Macroeconomics of Regional Integration: Withdrawal from a Customs Union

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Abstract

This paper has two unique features: it deals with withdrawal from a customs union, which is a neglected aspect of international economic integration, and does so within a macroeconomic framework rather than standard general-partial equilibrium analysis. Withdrawal was in the British Labour Party's 1983 election manifesto; Greenland actually withdrew from the European Communities in 1985; presently an influential section of the British Conservative Party and others wish to do so for the UK; and the European Union's Reform Treaty for the first time allows for it. Moreover, given the recent proliferation in preferential trading arrangements, with overlap in membership, withdrawal is on the horizon. A simple, almost naïve, macroeconomic framework is tailored for the purpose not only because of its direct policy relevance, but also because it adds variety to relevant discussion. The conclusion reached is that the model does not negate the general conclusion of the orthodox analysis: in the presence of constraints on the use of domestic and exchange-rate policies to achieve full employment, the model points to the general potential superiority of continued customs union membership over a policy of withdrawal.
I. Introduction

For the first time in the history of the European Union (EU), Article I-59 of the shelved constitutional treaty extended the right to any member state to secede from the union. This article is however maintained in the Reform Treaty, agreed in June 2007 and finalised in October 2007, but it is yet to be ratified before becoming EU law; a treaty which largely retains the essentials of the constitutional treaty, deleting only its controversial ‘federalist’ overtones. This development ushers in a new area for research in the field of international economic integration since the literature has for all intents and purposes been confined to the ‘joining’, not the ‘withdrawing’ from schemes of preferential trading arrangements (see, inter alia, El-Agraa, 2007). Also, withdrawal from the EU is not merely a theoretical possibility: Greenland actually left the European Community (EC), the EU’s predecessor; the British Labour Party proposed it in its manifesto for the 1983 general election; a large section of the present United Kingdom (UK) Conservative Party desires it and so does one minor party whose only aim is to do precisely that; and so on and so forth. It is even given academic credibility by Minford et al (2005) who advocate it for the UK, as well as other EU member nations, since they are adamant that the UK has incurred costs due to EU membership in practically every sector of the economy. One may even add to this list the proposal by the Scottish Nationalist

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1This came about largely because of the efforts of German Chancellor Angela Merkel who had put the revival of the stalled EU constitutional treaty at the top of her agenda for the EU presidency for the first six months of 2007. One must however give due credit to both the moral as well as the openly-aired endorsement and collaboration of the present president of the EU Commission, Mr José Manuel Barroso.

2Greenland initially voted against joining the EEC when Denmark acceded in 1973, but because Denmark as whole voted to join, Greenland, as a part of Denmark, also had to likewise. When home rule for Greenland commenced in 1979, the country held a new referendum and voted for exit from the EEC. After a period of wrangling over fishing rights, in 1985 the ‘Territory’ left the EEC. However, it remains subject to the EU treaties through the EU’s Association of Overseas Countries and Territories. This was permitted by the Greenland Treaty, a special treaty signed in 1984 to allow the withdrawal.

3We are not suggesting that we agree with either the methodology adopted by the Minford et al (2005), or their findings, but this is not the place to go through these issues.