OVERVIEW OF ECONOMIC INTEGRATION: STAGES OF ECONOMIC INTEGRATION FROM FREE TRADE AREAS TO ECONOMIC AND MONETARY UNIONS.

What Is Economic Integration?

Economic integration is an arrangement among nations that typically includes the reduction or elimination of trade barriers and the coordination of monetary and fiscal policies. Economic integration aims to reduce costs for both consumers and producers and to increase trade between the countries involved in the agreement.

Economic integration is sometimes referred to as regional integration, as it often occurs among neighboring nations.

Economic Integration Explained

When regional economies agree on integration, trade barriers fall and economic and political coordination increases.

Specialists in this area define seven stages of economic integration: a preferential trading area, a free trade area, a customs union, a common market, an economic union, an economic and monetary union, and complete economic integration.

The final stage represents a total harmonization of fiscal policy and a complete monetary union.

Advantages of Economic Integration

The advantages of economic integration fall into three categories: trade creation, employment opportunities, and consensus and cooperation.

More specifically, economic integration typically leads to a reduction in the cost of trade, improved availability of goods and services, a wider selection of them, and gains in efficiency that lead to greater purchasing power.

Economic integration can reduce the costs of trade, improve the availability of goods and services, and increase consumer purchasing power in member nations.

Employment opportunities tend to improve because trade liberalization leads to market expansion, technology sharing, and cross-border investment.

Political cooperation among countries also can improve because of stronger economic ties, which provide an incentive to resolve conflicts peacefully and lead to greater stability.

The Costs of Economic Integration

Despite the benefits, economic integration has costs. These fall into three categories:

1. Diversion of trade: Trade can be diverted from non-members to members, even if it is economically detrimental for the member state.
2. Erosion of national sovereignty: Members of economic unions typically are required to adhere to rules on trade, monetary policy, and fiscal policies established by an unelected external policymaking body.
3. Employment shifts and reductions: Economic integration can cause companies to move their production operations to areas within the economic union that have cheaper labor

prices. Conversely, employees may move to areas with better wages and employment opportunities.

Because economists and policymakers believe economic integration leads to significant benefits, many institutions attempt to measure the degree of economic integration across countries and regions. The methodology for measuring economic integration typically involves multiple economic indicators including trade in goods and services, cross-border capital flows, labor migration, and others. Assessing economic integration also includes measures of institutional conformity, such as membership in trade unions and the strength of institutions that protect consumer and investor rights.

Real-World Example of Economic Integration

The European Union (EU) was created in 1993 and included 27 member states in 2024. Since 1999, 20 of those nations have adopted the euro as a shared currency.

According to data from the World Bank, the EU accounted for roughly 16.6% of the world's gross domestic product in 2022.

The United Kingdom voted in 2016 to leave the EU. In January 2020, British lawmakers and the European Parliament voted to accept the United Kingdom's withdrawal. The UK officially split from the EU on January 1, 2021.

What Are Examples of Economic Integration?

There are numerous examples of economic integration around the world. In North America, the United States–Mexico–Canada Agreement (USCMA) is an example of a free trade agreement between the three countries. The Asia-Pacific Economic Cooperation is a forum of 21 Pacific Rim countries aimed at fostering free trade across the region. As mentioned above, the EU is another such example of economic integration, as is the Eurasian Economic Union (EAEU).

What Are Risks of Economic Integration?

Economic integration can come with downsides and risks. Primarily, countries participating in regional integration may have divergent priorities when it comes to fiscal and monetary policy. Resolving such conflicts can be challenging and costly in terms of time and resources. In addition, economic integration can create a system in which a select group of stakeholders reap the economic benefits, such as more revenue from trade, while others bear the costs, such as job market shifts. These are important considerations to weigh when assessing the value of economic integration.

What Are Benefits of Economic Integration?

Economic integration can increase trade, benefiting both producers, consumers, and involved countries. For instance, with the elimination of trade barriers, a firm may be able to produce and sell more products, earning more revenue, and increasing their home country's gross domestic product (GDP). For customers in other countries, they can count on having more product selection and potentially lower costs, as well.

The Bottom Line

Economic integration is a form of coordination between different states, in which barriers to trade are eliminated and fiscal and monetary policies are harmonized. These arrangements can lead to increased economic activity, job creation, and stronger political ties. They may also come with drawbacks, such as trade diversion and loss of national sovereignty.

The EU is a well-known example of regional economic integration, as it is comprised of 27 member states, 20 of which use the same currency.

KEY INTEGRATION MECHANISMS: PREFERENTIAL TRADE AGREEMENTS, CUSTOMS UNIONS, AND COMMON MARKETS.

So far you have seen how international organizations such as the WTO, IMF, and World Bank support global trade, but this is only part of the story. Where global trade really gets a boost is from trade agreements (also called trade blocs). This is where the term “global economic integration” gets its legs—from the process of modifying barriers among and between nations to create a more fully integrated global economy. Trade agreements vary in the amount of free trade they allow among members and with nonmembers; each has a unique level of economic integration. We will look at four: regional trade agreement (RTA) (also called a “free trade area”), customs unions, common markets, and economic unions.

Regional trade agreements (RTAs) are reciprocal trade agreements between two or more partners (nations). Almost all countries are part of at least one regional trade agreement (RTA). Under an RTA, countries “huddle together,” forming an international community that facilitates the movement of goods and services between them. Let’s take a look at a few examples of regional trade agreements:

The United States-Mexico-Canada Agreement (USMCA) facilitates trade among these countries through tariff reductions and elimination of a number of duties and quotas. You can view the full text of the USUMA agreement. The USMCA was signed on November 30, 2018 and entered into force on July 1, 2020. This agreement was created to replace the North American Free Trade Agreement (NAFTA), which was established in 1994.

The Association of Southeast Asian Nations (ASEAN), shown in Figure 1, provides for the free exchange of trade, service, labor, and capital across ten independent member nations to provide a balance of power to China and Japan.

The Central American Free Trade Agreement (CAFTA) (Costa Rica, Dominican Republic, Guatemala, Honduras, Nicaragua, and El Salvador) eliminated tariffs on more than 80 percent of U.S. exports and opened U.S. trade restrictions for Central American sugar, textiles, and apparel imports, thereby reducing costs on these products for American consumers[1].

Map of ASEAN Countries. Countries include Lao PDR, Thailand, Myanmar, Viet Nam, Cambodia, Philippines, Brunei Darussalam, Malaysia, Singapore, and Indonesia

Customs unions are arrangements among countries whereby the parties agree to allow free trade on products within the customs union, and they agree to a common external tariff (CET) on imports from the rest of the world. It is this CET that distinguishes a customs union from a regional trade agreement. It is important to note that although trade is unrestricted within the union, customs unions do not allow free movement of capital and labor among member countries. An example is the customs union of Russia, Belarus, and Kazakhstan, which was formed in 2010. These countries eliminated trade barriers among themselves but have also agreed to some common policies for dealing with nonmember countries.

Common markets are similar to customs unions in that they eliminate internal barriers between members and adopt common external barriers against nonmembers. This difference is that common markets also allow free movement of resources (e.g., labor) among member countries. An example of a common market is the Economic Community of West African States (ECOWAS), comprised of Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

An even more economically integrated arrangement is the economic union. Economic unions eliminate internal barriers, adopt common external barriers, permit free movement of resources (e.g., labor), AND adopt a common set of economic policies. The best-known example of an economic union is the European Union (EU). EU members all use the same currency, follow one monetary policy, and trade with one another without paying tariffs.

UNDERSTANDING GLOBALIZATION: IMPACT ON ECONOMIC STRUCTURES, TRADE LIBERALIZATION, AND MARKET INTERCONNECTION.

Globalization represents an ongoing phenomenon characterized by the growing connectedness and interdependence among nations, individuals, and businesses worldwide. This process involves the integration of economic, political, social, and cultural systems across borders, resulting in increased flows of goods, services, capital, people, and ideas.

The rate of globalization has increased in recent years and is being shaped by rapid advancements in communication and transportation technologies, as well as the liberalization of trade and investment policies. Our World Data attributes the rapid increase in international trade and investment as being the main drivers behind this increased rate. Facilitated by the reduction of trade barriers and the emergence of new technologies that allow for the rapid movement of goods, services, and capital across borders, the rapid increase in international trade and investment is the key driver behind the increased rate in globalization we see today. However, other drivers are also responsible for shaping globalization today, these drivers include advances in transportation and communication technologies, the rise of multinational corporations, the growth of global financial markets, and the spread of cultural and social norms. The combination of these drivers has led to increasingly integrated economies and societies around the world, and thus we are seeing the emergence of a globalized world. But what exactly does this mean for economic development?

What are the impacts of globalization on economic development?

The effects of globalization on economic development have been both positive and negative. Globalization has paved the way for new markets, enhanced trade and investment, and fostered cross-border technology and knowledge transfers. These developments have contributed to greater economic growth, improved productivity, and job creation in numerous areas worldwide. However, globalization has also given rise to intensified competition, income disparity, and environmental damage in certain regions.

This article will not only analyze the positive and negative impacts of globalization on different regions and industries, but we will also discuss the strategies that governments and businesses can use to adapt to and take advantage of a globalized economy.

Positive impacts of globalization on economic development

As mentioned above, the effects of globalization on economic development include a variety of positive impacts on economic development, including increased trade and investment opportunities, access to new markets and customers, greater efficiency and productivity, the spread of new technologies and knowledge, increased competition, and the potential for economic growth and development.

Increased trade and investment opportunities:

Globalization has created new opportunities for countries to trade and invest across borders. This has led to increased economic activity and higher levels of economic growth.

Access to new markets and customers:

Globalization has allowed businesses to expand their customer base and access new markets, which has helped to boost sales and profits.

Greater efficiency and productivity:

Globalization has increased competition among businesses, which has driven innovation and efficiency, leading to increased productivity.

Spread of new technologies and knowledge:

Globalization has facilitated the spread of new technologies and knowledge across borders, allowing countries to learn from one another and adopt best practices.

Increased competition:

Globalization has increased competition among businesses, which has led to lower prices and higher quality products for consumers.

Potential for economic growth and development:

Globalization has the potential to drive economic growth and development, particularly for developing countries that have been able to attract foreign investment and benefit from increased trade opportunities.

Negative impacts of globalization on economic development

The effects of globalization on economic development include both positive and negative impacts. Alongside the positive impacts of globalization on economic development, globalization has also brought about a range of negative impacts on economic development, including job losses and industry declines in some regions, widening income inequality, cultural homogenization, environmental degradation, dependence on foreign markets and investors, and vulnerability to global economic downturns.

Loss of jobs and industries in some regions:

Globalization has led to the relocation of industries and jobs to countries with lower labor costs, which has led to job losses and industry declines in some regions.

Widening income inequality:

Globalization has increased income inequality between and within countries, with some countries and individuals benefiting more than others.

Cultural homogenization:

Globalization has led to the spread of Western culture and values, which has resulted in the homogenization of cultures and the loss of traditional cultures.

Environmental degradation:

Globalization has contributed to environmental degradation, with increased trade and economic activity leading to higher levels of pollution, deforestation, and climate change.

Dependence on foreign markets and investors:

Globalization has led to increased dependence on foreign markets and investors, which can leave countries vulnerable to economic shocks and downturns.

Vulnerability to global economic downturns:

Globalization has increased the interconnectedness of economies, making them more vulnerable to global economic downturns and crises.

Strategies for governments and businesses to adapt to and take advantage of a globalized economy

Undoubtedly, globalization has generated both favorable and adverse effects on economic development. To capitalize on these outcomes, governments must adjust and seize the opportunities presented by a globalized economy.

There are several strategies that governments and businesses can implement to adapt to and take advantage of a globalized economy, such as investing in education and training, diversifying industries, developing infrastructure, supporting Small and Medium-sized Enterprises (SMEs), implementing environmental and social standards, promoting foreign investment, and finally promoting networking and collaboration.

Investment in Education and Training:

Governments and businesses can invest in education and training to improve the skills of their workforce and increase their competitiveness in a globalized economy. This can include providing training programs for employees, supporting vocational and technical education, and investing in research and development.

Diversification of Industries:

Governments and businesses can diversify their economies and industries to reduce their reliance on a single industry or market. This can help to reduce the impact of economic shocks and increase resilience to global economic trends.

Infrastructure Development:

Governments can invest in infrastructure such as roads, ports, and airports to facilitate trade and attract foreign investment. This can help to improve the efficiency and competitiveness of local businesses, increase trade flows, and create employment opportunities.

Support for Small and Medium-sized Enterprises (SMEs):

Governments can provide support for SMEs to help them compete with larger firms in a globalized economy. This can include providing access to finance, facilitating market access, and providing training and advisory services.

Implementation of Environmental and Social Standards:

Governments and businesses can implement environmental and social standards to ensure sustainable economic development. This can include implementing environmental regulations to reduce pollution and waste, promoting sustainable resource use, and protecting workers' rights.

Promotion of Foreign Investment:

Governments can promote foreign investment by offering incentives such as tax breaks, low-interest loans, and simplified regulations. This can help to attract foreign investment and create new employment opportunities. Learn more about promoting foreign investment to your region here.

Collaboration and Networking:

Governments and businesses can collaborate and network with other countries and industries to share knowledge, expertise, and best practices. This can help to improve competitiveness, access new markets, and create new business opportunities.

How to balance the opportunities and challenges of globalization for economic development?

Overall, globalization has brought about a range of both positive and negative impacts on economic development in a variety of regions and industries. Governments and businesses need to adapt to and take advantage of a globalized economy while also ensuring that they can balance the opportunities and challenges of globalization for economic development.

Balancing the opportunities and challenges of globalization for economic development is essential for taking advantage of the opportunities of globalization while also mitigating its negative impacts on society and the environment. This balance will require a comprehensive approach that addresses the various aspects of the globalized economy.

Governments and businesses must utilize a comprehensive approach that prioritizes inclusive economic growth, fosters innovation and technological advancements, promotes sustainable development, focuses on international cooperation, invests in education and skills development, and implements effective regulatory frameworks.

With this amount of research, it can be expected that the effects of consolidation and increase in the scale of operations of entities will be very well recognized. All the more so because the conviction that "bigger is better" belongs to the so-called intuitive knowledge, deeply rooted in the minds of many representatives of administration and politics. However, a review of the meta-analyses presented above leads to a surprising conclusion. Focusing on the economy of scale, expressed in economic values, these studies do not lead us to consistent conclusions - scientists are far from unanimous in this respect. The surprising effect of these analyses is the lack of confirmation of the seemingly common-sense view that larger units are more efficient.

The authors of these studies carefully summarize the results of their research as ambiguous and far from confirming the hypothesis of "economies of scale". Some of them state that consolidation has not resulted in relatively cheaper operation, while others state that the differences in unit costs between small and large units are negligible. Especially when compared with the costs of reforms undertaken and the losses resulting from economies of scale. There are even opinions that the costs of memory disorders in institutions and the costs of employee opportunism are clearly underestimated by the authors of the reforms and far outweigh the effects of consolidation. There is also a specific effect of the "upward equation" in which both remuneration and services are at the highest level of the consolidated entity. In such cases, it is not even difficult to find the disefect of scale, where the operating costs of large municipalities are much higher than those of smaller ones. Such negative effects are particularly visible in those categories of services that are labor-intensive (social services). Most often, a decrease in unit costs of services, along with an increase in the scope of their provision, is recorded in infrastructure services. At this point, it is worth noting that each type of service may have its optimum in a different place. Therefore, it is difficult to determine the optimal size for their diverse package. To this extent these are opinions recommending changes inside the units, increasing the freedom of organization and flexibility of service provision, not border reforms.

Therefore, if the results of the research do not confirm the relationship between the effectiveness and size of a local government unit, why is this belief so strong in the public debate? Why do many representatives of organizational and management sciences accept this statement a priori? The specificity of the public sector means that theories that work well in production activities are not fully applicable to public administration. They are subject to much more diverse conditions, defined as institutional norms. The result, among others, from the structure of management, tendency to atomize units and organizational divisions, disturbances in the flow of information, aspiration to accumulate resources, and suppression of the main goals and principles of the unit's functioning.

The first problem is to determine the point at which further growth of the unit may already bring disadvantages of scale. This situation occurs when the size of a unit causes increased transaction costs. As analyzed studies show, consolidation processes are a popular way to implement reforms, regardless of the initial size of units. Such demands are made and substantiated, both in countries with high fragmentation (France, Czech Republic, Slovakia) and in states with very large entities (Denmark, England, Ireland, South Korea). Meanwhile, many studies indicate that too much fragmentation may generate additional costs, but also the optimal size scale may be relatively low - between 8-20 thousand inhabitants. Perhaps the optimum, behind which scale disadvantages appear, is located at a relatively low level. Unnoticed by those who seek it always in the largest units. In this case, the term 'large' would take on relative importance.

The second element explaining the lack of clear results of these studies may be the complex structure of services provided by local governments. The impact of economies of scale in particular areas may be different. As a result, there may even be negative couplings in which economies of scale, e.g. from the provision of a selected municipal service, will be eliminated by disseffects in a service qualified to the group of social or administrative services.

A very important element is the social control - more direct in smaller units. Large structures are much more abstract for local communities, which in turn increases the anonymity of the officials working there. As a result, the whole administration becomes less transparent for the local community. It also hinders the direct supervision of managers, making it impossible for them to strictly assess the current functioning, as well as the legitimacy and directions necessary to make changes. These conclusions show the importance of local institutional conditions. The automatic adoption of reform patterns can produce different results in different places. This fact should serve as a warning against thoughtless changes in local administrative structures. They should be preceded each time by a detailed and interdisciplinary analysis of the conditions of a given country or region. Therefore, we are dealing with a situation where global and universal solutions can bring different results on a local scale.

Therefore, the need to adapt them to the local conditions bears the signs of a glocalization process. Megatrends related to digitalization, globalization of economic activity, and urbanization contribute to strengthening the role of sub-national governments. Globalization, eliminating barriers to the flow of capital and ideas between countries, also means freedom of penetration within countries. It means that cities can compete for foreign direct investment, a task once monopolized by central governments. Urbanization and metropolization processes support the trend of increasing the scale of local units.

The results of the review of the scope of consolidation reforms in the world lead to the conclusion that we are dealing with a global trend. Although it is not universal, it seems to be part of the implementation of management reforms in countries with higher levels of development. These conclusions fulfill the first objective of this study, defined in the introduction, concerning the characteristics of the scope and scale of consolidation reforms in various countries of the world. The question of the future of these reforms directions remains open, especially in countries with lower levels of development. The link with other megatrends, such as the development of digital communications and the detoralization of public services, allows us to make a cautious assumption that this direction of reform will be imitated in subsequent countries. The deepening of globalization in this area is an interesting subject of further research.

On the other hand, globalization has revived local cultural identities, resulting in the need to adopt reforms more to local conditions. In the context of the democratic crisis, many countries have also emphasized the role of local governments as the closest level of authority to citizens and a way to better reflect their needs. The "local" approach may be a response to global solutions, which indicates the importance of the glocalization process.

It takes on importance in the light of the research results shown in the article, which, to put it mildly, do not confirm the economies of scale in the provision of public services. This part of the conclusions fulfills the second objective of this research. The added value of these studies is to draw attention to the fact that uncritical implementation of global trends does not automatically produce the expected results. It is necessary to apply in practice glocalization, i.e. critical adaptation of global solutions to local institutional conditions. Due to this ambiguity of the effects of consolidation reforms in the world, deepening this direction of research seems to be a very attractive direction for further in-depth research.

CHALLENGES AND OPPORTUNITIES: WEALTH DISPARITIES, POLITICAL SOVEREIGNTY SHIFTS, AND TRANSNATIONAL INSTITUTIONS.

Economic inequality has spiked in many countries in the last several decades, raising questions about whether policy should do more to combat it. Until scholars, such as Thomas Piketty, put economic inequality on the public agenda, a common view among policy analysts and government officials was that economic inequality was not a matter of moral concern, as long as the least well-off received adequate resources to satisfy their basic needs (which Debra Satz and Stuart White call the 'sufficiency' view in their article) (Frankfurt 1987). This view has come under pressure in recent years. But the questions of what is wrong with inequality, and what is the best way to address it, remain highly contested.

One view, reflected in Benthamite utilitarianism, as well as the more sophisticated social welfare functions used in the public finance literature, is that income inequality reduces aggregate welfare because of the diminishing marginal utility of money. A millionaire values a dollar less than a homeless person does, so moving dollars from the millionaire to the poor enhances aggregate utility. Another view is that economic equality is a distinctive value on its own (Nagel 1995). A third is that it generates pathologies by dividing society into mutually suspicious castes or creating relationships of dependence.

But these claims have been met with scepticism in some quarters. As Satz and White discuss, the commitment to economic equality implies that policy should seek to 'level down' the best-off even when such policies are wasteful and do not help the poor. A dollar transferred from a billionaire to a millionaire is a victory from the standpoint of equality; so is burning that dollar rather than transferring it to anyone. Moreover, commitment to economic equality may conflict with other values, such as liberty and equality of opportunity. Although neglected by philosophers, many people seem to value hierarchy for its own sake, as shown by their support for authoritarian rulers or their voluntary association with hierarchical religious, military and social organizations. And equality-promoting policies may distort incentives to work or require substantial administrative costs, leaving fewer resources available for public projects and private consumption. Finally, it is worth observing that the two most powerful engines toward economic equality in the last several decades—the expansion of international trade and of worker migration—have also been the most reviled because of their distributive impacts within nations and their harms to other moral values.1 People who hold the sufficiency view are unbothered by inequality as long as basic needs—which can be defined narrowly to mean nutrition, literacy and shelter, or broadly to encompass a range of capacities necessary for the good life—are satisfied (Nussbaum 2013).

Satz and White offer a pluralistic account of the wrongs of economic inequality (by which they mean inequality of wealth and income).2 They argue that policy should aim to reduce income inequality for three reasons. First, inequality is harmful to human well-being—because it hampers economic growth, undermines social stability, and reflects a misallocation of resources so that some people have too much and others have too little. Second, economic inequality often reflects unfairness, as it can be the result of historical injustices or imperfections in the institutional structure of the market economy. Third, inequality can generate further unfairness and harms to well-being by giving the wealthy excessive political influence, damaging social relationships, and creating caste-like divisions among races and other groups.

Pluralism is all very well, but pluralistic justifications for a policy approach—here, broad-based reduction of economic inequality—are vulnerable to the objection that different justifications imply different remedies. It is possible that the harms identified by Satz and White can be more effectively addressed by policy instruments tailored to those harms than a general policy of reducing economic inequality through taxes and transfers, as they appear to advocate. For example, a more direct way for remedying a historical injustice is to make awards to victims or their descendants, who normally seek public recognition of the harm imposed on them and not just money or restitution of property. A higher income or wealth tax will not accomplish that aim—especially when the victims or their descendants are wealthier than average, as is sometimes the case (e.g. some of the victims of communist-era expropriations). If imperfections in the market economy cause harms, then the natural remedy is correction of those imperfections through market regulation rather than redistribution of wealth. Antitrust law or price regulation, for example, is the normal response to market concentration—and these policy tools both increase efficiency and mitigate economic inequality. Redistribution of wealth is not a good remedy for market concentration because the concentration remains in place, causing a waste of resources. Social instability, segregation, and related ills have traditionally been addressed with reforms in education, zoning, political structure, and much else.

On this view, the appropriate policy approach is to improve institutions—economic, political, educational, etc.—and to do so by using tailored or piecemeal policy reforms that correct whatever imperfections are identified, rather than large-scale redistribution, which is typically conducted through taxes and transfers. Policies that advance economic equality are then justified only by reference to fundamental norms. This view is the traditional view among policy analysts in western countries, and we see it in the division of policy labour in many countries. Some policy analysts specialize in markets and advocate market reforms; others specialize in politics and advocate political reforms; and so on. Meanwhile, other policy analysts recommend tax and welfare reforms that advance distributive justice.

However, this work has assumed that if the basic institutions of society improve, economic inequality will decline as a result—either automatically or as a result of progressive taxes-and-transfers. Rising economic inequality over the last several decades suggests that this assumption is unwarranted. In some countries, rising economic inequality has been accompanied by a degradation of many institutions (the United States is the most prominent example). This raises the possibility that the causation is backwards, or at least partly so: perhaps some degree of economic equality is a necessary premise for effective social, economic, and political institutions, rather than a consequence of them. Satz and White suggest as much, but their discussion is vague, leaving it unclear how one would determine empirically whether economic equality is a necessary premise for the effective operation of the institutions, or not. Below, I fill in some of the detail with the hope of stimulating research in this area.

The market economy

The standard economic justification of the market economy is that it generates wealth (‘efficiency’). If competition is perfect, the distribution of resources will be Pareto-optimal. Most economists recognize that a pareto-optimal economy does not exhaust the responsibility of society. The view is rather that policy should attempt to improve market institutions where they are appropriate, and that other institutions—mainly the tax-and-transfer system—should be used to achieve distributive fairness. That is why questions of economic equality and distributive justice are mostly absent from economic analysis of market institutions, and the focus is instead pareto-optimality or another measure of efficiency.

In a standard model of a competitive market, the initial distribution of wealth (or ‘endowments’) makes no difference to efficiency. To see why, imagine two initial scenarios. In the first, the distribution of wealth is equal. In the second, it is highly unequal. Let a perfect market operate on both scenarios. People in both scenarios will trade until no more mutually beneficial trades can occur; the outcomes are in both cases by definition Pareto-optimal. The degree of inequality at the start might influence the distribution at the end but it does not interfere with market exchange or degrade efficiency. Sellers earn a competitive rate of return regardless of whether they are wealthy or poor. Entrepreneurs with good ideas can self-finance if rich and borrow if poor, so they will produce the same output regardless of their initial wealth. Only consumption will vary with wealth.

However, in the real world of imperfect markets, there are reasons to think that economic inequality can interfere with efficiency. Consider two talented entrepreneurs who are identical in all respects except that one is rich and the other is poor. As before, the rich entrepreneur can self-finance any entrepreneurial activities. The poor entrepreneur is likely to have trouble persuading an investor to contribute capital. In real-world conditions, the poor entrepreneur faces obstacles: she may have talent and a good idea but investors will be sceptical. She cannot credibly disclose her private information about her ability. This means that the poor entrepreneur will have to take costly actions to prove herself. For example, she may go to work for a firm in the relevant industry where she can demonstrate her talents and work her way up the corporate hierarchy. But this will take time from her entrepreneurial activity (by hypothesis, her highest-value use), and she may end up being further bound by covenants not to compete and related restrictions imposed by employers who seek to profit from her talents. Or she may simply forgo the entrepreneurial route for an economically inferior job. The imperfection of capital markets offers an advantage to wealthy entrepreneurs, and thus results in misallocation of human capital.

It is easy to think of other ways in which economic disparities combine with market imperfections to generate inefficiencies. Consumers face significant search costs for complicated goods and services, such as housing, insurance, and credit. In theory, consumers could borrow to finance their search costs; in practice, borrowing is itself costly. It seems likely that sellers realize that wealthy and sophisticated buyers can compare prices more efficiently than poor buyers can and will offer them better terms than those they offer to the poor. This will result in effective higher prices for the poor, and less output and consumption. Moreover, sellers will engage in a form of rent-seeking by trying to segregate customers into rich and poor, so that they can offer different terms to the two groups—while the less well-off will try to conceal their economic position so that they avoid these extra costs. Even a more innocent form of price discrimination to take advantage of wealthy people who are less price-sensitive generates inefficiencies. Sellers will try to reconfigure essentially identical goods or services so that they appeal differently to the wealthy and to the poor, as the familiar example of business and economy class for air travel illustrates.

Further, as economic inequality increases, market efficiency will increasingly deviate from public welfare. While in an egalitarian society, talented people will do work that benefits everyone, in an unequal society, talented people will be led by market incentives to become tax lawyers, financial whizzes, yacht-builders, and other servants of the wealthy. That means that even a perfectly competitive market that generates a Pareto-optimal outcome will tend to reinforce inequalities. And while those inequalities can in principle be reversed with taxes and transfers, the political and economic costs of taxes and transfers will increase as inequality increases.

A standard rebuttal is that economic inequality is essential to a well-functioning market economy because people will engage in risky investment only if they are compensated with outsized returns. As long as multiple people engage in such risks, there will unavoidably be winners and losers, resulting in large disparities of wealth even if everyone started from an equal position. But while it may be correct that a well-functioning market economy will inevitably generate some inequality, it does not follow that policy should not mitigate it. There are two reasons for this. First, real-world markets almost certainly generate returns in excess of what is necessary to motivate people to take risks, at least in some corners of the economy. Second, inequalities that are the legitimate outgrowth of risk-taking must be balanced against the harms that those inequalities generate for the next round of market activity, as described above. It is not clear how these concerns should be balanced out, but it is clear that reduction of inequality on the margin should generate more good than harm.

Regulation

Government agencies regulate the market economy to correct externalities and resolve other market failures. Familiar examples include environmental, financial and workplace-safety regulation. Regulators must choose when to regulate and how strictly to regulate, and these choices require regulators to balance the costs to industry (typically passed on as higher prices to consumers) and the benefits. Regulators commonly use cost–benefit analysis, in which the trade-off is made after the costs and benefits are converted into monetary values based on the willingness of consumers to pay for the benefits and the costs of industry compliance.

To perform cost–benefit analysis, regulators usually rely on market prices or willingness-to-pay figures elicited with surveys. In ideal conditions, cost–benefit analysis should advance social welfare. Imagine a population in which people have equal wealth. The government must decide whether to build a bridge. The cost is $1 million. The bridge satisfies a cost–benefit analysis if the people who use it would be willing to pay in aggregate more than $1 million. They might do so because they save time or gasoline costs; these benefits can be easily converted into monetary values.

But if economic inequality prevails, both market prices and willingness-to-pay figures become less accurate approximations of well-being. Because of the diminishing marginal utility of the dollar, wealthy people will pay more for a public good than poor people will, even if the public good benefits the two groups the same. A bridge that benefits a small number of rich people and harms a large number of poor people may pass a cost–benefit analysis. If rich and poor are equally affected by the project, the excessive influence of one group of rich people will be cancelled by the excessive influence of the other group. But this need not be the case. And, while willingness-to-pay can be adjusted on the basis of wealth, so that it better approximates the welfare effects of projects or regulations, there is no consensus as to how to do this. Thus, as inequality increases, cost–benefit analysis becomes a noisier signal of the normative value of public projects. Welfare-maximizing regulation becomes more costly as inequality increases, and so will be less common.

Economic inequality can cause other problems for regulation. As inequality increases, regulators may increasingly prefer the interests of the rich, and so issue inefficient regulations that further advance inequality. Part of the reason for this preference is the greater political influence of the rich, a topic I will address below. But another reason is specific to the way regulation works. Regulators are rarely paid as well as the people they regulate. That means regulators may be tempted to quit the government and go to work in the regulated industry where they can share their expertise about the government's investigative methods and priorities. Industries in which people are highly paid—e.g. finance—will attract more talented regulators than industries in which people are less well paid (e.g. agriculture). Thus, inequalities can reverberate through the system, distorting the talent pool available to government agencies and the quality and strictness of regulation in different sectors of the economy.

The rule of law

The market and the regulatory system are underpinned by the legal system, which is administered by courts. In most countries, citizens enjoy equality under the law, which means that the courts will resolve disputes impartially and not recognize advantages based on status or wealth. But legal systems are also vulnerable to economic inequality, which through various paths may convert legal equality into an empty form.

In the United States, for example, an elaborate hierarchy of legal talent prevails. The wealthiest people and institutions hire the best legal talent, and often, teams of lawyers who can overwhelm the resources of their opponents with a blizzard of subpoenas, depositions, paperwork, and the other weapons of legal attrition. This leads to a host of pathologies. Wealthy people can hire legal talent to advise them on tax-minimization strategies, to identify regulatory loopholes, and to defend them if they violate the law. Poor people cannot, and have access to lawyers only when they are accused of crimes. Wealthy people can make credible threats to sue in order to elicit settlements from opponents; other people cannot. And judges themselves are usually drawn from the pool of wealthy and talented lawyers, and so may not feel much sympathy for the less well-off.

Inequality in the legal system can undermine market efficiency. A well-functioning market assumes that the government impartially enforces property rights and contract rights. If the legal system actually is biased in favour of the wealthy, then the non-wealthy will be less willing to use it. If people cannot depend on their property rights, they will not invest in improving their property. If people cannot depend on contract rights, they will not enter deals. Ironically, even wealthy persons and corporations are harmed by a legal system that favours them because they cannot make contractual commitments that counterparties can depend on. Historically, when legal systems were inadequate, people relied on family and ethnic ties, private institutions and organized crime. Today, the legal system is too expensive for most people, who may as a result be reluctant to enter mutually beneficial transactions.

The political system

The dangers posed by economic inequality to the political system are well understood, as Satz and White observe. Democracy guarantees formal political equality in the form of the right to vote and to run for office. Other political rights—including the right to free speech and assembly—are also distributed equally. But in conditions of economic inequality, these political rights are hollow. While outright bribery is rare in advanced countries, the wealthy can exert greater influence on political outcomes than poorer people by donating money to preferred candidates and causes. And extremely wealthy people can self-finance their own political campaigns, obtain offices in return for their financial support for parties and officials, and even use their funds to influence academic writing and political commentary.

Many countries have limited the role of money in politics by regulating donations and spending. But in countries where economic inequality is high, the wealthy can use their political influence to resist efforts to implement such regulations in the first place. In the United States, efforts to restrict campaign financing began in the early 20th century, and accelerated in the 1970s in the wake of the Watergate scandal. But the Supreme Court has overturned many such restrictions, and has taken an increasingly hard line, culminating in the Citizens United case of 2010, which struck down a law that prohibited political expenditures by corporations and other organizations under the First Amendment. Increasing economic inequality in the United States accompanied by looser restrictions on political expenditures has led to widespread unhappiness with the political system.

In the last several decades, governments have found it increasingly difficult to regulate large multinational corporations, whose political power derives from their ability to easily move assets across borders as well as from their teams of lobbyists. This in turn has led to a new style of shareholder activism. Shareholders organize and pressure managers to reduce greenhouse gas emissions, diversify boards, and avoid business with dictators. In this way, shareholders can force corporations to 'self-regulate' for the sake of policy goals that government regulations can no longer attain. Many commentators welcome a growing movement that pressures corporations to act in a socially responsible way. But 'shareholder democracy' is not the same as democracy. The vast majority of shares are owned by relatively wealthy people. Shareholder democracy is actually a form of oligarchy, and so the policy agenda of shareholders will tend to favour wealthier interests.

Educational attainment and meritocracy

In recent years, people have expressed worries about the impact of economic inequality on education and, more broadly, meritocracy. These worries are related to the idea that economic inequality may undermine the modern market economy, which depends on large investments in human capital. But the worries about education and meritocracy reflect a separate cultural and political dimension and involve additional complexities. One such worry is that inequality advances educational disparities. In the United States, wealthy people self-segregate in expensive suburbs where the tax base can finance high-quality public schools or send their children to expensive private schools. Poorer children end up in worse schools. As a result, many Americans are poorly educated, and, as a result of technological advances, the US economy can no longer supply jobs to unskilled or poorly educated labour. While in the past, the uneducated could obtain reasonably well-paying jobs, support a family and obtain status in their communities, today those jobs are disappearing. A large unemployed and unemployable population is a waste of human resources, a source of political instability and a failure of public policy.

Meanwhile, at the upper end of the wealth distribution, growing economic inequality feeds anxiety among parents that their children will be left behind. As the income distribution flattens, fewer but more-high-paying jobs become available for the most talented and best educated, which means that parents pressure their children, pay for tutors, and foot expensive tuition bills or move to expensive suburbs. The increasing competition for a decreasing number of ever more lucrative jobs—mainly in finance, law and business—has, in the popular imagination and possibly in reality, put unrelenting psychological pressure on children and parents alike.

As wealthy parents put more resources into their children, the idea of meritocracy has come under pressure. The theory of meritocracy is that the most talented people are assigned the most important jobs and are commensurately rewarded for their contributions to the public good. But both prongs of this theory are questionable. Unavoidably, educational institutions rely on tests and other screening mechanisms to identify the most talented children. These mechanisms can be gamed. Wealthy parents can afford tutors, enrichment activities and consultants, and this can help less-talented children obtain slots in schools and universities that should be reserved for more-talented children of poor families. As a recent admissions scandal in the United States has shown, wealthy parents can also bribe universities to accept their children, although this activity has traditionally been accomplished lawfully through donations and other subterfuges. But if wealthy parents can game the system by making donations and financing activities for their children that satisfy admissions requirements without actually improving their children, then meritocracy has been replaced with a wasteful and unfair system that allocates rewards to elites.

Even more troubling, evidence suggests that educational attainment—and, more broadly, the capability to compete with others in the market—heavily depends on early childhood development, and even development in the womb. Large-scale redistribution that put money in the pockets of the poor could equalize economic outcomes, and yet if that redistribution were not supplemented by aggressive and early educational (and possibly nutritional) intervention, economic equality at the population level will mask serious inequality in terms of human capacity and a waste of human resources. A policy of advancing economic equality by distributing resources might detract attention and urgency from tailored reforms that more directly advance human well-being.

Let us take stock. Economic equality is not a fundamental moral value that commands widespread consent. There are too many competing values and goals, many of which seem more urgent, such as the goal of eliminating poverty and improving people's capacities to advance through life. If economic equality is a policy goal, then the argument must rest on a more complex set of considerations, as Satz and White (2023) argue. A better argument is that economic equality to some degree is a necessary premise of prized institutions that form the bedrock of our way of life. This argument is that the institutions advance economic prosperity, political stability, and other values only when the economic inequality is limited.

This argument depends on a key premise—which is that these institutions cannot be reformed so that the influence of wealth on their operation can be minimized to an adequate degree. I will call such reforms institution-specific, to distinguish them from the systemic policy of using taxes and transfers to reduce economic inequality. Consider the political system again. The traditional strategy for preserving political equality has taken the form of campaign finance laws and other restrictions on the unfair use of money to influence political outcomes. If wealthy people can donate no more than poor (or, more realistically, middle-class) people to candidates (which is currently the law in the United States), and can spend no more than others on political advertising and other indirect methods for supporting preferred candidates (which is not currently the law), and in other ways cannot use their wealth and influence to pressure elected officials and bureaucrats, then we might believe that formal political equality will produce real political equality. Campaign finance regulations are institution-specific because they protect the political system—and no other institution—from economic inequality. They are more tailored to the problem of the excessive influence of wealth on politics than the policy of reducing economic inequality through taxes and transfers.

As we have seen, an institution-specific response to political inequality may be impossible in the United States because the Supreme Court has blocked the most effective means of campaign reform. As a result, the case for untailored taxes-and-transfers is strengthened. If the government cannot regulate campaign finance to reduce the influence of wealth on politics, then the only way to do this is to redistribute wealth so that fewer wealthy people will have excessive political power. In other countries; however, the untailored response may be unnecessary.

A similar point can be made about the other institutions. In theory, market reform could reduce the distortions caused by economic inequality. A push to improve the competitiveness of markets, for example, would reduce the economic advantages of wealthy investors, sellers and consumers. This would require a greatly strengthened antitrust law, as well as regulations that preserve market competition. And where markets are naturally monopolistic, rate regulation could keep prices in line. But many economists and lawyers are sceptical that antitrust law and regulation can improve markets. And even if legal reform would work, it is steadily resisted by the wealthy who benefit from the status quo. Again, if markets work best when economic equality prevails, and regulation to limit the influence of inequality on markets is costly and ineffective, then a commitment to markets may also commit one to untailored reforms that reduce inequality.

Efforts have also been made to reduce the influence of economic inequality on regulation and law. For example, regulators use an identical value of a statistical life (VSL) for rich and poor even though wealthy people are willing to pay more to avoid mortality risks than poor people are. But, as many commentators have pointed out, the use of an identical VSL across income classes may result in products and services that are not affordable for low-income people. As for the legal system, governments supply free legal assistance to criminal defendants, and lawyers in private practice donate some of their time pro bono. But these bandages are plainly inadequate. Here again a strategy of reducing economic inequality—so everyone can afford legal talent—may be more effective than the modest regulation of the legal system that seems to be politically and practically realistic.

Similar points can be made about the education system. Public schooling promised to provide an equal education for all, but wealthy people self-segregated in suburbs or sent their children to private schools. Universities offer scholarships, and the government offers grants and guarantees loans, but these resources do not offset the advantages offered by wealth. Early interventions to improve prenatal health and offer educational opportunities to young children may conflict with parents' autonomy and their legitimate interest in having control over their children.

The root problem is that rules that are meant to restrict the influence of money on attainment in the market, the political system, the legal and regulatory system, and education can all be gamed by the wealthy. Wealth enables one to buy lawyers, experts, consultants and other resources that allow one to outmanoeuvre less wealthy competitors in all of these institutions. A related problem is that restrictions on the influence of wealth may undermine institutions by overloading them with complex and unworkable rules that undermine their effectiveness. And then, of course, wealthy people have strong incentives to resist reform, or to ensure that reforms include loopholes through which the rich can crawl. All of this makes a case for a general, rather than institution-specific, reform—in the form of taxes and transfers that redistribute.

Importantly, this argument explains why levelling down (at least within limits) may be justified. Burning a billionaire's dollar incrementally improves the function of markets, the political system, education, and so on. The reason is that relative wealth distorts the operations of the institutions that modern society relies on. If everyone is rich or everyone is poor, market prices will reflect people's valuations and (if they are reasonably well-informed) well-being, and so the market and institutions that incorporate market prices should advance well-being. If some people are rich and others are poor, market prices become noisy indicators of well-being.

Several counterarguments should be addressed. First, if the wealthy use their political power to resist institutional reform that limits the impact of income inequality, why would they consent to large-scale redistribution? The answer is that the wealthy as well as the poor benefit when social institutions operate effectively. Moreover, it seems politically more feasible to organize a coalition that will support large-scale redistribution since it benefits the majority and its effects should be clear. Reform of antitrust laws, regulatory methods, campaign finance and education is less politically visible, harder to understand, and more vulnerable to back-room deals and legal challenge.

Second, one might believe that untailored redistribution through the tax-and-transfer system is just as costly, complex and vulnerable to gaming as the institutional reforms I have discussed. That may well be true, but it is hardly clear. Taxes and transfers involve administrative costs but these costs are relatively low. They reduce incentives to work and invest, but there is a great deal of uncertainty about how great this distortion is, and some economists believe that it is small even for high marginal income tax rates. The biggest problem is probably (legal) avoidance or (illegal) evasion, including the risk that capital will move overseas. But the extent of this problem too remains empirically uncertain.

Third, one might believe that tailored approaches to institutional reforms allow for a calibrated response that is attentive to competing values, while wholesale redistribution through tax and transfers has a blunderbuss feel. However, on reflection, the truth may be the opposite. Institutional reform that limits the impact of politics will unavoidably tell wealthier people that they cannot spend money to advance their political preferences and values, which will be seen as, and may well count as, an unacceptable constraint on liberty. Reform that improves the fairness of education may require restrictions on how parents spend money on their children, and that too may be an unacceptable constraint on the liberty of parents and the autonomy of the family. By contrast, taxes work on only one margin—wealth or income—and, while they may influence broad choices as to how much to work, redistributive taxes-and-transfers do reflect intrusive and possibly wrong-headed judgements about how much people should contribute to politics, educate their children and so on.

As should be clear, there are a large number of unresolved empirical issues about the relationship between economic inequality, the effectiveness of institutions, and outcomes for the public. Rigorous empirical work by social scientists is desperately needed.

- **Economic Integration and Sustainability**: Governance, innovation, and inclusive global systems.

Economic globalization changes the "balance of power" between markets, national governments and international collective action. It enhances the influence of markets on economic, social, and environmental outcomes and reduces the degree of freedom and unilateral management capabilities of national governments, and it creates the necessity for states to cooperate both in the management of the global commons and the coordination of domestic policies (Zarsky 1997). Globalization creates market driven political pressures to gain or maintain competitiveness and this forces premature and not necessarily appropriate convergence of environmental policy. In the presence of diversity of environmental endowments, assimilative capacities and preferences efficient environmental management requires sensitivity to local ecological and social conditions. Diversity of conditions calls for a diversity of policies. Yet globalization leads to uniformity and inertia in environmental policy in the absence of collective action.

The main channel through which globalization influences environmental policy is through the cost of production. To the extent that environmental policy raises or is perceived to raise the cost of production, globalization-inspired concerns about gaining or maintaining competitiveness, mitigate against any change of policy, that might change the cost parameters unless competitors are subject to the same policy. The creates the inertia, pressures toward uniformity and a shift of power from national governments to market and global governance.

Countries and people have the potential to drive significant benefits from the globalization process but there is still the problem of realizing this potential. Too much attention has been paid to the economic benefits of globalization and not enough to the social and environmental implications. As a result, the promise and potential of globalization as a force of sustainable human development may not be realized. Furthermore, at the same time that globalization improves the prospects for economic growth worldwide, it may reduce the economic prospects in individual countries, sectors and communities. A variety of factors contribute to wide disparities both within nations and between nations:

• Lack of access to more efficient technologies

• Lack of access to capital • Inadequate flexibility to respond to changes in market demand

• Inability to manage structural change

• Weak institutions and absence of effective safety nets.

To the extent that globalization marginalizes economies, sectors, and people, it results in poverty-induced resource depletion and environmental degradation, which lead to further human deprivation, disparity and dispowerment. Globalization is likely to place significant stresses on the environment if perverse subsidies and other distortions are not removed and environmental costs fully internalized or if “social adjustment” policies are not in place to cushion economic dislocation and avert marginalization of the poor.

Globalization, by driving a wedge between what is produced and what is consumed in any given locations, alters the distribution of environmental impacts and the costs of avoiding them within the current generation and between the current and future generations. The environmental consequences of globalization differ from the economic effects both in time and space:

(1) environmental impacts are more long-term, dynamic and cumulative and they are beset with uncertainty; we don't really know what the long-term damages are; and

(2) environmental impacts involve both physical and non-physical spillovers that may or may not be transmitted through markets such as cross-border pollution, aesthetics, ethical or moral concerns of parties not involved in the transaction.

Globalization generates international interest in what traditionally were considered purely domestic policies, since economic integration implies that trade and investment are now being affected by such policies. Globalization increasingly brings into conflict notions of national sovereignty over production processes with globally-oriented life-cycle perspectives, where consumers want to know the overall environmental impact of what they buy and consume.

In conclusion globalization brings with it potentially large benefits as well as risks. The challenge is to manage the process of globalization in such a way that it promotes environmental sustainability and equitable human development. The ability of nation-states to manage risks, inequalities and change is severely restricted by taxation constraints and the need to remain competitive. Hence, the traditional instruments of trade barriers and command and control regulations would not work because they would have unacceptably high costs in a globalized world and at the same time be less effective. To manage globalization in the interest of both people and the environment, it would be necessary to implement more efficient and innovative policies domestically and more effective global governance internationally

CASE STUDY: THE EUROPEAN UNION: EVOLUTION FROM AN ECONOMIC COMMUNITY TO A MONETARY UNION.