K4D Knowledge, evidence and learning for development

Relationship between regional cooperation and political stability and prosperity

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16 March 2018

Question

What evidence is there internationally that increased regional cooperation can lead to greater national/regional political stability and prosperity?

Contents

1. Overview

Regional cooperation takes a number of forms. Types of formal regional cooperation include preferential trade agreements, free trade agreements, customs unions, common markets, economic unions, economic and monetary unions, full economic integration, and political unions (Marinov, 2015, pp. 24-25).

The literature identifies a number of benefits and risks of regional cooperation. In terms of its impact on prosperity, regional cooperation can have the following impact:

- **Expanded markets:** This should lead to economic growth, but can only do so if member states have the capacity to produce goods and services to benefit from wider markets.
- **Income convergence or divergence:** Depending on the nature of cooperation (economic or political) and on whether the cooperating countries are low, middle or high income, countries within a region can experience income convergence or divergence.
- **Increased investment:** Regional cooperation can increase Foreign Direct Investment (FDI) due to market enlargement and product rationalisation.
- **Integrated labour markets:** Free movement of labour is believed to increase prosperity as access to the labour force and skills of all member states in a region ensures that the skills and manpower needed for economic development are available.
- **Contagion:** If one country experiences an economic shock this can rapidly spread to neighbouring countries.
- **Increased income inequality within a country:** As a result of the expansion of the labour market beyond national boundaries, labour markets within a country lose much of their bargaining power. This can result in increased inequality within a country.

While the literature search conducted for this report did not find evidence that there is a direct link between regional integration and economic growth, the evidence does suggest that regional integration still has a positive impact on growth in member states via the effects of increased trade and investment.

Regional cooperation can also affect political stability. Ways in which this can occur include:

- **Increased cost of conflict**: Interdependence increases the cost of conflict and therefore constitutes an incentive to maintain stability.
- **Increased trust**: Regular political contact builds trust between countries and facilitates cooperation on security matters.
- **Inappropriate conditions for regional integration can increase the risk of conflict:** Attempts at regional integration in inappropriate conditions, such as the absence of democracy or presence of internal tensions within member states, can increase the risk of regional conflict.

All of the above benefits and risks are however dependent on a range of variables. These include the political and economic nature of the countries engaging in integration, the size of the countries integrating, the political will of member states for increased integration, and their capacity to implement integration. These factors therefore have to be taken into account when considering the impact on prosperity and political stability of individual regional cooperation agreements.

There is a considerable body of literature on the impact of regional cooperation on prosperity and political stability. The literature consists of books, peer-reviewed journal articles and policy papers. The studies considered in this review use both qualitative and quantitative methods. While many ways in which regional integration affects prosperity and political stability are identified in the literature, there is often a lack of rigorous evidence to support these findings. The literature identified during the course of the research was largely ‘gender-blind’.

2. Regional cooperation and political stability

Benefits

- **Increased cost of conflict:** Increased interdependence between states increases the costs of conflict, serving as an incentive to maintain stability (UNECA, 2004, p. 15). Focusing specifically on the East African Community (EAC), Mayer and Thoenig estimate how changes in trade patterns affect the statistical risk of conflict. They find that regional integration has the potential to decrease the statistical risk of war among member states substantially (-10% for the customs union, -4% for the common market and -1% for the common currency). This is due to the fact that member states being dependent on trade amongst each other increases the opportunity cost of war (Mayer et al, 2016, pp. 4-5).
- **Increased trust:** Regular political contact between members can build trust and facilitate cooperation on security issues (UNECA, 2004, p. 15).

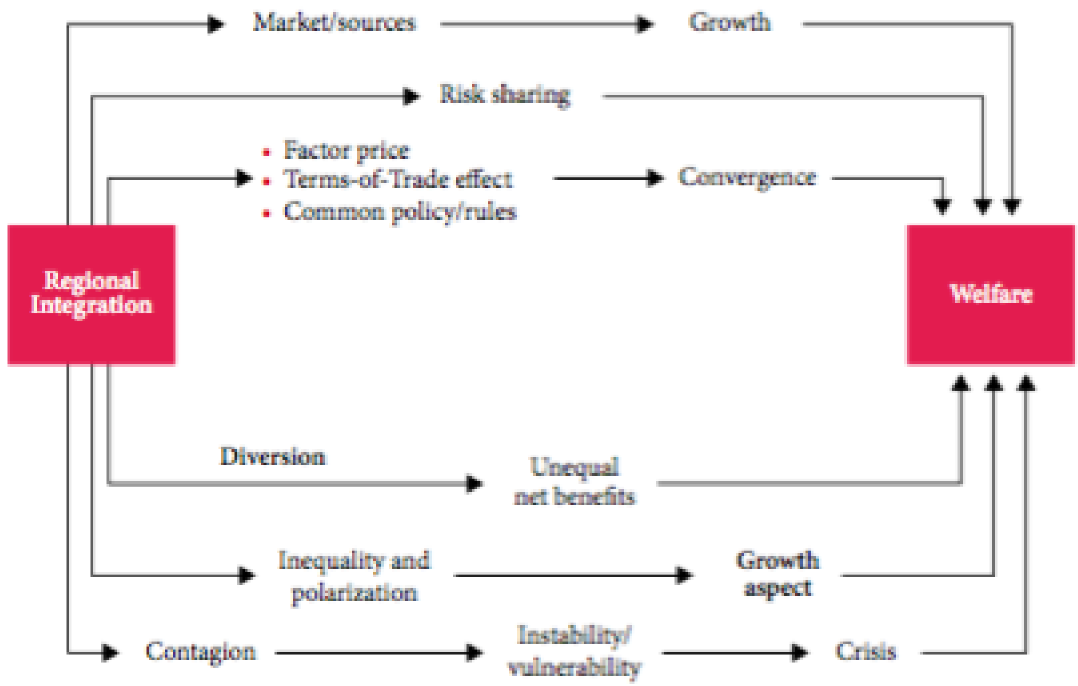
Risks

- **Inappropriate conditions for regional integration can cause regional conflict:** Attempts to bring countries together into regional cooperation schemes under inappropriate conditions, such as internal tensions and the absence of democracy in member states, can bring about the same conditions that generate conflict within states (El-Affendi, 2009). For example in the early years of the Intergovernmental Authority for Development (IGAD), member states provided support for rebel movements in other member states. Somalia and Sudan provided support to rebels fighting the Ethiopian regime and Ethiopia reciprocated by providing support to Somali and Sudanese rebels. Moreover, Kenya and Uganda also provided support to Sudanese rebels (El-Affendi, 2009, pp. 6-7). El- Affendi argues that regional cooperation creates winners and losers and ‘if the losses are too high, too sudden or too detrimental to values held dearly by some actors, then a violent reaction is likely to follow’ (2009, p. 15). This can be avoided if there is an awareness of these dynamics and their consequences, and if there is a timely and proportionate intervention (El-Affendi, 2009, p. 15).
- **Trade diversion is associated with a higher risk of intra-state conflict:** In a study focusing on the EAC, Mayer and Thoenig find that because increased trade among member states diverts internal trade, and diverts trade with neighbouring countries that are not part of the union, it slightly increases the statistical risk of intra-state conflict and conflict with the EAC’s neighbouring countries (Mayer et al, 2016, pp. 4-5).

3. Regional cooperation and prosperity

The literature identifies a large number of economic benefits and risks associated with regional integration regarding prosperity. However, many of these are not substantiated by evidence. The Asian Development Bank's diagram below provides an overview of the key benefits and risks associated with regional integration. These are discussed in further detail below, alongside benefits and risks identified from other sources.

Figure 1 Impact of Integration



Source: Office for Regional Economic Integration, ADB.

Benefits

- **Expanding markets:** A wider market for goods and services, for both output and inputs, should lead to higher economic growth and improved welfare (ADB, 2013, p. 4). However, expanding market access by lowering the transaction costs of trade does not guarantee economic growth and development. Enhanced market access without an increase in the capacity to produce goods and services to benefit from those opportunities will result in failure to produce higher economic growth (Hartzenberg, 2011, p. 17).
- **More efficient resource allocation across the region:** This is due to the principle of comparative advantage. If, as a result of comparative advantage, productivity growth is increased, regional integration can speed up economic growth and increase employment (ADB, 2013, p. 4).

- **Reduced income inequality between countries:** Political integration has the greatest impact on reducing inequality because convergence results from the diffusion of common development policies and common rules and market regulations. Therefore political relations matter more than region markets for the process of economic development. (ADB, 2013, p. 6).
- **Risk sharing:** According to the ADB, ‘if inter-regional or international capital markets are well integrated, countries can insure against idiosyncratic shocks’ (2013, p. 7). However, the same report finds that the degree of risk sharing following integration is often limited (2013, p. 7).
- **Investment:** Regional trade agreements can attract FDI both from within and outside the regional integration arrangement (RIA) as a result of:
  - market enlargement
  - production rationalisation (reduced distortion and lower marginal cost in production).

  Enlarging a sub-regional market will also bring direct foreign investment, which will be beneficial, as long as the incentive for foreign investors is not to engage in ‘tariff-jumping’. It is therefore necessary to reduce protection and more specifically external tariffs (Kritzinger-van Niekerk, p. 2).
- **Integrated labour markets:** Free movement of people, by improving market access through economic integration and encouraging the movement of the labour force, can benefit the economic situation within a region (Nita, 2018, p. 24). According to a policy brief published by Global Migration Policy Associates, free movement of people is the means to ensure availability of skills and labour where needed. This can increase investment and economic development by enabling countries to draw on the diverse range of professional and technical competencies across countries in a region. It is therefore the practical means for increasing free trade and commerce, particularly of locally-produced goods and services (Global Migration Policy Associates). However, economic imbalances within a given region are often cited when arguing against free movement (Nita, 2018, pp. 24-25). The SADC, for example rejected freedom of movement on the basis of socio-economic disparities between member states (Nita, 2018, p. 25). However, according to Nita, it is unclear whether this decision was based on sound economic analysis or whether it served political purposes (2018, p. 25)
- **Provision or protection of regional public goods:** Regions are better placed than individual countries to provide ‘hard’ infrastructure such as roads and energy networks and ‘soft’ infrastructure such as institutions to facilitate and govern trade (The Commonwealth, 2017, p. 21). A regional approach to infrastructure development can help leverage economies of scale in financing and investment. It can also pave the way for further integration by reducing trade costs (The Commonwealth, 2017, p. 21). Moreover, adopting a regional approach to issues like the environment, water management and migration can have a positive impact on prosperity as these are all factors that affect the economy (GTZ, 2008, p. 7)

Risks

- **Contagion:** While a shock may originate in the financial sector of one country, it can rapidly infect others across a region—affecting entire economies and affecting people’s welfare (ADB, 2013, p. 9). An example of this is the Asian Financial Crisis of 1997/1998, which began in Thailand but rapidly spread to other countries in the region (ADB, 2013, p. 9).

- **Trade diversion:** This is the displacement of lower cost production from non-members by higher cost production from partner countries due to lower barriers within the free trade zone (ADB, 2013, p. 9). Trade creation and trade diversion can occur simultaneously and trade creation can make up for trade diversion so that there is still a net positive effect on the growth of trade (Bhalla, 1997, p. 25). However, trade diversion may result in the formation of new interest groups who may oppose moves towards a more open trading system (Bhalla, 1997, p. 25). According to the ADB, the risk of trade diversion can be minimised when regional integration is pursued at the same time as unilateral and multilateral liberalisation (2013, p. 9).
- **Income divergence:** While income convergence is listed among the economic benefits of regional cooperation, income divergence is also a possible outcome. The first East African Community was dissolved in 1977 because comparative advantage and agglomeration effects concentrated manufacturing in Kenya at the cost of Tanzania and Uganda (UNECA, 2004, p. 13). The literature suggests that income divergence is more likely to occur when regional cooperation is between developing countries rather than developed countries. Poorer countries should therefore implement economic reforms to ensure that they reap the potential benefits of regional cooperation or integration. Examples of such reforms are compensation schemes or adjustment processes (UNECA, 2004, p. 13).
- **Increased inequality within countries**: Economic integration tends to create a larger labour market and increase wage competition between workers. As a result of the expansion of the labour market beyond national boundaries, labour markets within a country lose much of their bargaining power. This can occur through unions losing their influence, for example. When this happens regional integration is expected to increase inequality within countries (ADB, 2013, p. 10). The same report mentions that other factors can have the same effect, but does not specify what these factors are.

Despite these benefits, a peer-reviewed quantitative analysis covering almost 100 developing countries does not find any robust growth effects of regional integration (Willem te Velde, 2011, p. 23). However, the paper also finds that trade and FDI promote growth, and as regional integration increases trade and FDI, regional integration still has a positive impact on growth in member states via the effects of this increased trade and investment (Willem te Velde, 2011, p. 23).

There are a lot of variables that impact the effect of regional cooperation on prosperity. These include:

- **Level of commitment to increased integration:** A lack of commitment results in a lack of supranational authority and weak regional coordination mechanisms (GTZ, 2008, p. 9).
- **Multiple membership of regional integration agreements:** Many countries belong to more than one such agreement for strategic reasons. However, this can result in conflicting obligations and the loss of efficiency related advantages (GTZ, 2008, p. 9).
- **Imbalance of political and economic power among members:** Powerful members of regional economic integration systems may wish to dictate the speed and orientation of the integration process thereby hindering a fair and equitable distribution of benefits (GTZ, 2008, p. 9).

- **Size of the economies that are cooperating or being integrated:** Integrating very small and poor economies still results in a relatively small regional market. While any market expansion will result in some scale benefits, promoting more competitive industrial development, the small regional market will still constitute a constraint on economies of scale (WTO, 2011, p. 12). However, if a small country is integrating with a large one the benefits for the small one are bigger because there is more demand for its exports. This is particularly the case when the small country is a developing one and the large country is a developed one, with higher purchasing power (Marinov, 2015, p. 31). The counter argument to this is that the larger country will inevitably benefit disproportionately due to the disparity in the economic potential of the two countries. The small country is seen as an unequal partner who has to adjust to the economic and price structure in the larger member-state (Marinov, 2015, p. 31).
- **Ability to implement regional integration agenda:** Weak states can constitute obstacles to the development of robust rules-based regional integration agreements, as they are often unable to develop, manage and implement them (WTO, 2011, p. 17).
- **Level of divergence of macroeconomic policies among member states:** A high level of divergence of macroeconomic policies, combined with lack of coordination among member-states, can reduce the potential gains of integration, especially in terms of an increase in inter-regional trade (Marinov, 2015, p. 30).

The economic benefits and risks of regional cooperation can therefore differ from country to country because of these factors.

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Suggested citation

Strachan, A.L. (2018). *Relationship between regional cooperation and political stability and prosperity.* K4D Helpdesk Report. Brighton, UK: Institute of Development Studies.

About this report

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