Chapter 6

Enlarging the Integration Bloc

Along side deeper regional integration among a given number of member states, the enlargement of an existing trading bloc displays the second major form of regional integration. With enlargement, in contrast to a deepening of integration, barriers to trade, factor flows and other regional integration measures between 'old' members of the integration bloc remain the same. Rather, the number of member states increases and the relationship between old and new members is altered.

In order to distinguish enlargement from the deepening of integration adequately, we need to analyze the enlargement process in at least a three-country framework. This enables us to leave the relationship already established between the members unchanged, while altering the two countries' relationship vis-à-vis the entrant. A two-country model can not encompass the decisive impact of the enlargement process on the relationship among already established members.

The most prominent example of an integration bloc where enlargement has played an important role is, once again, the EU. Consisting initially of six founding countries, it has expanded steadily ever since. After the fourth enlargement step which entailed the inclusion of the former EFTA-countries Austria, Sweden, and Finland, it now includes fifteen member states. There is a long list of countries willing to enter in the foreseeable future. In particular, integration of Central and Eastern European countries is on the po-
political agenda. In 1998, the EU started official negotiations for accessions with Poland, Hungary, the Czech Republic, Slovenia and Estonia (see Berliner Morgenpost (1998)). In addition, Roumania, Slovakia, Latvia, Lithuania and Bulgaria have applied for membership in the European Union. In Central and Northern Europe, Norway and to a lesser extent Switzerland are the two candidates most likely to join the EU in the not too distant future. Furthermore, with the formal Turkish application for membership, the announced reapplication of Malta as well as with the official negotiations for accession between the EU and Cyprus, a potential for EU enlargement to the South direction is on the way.

In other integration blocs, enlargement also plays a decisive role. One of the most recent examples is the integration of Mexico into the US-Canadian free trade agreement via the creation of NAFTA. More recently, talks have been started on expanding NAFTA through the inclusion of Chile. Even further reaching agreements of closer economic cooperation between the countries of the Western Hemisphere are targeted towards an enlargement of NAFTA across basically the entire American continent (see Financial Times (1994)).

The above mentioned potential and actual entrants fall into two broad classes of countries. The first group consists of developed, high-income countries like Sweden, Austria, and Switzerland. The second group of countries embraces candidates such as Poland, Hungary, Turkey and Mexico, constituting lagging economies with a relatively low income per capita and specialization patterns oriented more towards the traditional sector. We will discuss these two groups separately.

In the following, we look at the consequences from the integration of a country belonging to either group. In section 6.1, we extend our basic framework to a three-country setting. With the help of this three-country model, we analyze the gradual integration of a less-developed country into an integration bloc, consisting initially of two countries with endogenously determined specialization patterns. We focus on the growth effect of integration and the impact of enlargement on the relationship between the two ‘old’ member countries. In section 6.2, we look at an enlargement scenario with an advanced country as the candidate for integration. In contrast to section 6.1, innovation as well as production in advanced sectors takes place in the third country which becomes integrated in stages.

\footnote{Thereby, we draw on the analysis in Walz (1998).}