alternative between what we have called an isolationist and an integration policy. Growth benefits were obtained through macroeconomic policies aimed at maintaining domestic popularity in a war economy context which increased, ceteris paribus, the costs of state intervention, Yc. No real pressure for adjustment was exercised. Major benefits from integration derived from increased labour mobility within th region and from the ensuing financial remittances.

The second episode is, of course, to be fully explored. We may assume, however, that it could present the following characteristics. In the first place, credible peace would allow to lower government expenditure on armaments, thus increasing, ceteris paribus, net growth benefits as the Yc curve would shift to the right. Secondly, the possibility of economic integration would bring net integration benefits in the picture. To consider this aspect we must distinguish among possible alternatives for integration.

"Weak integration". The process of integration is limited to partial trade liberalization and to some common infrastructural projects. Net benefits from integration may be small or even negative as a critical level of integration T* is not reached. This may be due to the fact that the exploitation of comparative advantages following liberalization leads to limited benefits from reallocation. Countries in the region, or at least some of them, may not find it profitable to undergo the necessary domestic adjustments. In such a case only the benefits from lower military expenditure will result.

"Strong integration". Positive cumulative processes take off along the lines described in the first paragraph. The Ibcurve shifts upwards, possibly in different degrees for different countries, thus making the integration option more beneficial for at least a number of countries. In some cases, however, political considerations may make it impossible to pursue the necesary domestic adjustments.

The role of "External factors". In both cases incentives to integrate may be increased if the external conditions improve. These, in turn, may relate to two aspects:
1) Trade barriers are lowered by other regional agreements (e.g. the European Union). In such a case the Ibcurve shifts upwards both because of economic reasons (larger market access) and political reasons (insurance against threaths from global regionalism).
2) Reputation requirements are lowered by international organizations, the R(T) function in quadrant 3 of figure 6 shifts upwards thus bringing the critical value X(R*) upwards. The political costs of integration is thus lowered.

Finally consider that, while integration opportunities may vary in different countries for a given international environment due to diverse domestic political and economic conditions, a cumulative process of integration may start if a core group of countries finds it profitable to go along with the integration option. In such a case, even if some countries do not find it profitable to join the process, a dynamic thrust to integration may force the outsiders to engineer the necessary domestic adjustments. Needless to say a crucial role by the international organizations and industrialized countries can be played in providing the initial conditions for the process.

9. Conclusion

In this paper we have briefly reviewed the economic and political arguments for regional integration, we have then presented an exploratory model to investigate the integration choice, i.e. we have asked under what conditions a country would find it beneficial to partecipate to an integration agreement. Given external conditions a country will be more willing to undergo integration costs in order to exploit benefits from integration the more democratic is the political regime and the more market oriented is her economy. The case of the Middle East presents different national political and economic situations hence Middle Eastern countries face differnt incentives to integrate.

We have also considered two alternative scenarios for economic integration in the region, weak integration and strong integration but we have noted that political obstacles to integration may be strong and while Arab countries may prefer to pursue integration agreements among themseleves before they integrate with Israel, the latter could find it convenient to exploit the openness option. i.e. to pursue an outward oriented economic strategy without regional integration. In an optimistic scenario a cumulative mechanism may be started where a core group of countries in the region launches an integration agreement thus providing a critical mass for further enlargements. We also notice, however, that a fundamental role must be played by the industrialized countries and international organization to actively support this option.

Notes

(1) The process of European monetary integration is an obvious example. Inflation prone countries such as Italy, France and Spain have been willing to accept the costs of integration to "import discipline" and enhance their international creditworthiness.

(2) See Mansfield (1994) for recent evidence.

(3) Central European countries and the EU.

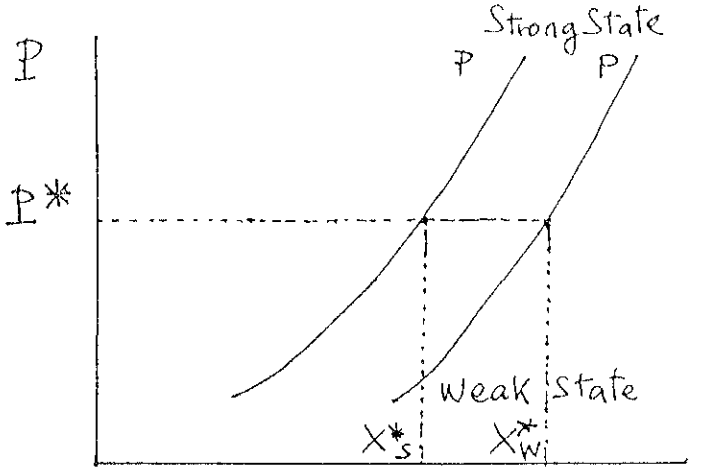

Figure 1

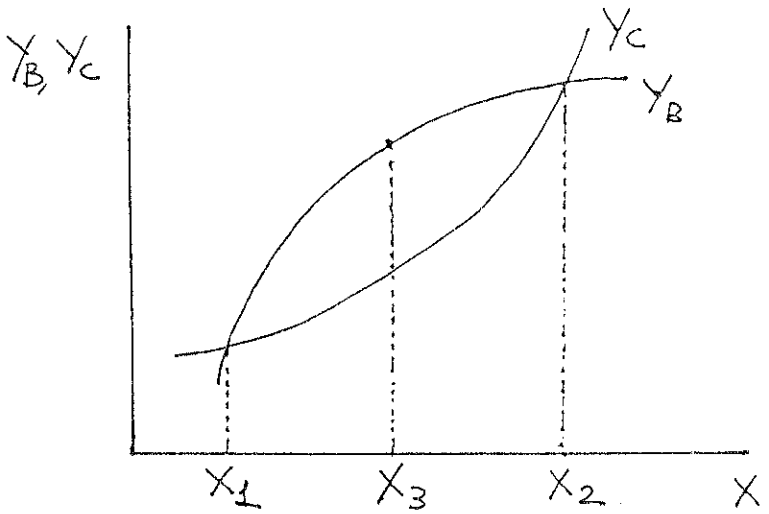

Figure 2

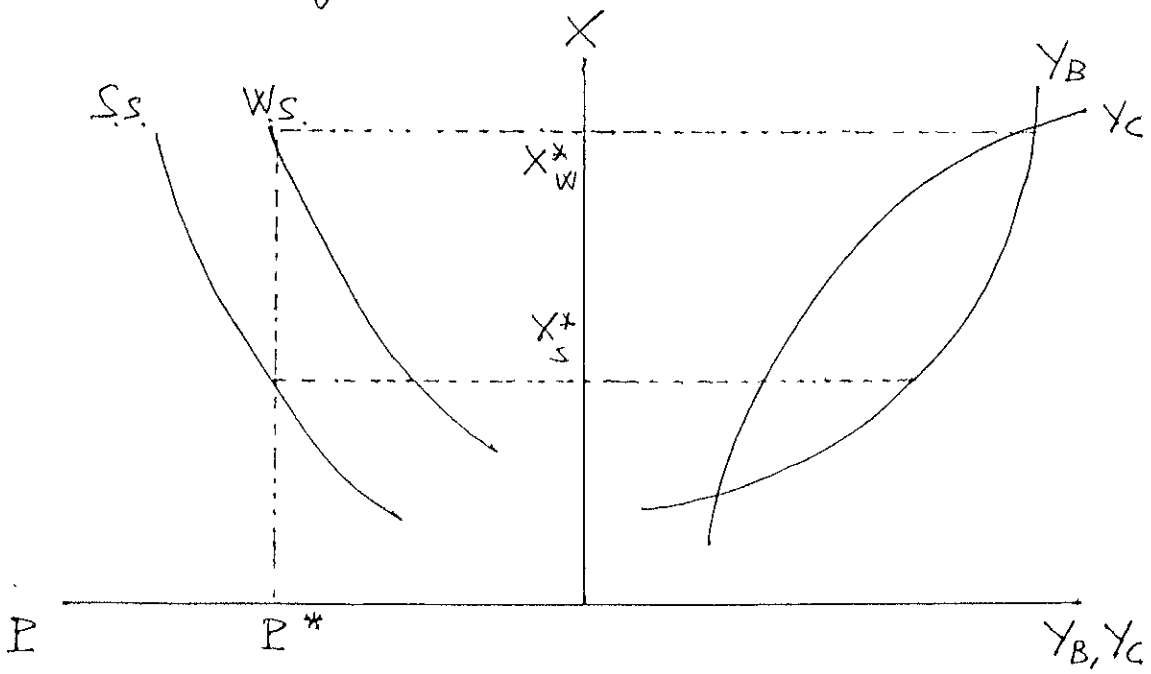

Figure 3

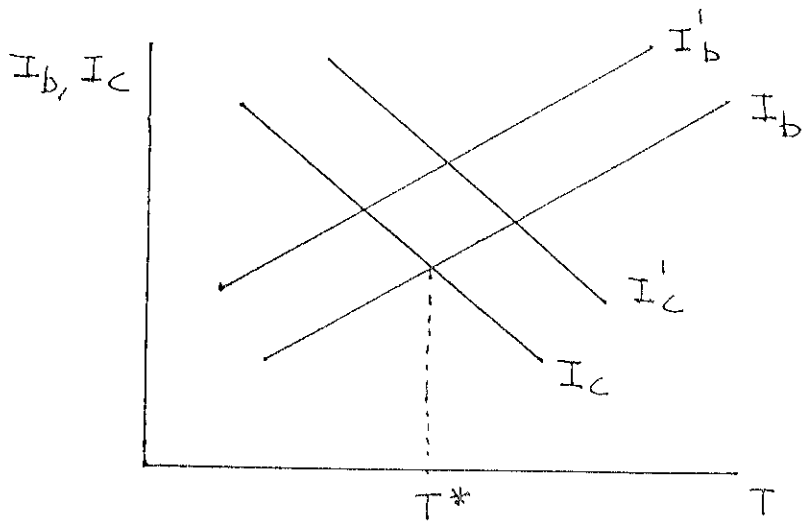

Figure 4

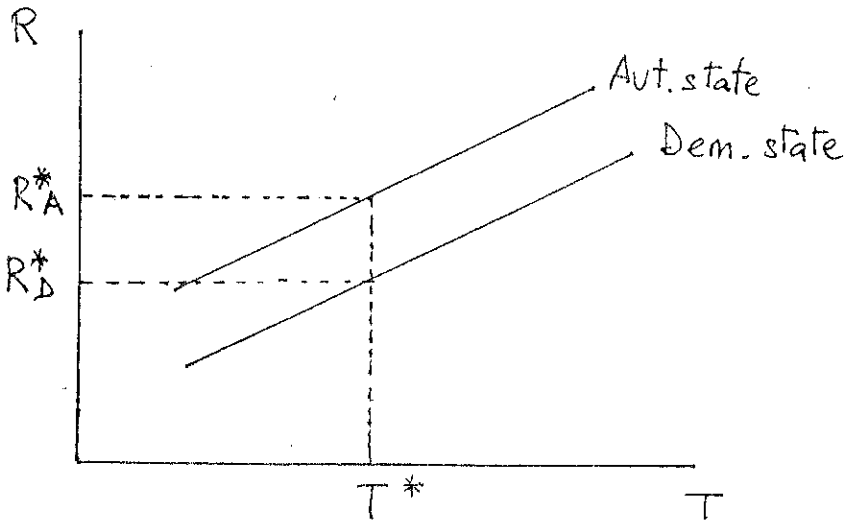

Figure 5

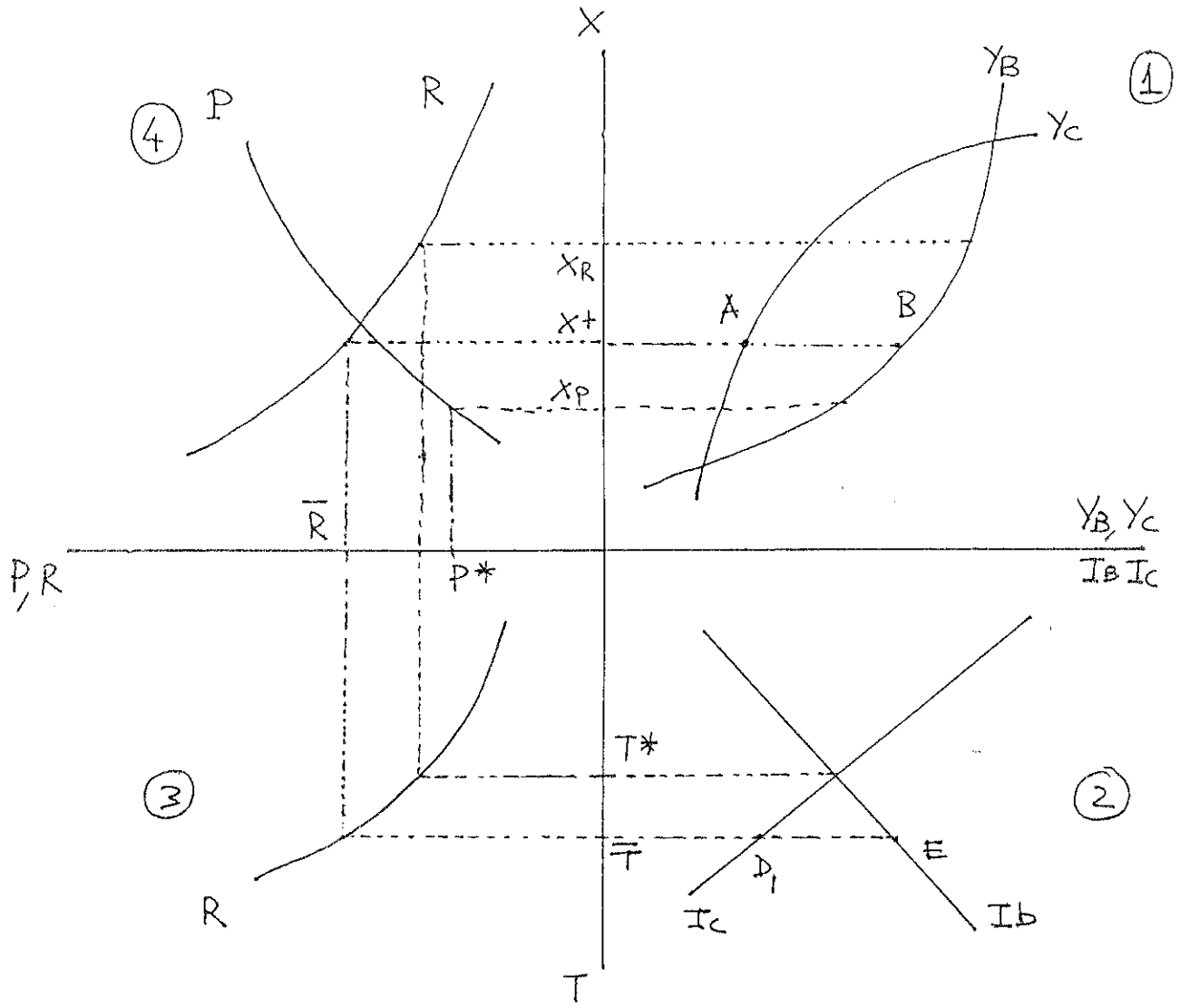

Figure 6