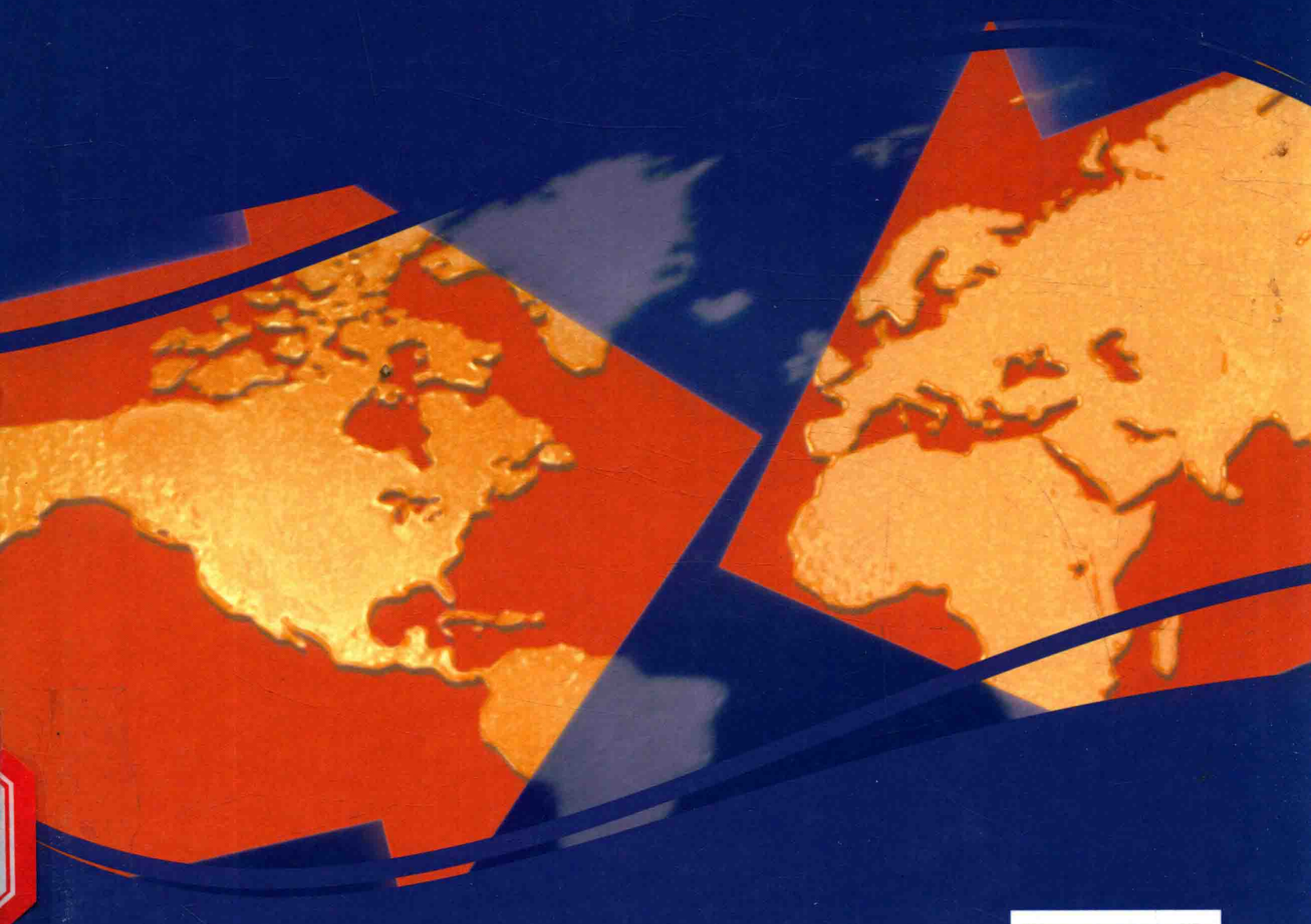


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# Regional Economic Integration and the Global Financial System



Engin Sorhun, Ümit Hacıoğlu, and Hasan Dinçer



# Regional Economic Integration and the Global Financial System

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## Preface

In the second half of the twentieth century, two dynamic changes shaped the world economy: Globalization and Regionalism. First, regional economic integration, in which a group of countries eliminates barriers to trade and competition on a regional rather than a global scale, became increasingly popular after World War II. This trend manifested itself at various strata from preferential trade agreement to economic union. The WTO estimates there are about 190 Regional Trade Agreements (RTA), 10 customs unions, 6 common markets, and 2 monetary unions. The OECD (2013) estimates RTAs cover more than half of international trade. Second, the unprecedented speed of liberalization of markets in the last quarter of the century has fueled globalization as mobility of goods, labor, and financial instruments increased. Trade relative to world output has grown faster than ever before. McKinsey & Company (2008) reports in the prelude of the Global Crisis that the world's financial assets are four times as large as the world's GDP.

The European Union is the most successful example for the regional economic integration when the WTO is the pioneering attempts of globalisation.

However, the interaction between globalism and regionalism that had been considered for long as competitor presents today a different challenge: Globalization of Regionalism. This is the third dynamic change that the new millennium gave rise to in economic integration. There are two innovations that support this challenge:

First, the trend of economic integration is about to enter another phase: integration of different regional supranational organizations. Can the Transatlantic Trade and Investment Partnership (TTIP) project potentially be the core of this future trend? Can integration of different regional supranational units be a transitional stage towards complete globalization?

Second, another innovation in economic integration results from the interaction among international and regional economic institutions. Both global integration and regional integration have their own institutions and regulations. However, the last global economic crisis explicitly revealed that these institutions are not sufficiently capable of dealing with the problems alone. In the absence of fundamental judiciary basis, the crisis compelled global and regional integration institutions to pragmatic collaborations while sharing the responsibility (IMF as a global institution and ECB as a regional institution collaborated to bail out some indebted EU members). This situation demonstrates that global integration and regional integration may contribute to the world economy as long as they complement each other.

The primary objective of this book is to discuss the latest advances in the economic integration and the interaction between globalization and regional integration from an interdisciplinary perspective. This book set out to illustrate the impacts on driving forces, changing strategies of international and regional institutions, and emerging new supranational units. Finally, the book explores the new trends in regional integration and globalization and provides insights on potential gains and losses of the new economic integration projects.



The authors of these chapters have accepted inclusion of their respective manuscripts. This book, consisting of 21 chapters, is divided into 4 sections: "Crisis in EU Regionalism," "New Dynamics in EU Regionalism and Enlargement," "New Dynamics in Globalization," "Globalization of Regionalism."

A brief description of each of the chapters follows.

Chapter 1 identifies the root causes of sovereign debt crisis in the EU and the economic and financial effects of and precautions for the crisis. In this globalizing world, countries that cannot compete on their own in all areas form common markets by establishing regional blocks, and to form common political, legal, and social systems. The EU, as one of the foremost regionally integrated markets, seems to be a gradually growing supranational organization. Thus, this study also discusses the degradation of the EU's economic and political integration as a result of the sovereign debt crisis.

Chapter 2 examines the impact of unemployment on economic growth in 15 EU countries from 1984 to 2012 by using several panel data techniques. Panel unit root tests suggest that the series employed in the study are stationary at first differences. In other words, the series are integrated of order one,  $I(1)$ . Panel cointegration tests show that the variables are cointegrated over the period implying a long-run relationship between the variables. Panel OLS estimations show that the impact of unemployment on economic growth is negative and statistically significant. This indicates that unemployment decreases economic growth in these countries. Finally, Granger causality tests based on vector error correction model suggest that there is a bi-directional causality between the variables in the short and long run. The findings may provide some policy implications.

Chapter 3 discusses the Franco-German axis in the EU and debates about the weakening of this axis during Eurozone Crisis. Since the inception of the European integration process, the Franco-German axis is considered to be a major driving force. Even today, Europe moves faster in the presence of an entente between France and Germany. However, the harmonization of German and French positions is not quasi-automatic as it used to be. The desynchronization that occurred over time is based on various factors such as the German unification, the EU's enlargements and the change in German self-perception. One of the contexts in which the divergences between Paris and Berlin can be seen is related to the Euro zone rescue operations. Germany came to the fore in the resolution process and made clear her preferences which are not always truly supported by France. The drifting-apart that started after the end of the Cold War thus continues.

Chapter 4 questions the Euroscepticism in UK where the government suggests a referendum for the EU. The European Community/Union has always been a controversial issue in the UK. At present, the probability of an in-or-out referendum makes it all the more divisive. Eurosceptics see a brighter future for their country outside the Union both in political and economic terms. Pro-Europeans, on the other hand, maintain that British membership brings up benefits that outweigh the costs. Both sides have their arguments. The former seek success through social mobilizations and debates support. The latter believe that the anti-EU stance may be costly in economic and political terms. Hence, the public must be convinced before the referendum –if it ever takes place.

Chapter 5 analyzes the fiscal factors and political objectives and means to overcome obstacles within the EU. And it focuses on the fiscal harmonization of the tax legislation that is the most important competition breaker element in the field. The chapter concludes that a complete economic integration will be possible only by providing this fiscal harmonization.

Chapter 6 draws a comprehensive frame for European Financial Integration throughout debates about a European Banking Union. In 2012, the European Commission created a roadmap towards a European banking union. The aim of this EBU is to ensure financial stability in Europe. The proposed framework



by the European Commission is based on three pillars: a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM), and a single deposit guarantee mechanism. The EBU project is a step towards a better functioning EMU in the future. However, there are several controversies on this project. The main concerns are conflicts of interest between monetary policy and banking supervision, and cooperation between ECB and other banking authorities. If the EBU is a necessary step, it is not a sufficient one to resolve all financial issues in the EMU and in Europe.

Chapter 7 provides some background information on the progress of each candidate and potential candidate country (Turkey, Iceland, Serbia and the Former Yugoslav Republic of Macedonia) on the way to EU accession and compares them with the current EU28 members in order to emphasize the main similarities and the differences.

Chapter 8 examines the economic profit of the EU in the case of Turkey's membership to the Union. Even though Turkey has become sixth largest economy in the Europe, there are still hesitations in the EU due to Turkey's low profile performance in the past. However, in last decade the country has a significant rise in economy by carrying out market economy and privatizations successfully. This give rise to a greater potential gain for the EU members that will get when Turkey joint the Union.

Chapter 9 deals with EU health policy. All parts of health sector (health insurances, health care services, health workforce, cross-border patients and medication, etc.) have to be subject to both freedoms and regulations of common market/single market system. Despite the value given to health and related issues, a separate or supranational policy, such as the common agricultural policy, dealing with health issues has not been formed by the EU. The member states keep their privilege on health policies. However, this does not mean that the EU stays completely aside of health issues, contrary, in the course of time, the EU got involved in certain areas of health especially the ones which have cross-border implications. This chapter analyzes to what extent the EU is involved in health issues and question whether the EU has a concrete health policy.

Chapter 10 analyzes the cost-effective spending on dental health expenditure, which is the biggest share in total health expenditure, by comparing the cases in Turkey (as a candidate country) and EU members. Because of this financial burden, Turkey and the EU countries are trying to find cost-effective methods to minimize dental health spending. This chapter emphasizes dental health conditions of both Turkey and European Union firstly, and then successful and cost-effective strategies will be discussed.

Chapter 11 deals with the problems of Small-Medium Enterprises (SME) in Turkey, which is a candidate country for EU membership. The majority of SMEs, accounting for 90% of commercial businesses in the country, are established in form of family companies. This causes some problems such as insufficiently use of financial instruments, leak of professional executives, informal economy, etc. To overcome these problems, Development Agencies, being in the first place, and some other public institutions may be a remedy for SMEs. This chapter explain how the institutions in question will act to support SMEs.

Chapter 12 examines the government intervention during the three major global crises. And deregulation is diagnosed as principal reason for these crises. However, it points out that the reasons of the crises are the unethical and irrational behavior of homo economicus. This chapter concludes that it require regulation policies to be applied in order to overcome the last global crisis as it was done for the past crises.

Chapter 13 establishes a link between fiscal paradises and the 2008 economic crisis and investigate the role of G-20 as a global actor in regulating the fiscal paradises problem. Fiscal Paradises are described as the "dark side of globalization" because of the negative role they have been playing in global economy. Today they are an extremely important reason of tax evasion and tax avoidance, financial instability, money laundering, terrorist finance, issues. Recent actions by G-20 have focused on fiscal paradise



countries, targeting tax evasion and avoidance issues, because of the fact that the economic crisis in 2008 has shown the importance of destructive influence of fiscal paradises in the economy not only on national but also on international level. This chapter aims to explain what has been achieved regarding the fiscal paradises problems at G-20 summits since the economic crisis of 2008.

Chapter 14 reviews the Historical Development of Financial Transaction Taxes from J.M. Keynes's idea of excising the security transactions to J. Tobin's thought of excising the speculative capital movements. Then the feasible alternatives as two-staged Tobin tax of P.B. Spahn were suggested. Today, the effects occurring due to the global finance crisis has resulted in forcing the EU to review the mechanisms that will be activated during the crisis. In this context, an implementation of financial transactions tax that has been drafted to be implemented across the EU has been brought to the agenda. In this study, it is aimed to discuss financial transaction taxes in the context of the European Union and Turkey from a historical view.

Chapter 15 aims to investigate the cointegration and causal relationship between financial development, trade openness and economic growth in Turkey for the period of 1980-2012. To analyze the data, the bounds testing and Johansen-Juselius approaches to cointegration and Granger causality test based on vector error-correction model are employed. The cointegration tests suggest that there is a long-run relationship between the variables. The Granger causality test reveals long run bidirectional causality between trade openness and economic growth. The findings also indicate unidirectional causality running from financial development to trade openness and economic growth in the long run as well as a bi-directional causality between financial development and economic growth in the short run. The results support supply-leading and trade-led growth hypotheses. Therefore, it can be suggested that Turkey can accelerate its economic growth by improving its financial systems and encouraging foreign trade.

Chapter 16 threats sustainable development approach in Economy-Ecology dilemma. The managerial model of cooperation and dialogue-driven, international and supranational efforts in the past half-century period which is the subject of one of the most important topics of "sustainable development" concept. Rapidly growing human population, due to the unsustainable pattern of consumption of renewable natural resources for future generations also leads to transfer of resources not worry. The concept of development with ecological concerns with the impact of the moving approach should be reformulated has become a concept. "Despite the economy, ecology?" or "Despite the economy, ecology?" Fed from such dilemmas, these debates illustrate the need for a rational approach. Without jeopardizing the needs of future generations, to meet the needs of today's resource usage envisioning a sustainable development approach seeks to balance protection and use should be addressed in the context of an understanding.

Chapter 17 analyzes the impact of trade openness on environmental pollution in the newly industrialized countries that have focused on trade over the period 1971-2010 by using recently developed panel unit root, cointegration and causality tests. The results indicate a cointegration relationship between the variables. The results also show that trade openness increases carbon dioxide emissions with the elasticity of 0.53 and there is a Granger causality running from trade openness to carbon dioxide emissions in the long run. These findings may provide some policy implications. Without taking into account impact of trade on pollutions, optimistic environmental Kuznets curve hypothesis would be invalid. Therefore, policy makers who decide on environment policies should pay attention to not only growth effects but also trade effects on pollutions. Future empirical analysis would expose the new evidences for governmental policies and environmental regulations to change these effects positively.

Chapter 18 reviews the financial crisis of 2008-09 and its impacts on the international trade in terms of regionalism and globalism. The chapter glances over different aspects of globalism and regionalism



as well as looks on historical pattern and recent developments of regionalism and globalism. The data used in the chapter indicates that the financial crisis of 2008-09 negatively affected both globalization and regionalization trends. In addition, the EU has experienced an interesting transformation from regionalism to globalism. This chapter suggests that the issue is not only related with the great trade collapse of 2008-09, but also the sovereign debt crisis of 2010-12.

Chapter 19 deals with China-Russia relationship throughout the Shanghai Cooperation Organization (SCO). Relations between China and Russia have evolved dramatically throughout the twentieth century. However, during the past decade China and Russia have made a number of efforts to strengthen bilateral ties and improve cooperation on a number of economic/political/diplomatic fronts. Since the mid-1990s, the Shanghai Cooperation Organization (SCO) has been an important feature of Eurasian politics and a vehicle to forge a new sort of cooperation between China and Russia. A number of issues related to geopolitics, security, economy and regional politics have been handled by the SCO member states. It would be fair to argue that the SCO achieved noteworthy results in the past decade. The organization, today, appears as a solid and inclusive multilateral regional organization, very active in terms of promoting economic development and security in Eurasia.

Chapter 20 reviews political, economic, institutional, and natural conditions for a successful economic integration. And the Transatlantic Trade and Investment Partnership (TTIP) and the Shanghai Cooperation Organization (SCO) are evaluated in the light of these success conditions. The last global economic crisis has prompted new dynamics in the scope of economic integration: on the one hand, the USA and the EU, which is together the largest and wealthiest market in the world; on the other hand, Shanghai Cooperation Organization (SCO) recently adopted the economic vision for forming a free trade area and initiating an economic integration. Since these two integration projects were recently launched, the concerned policymakers, academicians, NGOs, etc. have a very limited scientific resource. This study is intended to make a small contribution to fill the gap in this field.

Chapter 21 deals with the impact of regionalism and globalization on metropolitan governance schemes of Turkey from political economy perspective. This chapter tackles with different dimensions of the Turkish metropolitan policymaking within the context of Law No: 6360, namely, the administrative aspects, the public financial characteristics along with the political dimensions. The problematization of the work simply follows how regionalism and globalization have come and interacted to render such a reform in Turkish local management units, under the rule of the Justice and Development Party (JDP-Adalet ve Kalkınma Partisi). The effort shall also tackle with the philosophy and the rational of new system in reference to regionalism and globalization with the need to underline the ramifications of the implementation of the new scheme in Turkey.

The impacts of globalization and the 2008-2009 financial crisis on global economic activity have been sufficiently examined in the literature. However, a politic approach to economic integration has not been sufficiently connected to strategic issues in the literature yet. Therefore, it is important to develop an innovative and strategic approach to issues in the international political economy. In this regard, regional economic integration and globalization issues in the international political economy have been assessed from an interdisciplinary perspective. The authors of these chapters developed models and strategies for innovative solutions to regional and global issues in the international political economy by assessing critical empirical studies and theories.



## **Preface**

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*Istanbul 29 Mayıs University, Turkey*

*Ümit Hacıoğlu*

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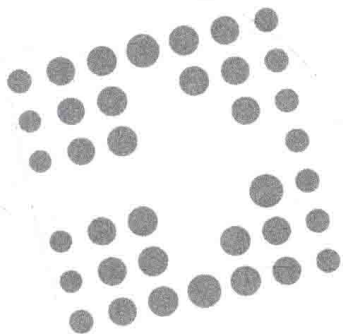
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The subprime mortgage crisis, which started in the United States in 2008, turned into a global crisis in a short time. Following the policies to reduce and mitigate the impacts of the global crisis, a sovereign debt crisis began that led to tremendous increases in government deficits and debt stock in the European Union region and made government financial systems unsustainable. This debt crisis, which started in the second half of 2009 in Greece, has resulted in a spillover effect for every EU member country. The ongoing crisis has rendered the future of Economic and Monetary Union uncertain. This chapter aims to determine the root causes of sovereign debt crisis in the EU and the economic and financial effects of and precautions for the crisis. This study also discusses the degradation of the EU's economic and political integration as a result of the sovereign debt crisis.

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Unemployment has become an increasingly serious economic and social problem in many European countries. Theoretically, unemployment has a negative effect on economic growth and development. This chapter examines the impact of unemployment on economic growth in 15 EU countries from 1984 to 2012 by using several panel data techniques. Panel unit root tests suggest that the series employed in the study are stationary at first differences. In other words, the series are integrated of order one,  $I(1)$ . Panel cointegration tests show that the variables are cointegrated over the period implying a long-run relationship between the variables. Panel OLS estimations show that the impact of unemployment on economic growth is negative and statistically significant. This indicates that unemployment decreases economic growth in these countries. Finally, Granger causality tests based on vector error correction model suggest that there is a bi-directional causality between the variables in the short and long run. The findings may provide some policy implications.

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<i>Güneş Yılmaz, Trakya University, Turkey</i>	

The concept of integration expresses an extremely fundamental and complicated formation. Despite such important and complicated issues and problems, Europe has made considerable progress and developments and been able to form the European Economic Community first and then the European Communities, and finally the European Union. It is necessary to precisely and smoothly complete the three stages of integration in order to mention about an exact integration. These stages, economic integration, fiscal integration, and political integration are discussed within this chapter. The first stage, economic integration, can be achieved only with the integration of the trade among the elements of the integration. Hence, it is required to seek for the fiscal harmonization of the tax legislation that is the most important competition breaker element in the field in question. A complete economic integration will be possible only by providing this fiscal harmonization.



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In 2012, the European Commission created a roadmap towards a European Banking Union. The aim of this EBU is to ensure financial stability in Europe. The proposed framework by the European Commission is based on three pillars: a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism (SRM), and a single deposit guarantee mechanism. The EBU project is a step towards a better functioning EMU in the future. However, there are several controversies on this project. The main concerns are conflicts of interest between monetary policy and banking supervision, and cooperation between ECB and other banking authorities. If the EBU is a necessary step, it is not a sufficient one to resolve all financial issues in the EMU and in Europe.

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In spite of the recent rise in Euroscepticism across most of Europe, owing to the recent Eurozone crisis and reflected by the European Parliament elections of May 2014 where far-right parties gained strength, there is little evidence to suggest that the enlargement of the EU will soon stop. The membership negotiations have started with Turkey, Iceland, Serbia, and the Former Yugoslav Republic of Macedonia. In terms of both economic and physical size, Turkey is more influential than the rest of the candidate countries. Therefore, the purpose of this chapter is to provide some background information on the progress of each candidate and potential candidate country on the way to EU accession and compare them with the current EU28 members in order to emphasize the main similarities and the differences. Finally, a literature survey of the economic implications of a potential Turkish EU membership is also provided as a case study.

#### Chapter 8

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*Eren Alper Yilmaz, Dokuz Eylül University, Turkey*

Even though Turkey has become the sixth largest economy in Europe, there are still hesitations and economic problems for the EU due to Turkey's rising population, low rate of GDP, budget deficit, migration, etc. In recent political history—before 2000s—Turkey failed in its economic liberalization policy. However, the country has seen a significant increase in the economy by developing a market economy and privatizations successfully in the last decade. There is no doubt that Europe would profit from the accession of Turkey to the EU in terms of internal market factors, agriculture, manufacturing industry, trade relations, tourism, and so on. For this reason, instead of looking for faults within the Turkish economy, the EU should try to see positive developments in the Turkish economic system and it should follow a policy that could overcome ongoing problems by mutual negotiations with Turkey. Approval of Turkey's membership to the EU would bring serious economic profits to Europe.

## Chapter 9

EU Health Policy: To What Extent the EU Got Involved in the Field of Health?..... 98

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Although not openly identified in treaties until the Maastricht Treaty, health has always been a crucial area for the European Union (EU), since freedoms provided and regulations brought by common market also dealt with several sections of the health sector. All concerning parts of health sector have to be subject to both freedoms and regulations of single market system. Despite the value given to health and related issues, a separate or supranational policy dealing with health issues has not been formed by the EU. The member states keep their privilege on health policies. However, the EU does not stay completely aside of health issues; on the contrary, the EU got involved in certain areas of health, especially the ones which have cross-border implications. In this chapter, the matter of to what extent the EU got involved in health issues is researched and the question of if the EU has a concrete health policy is analyzed.

## Chapter 10

An Evaluation of Oral and Dental Health Services in Turkey and in the Member States of the EU in Terms of Economy ..... 110

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Dental health expenditures are a big part of general health expenditures. In Turkey, oral health services are provided by both private practitioners and government sections. In 2012, approximately 7 million fillings were made by government clinics. According to Turkish Dental Association data, in the same year, the number of fillings that Turkish citizens needed was 247 million. Even if the entire budget of the Health Ministry of Turkey were spent for these fillings, it is impossible to handle this demand. In 2012, in the European Union with 24 member countries, dental health spending was close to 74 billion Euro. Because of this financial burden, Turkey and the other countries are trying to find cost-effective methods to minimize dental health spending. This chapter emphasizes dental health conditions of both Turkey and European Union, firstly, and then successful and cost-effective strategies are discussed.

## Chapter 11

Development Agencies, Grant System, and Financial Support for SMEs in Turkey..... 130

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SMEs form 90% of commercial businesses in Turkey and the support given to SMEs means support directly given to the real sector in a vast scale. SMEs have some problems currently that are accepted as structural throughout Turkey, such as that they were constituted in form of family companies, that they do not use financial instruments sufficiently, that they do not work with professional executives, their commercial activities without invoice, etc. There could be other common problems that SMEs can meet with as related to sector or location. The main duties of Development Agencies is to mobilize commercial potential in region, to support sectors that have the potential to grow, and thus, to decrease the difference of development between regions. This chapter explores SMEs in Turkey.



### Section 3

#### New Dynamics in Globalization

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The authors look at the three major global crises; they see state intervention in causes and solutions. The causes of the crisis were deregulation. To resolve the crises, again regulation policies have been applied. Although the causes of the crises seem to have been regulation policies, in fact, the main problem was homo economicus. In conclusion, the authors see that when we analyze the reasons for the three big global crises and the ways to overcome crisis, the reasons are the unethical and irrational behavior of homo economicus. That is why homo economicus must be constrained and obey constitutional financial and monetary rules.

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Fiscal Paradieses are described as the “dark side of globalization” because of the negative role they have been playing in the global economy. Today, they are an extremely important reason of tax evasion and tax avoidance, financial instability, money laundering, terrorist finance, and other issues. Recent actions by G-20 have focused on fiscal paradise countries, targeting tax evasion and avoidance issues, because of the fact that the economic crisis in 2008 has showed the destructive influence of fiscal paradieses in the economy not only on national but also on international level. The following year, in 2009, struggling with the fiscal paradieses was the main focus of the G-20 London Summit. In addition, the following four G-20 summits refined the issue concern in fiscal paradieses. This chapter aims to explain what has been achieved regarding the fiscal paradise problems at G-20 summits since the economic crisis of 2008.

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Along with the overthrow of the Bretton Woods system in the early 1970s, financial liberalization process started to be active in the whole world. The developing countries joined in the process by removing the obstacles on the capital flows in the 1980s. However, this process triggered subsequent crises and had destructive effects in these countries. Accordingly, the thought of excising the speculative capital movements, which were developed by J. Tobin through taking the idea of excising of security transactions of J.M. Keynes, came forward again. Then the feasible alternatives as two-staged Tobin tax of P.B. Spahn were suggested. After 2008 financial crisis, an implementation of financial transactions tax that has been drafted to be implemented across the EU has been brought to the agenda. In this chapter, it is aimed to discuss financial transaction taxes in the context of the European Union and Turkey from a historical view.