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INSIGHT

Assessing the Impact of Regional Integration on Inclusive Growth

Considering only one dimension in empirical analysis, such as trade, may not fully capture the impact of regional integration in promoting economic growth and reducing poverty and inequality. Photo credit: ADB.

Analysis using a multidimensional index suggests that regional integration boosts growth and reduces poverty, beyond the usual effect of trade openness.

Introduction

In many parts of the world, groups of countries have pursued regional integration as a strategy to promote economic growth and reduce poverty and income inequality for more than half a century. In Europe, the history of regional integration can be traced to the creation of the European Coal and Steel Community in 1952 and has since gradually and steadily progressed to build the European Union (EU) with the Maastricht Treaty in 1993. In the 1960s, a wave of regionalism led to the establishment of various regional institutions across developing regions, with the founding of the Central African Customs Union in 1964 in Africa, the Association of Southeast Asian Nations in 1967 in Asia, and, in Latin America, the Central American Common Market in 1960 and the Andean Pact in 1969.

A number of studies have tried to estimate the impact of regional integration on growth, poverty, and inequality, including examining the link between trade openness and economic growth. Although it is rather widely believed that international trade promotes economic growth, empirical evidence on the openness and growth nexus has been elusive.

A working paper from the Asian Development Bank explored the impact of regional integration on growth, inequality, and poverty using a multidimensional approach, while comparing the role of regional integration with that of trade openness.

Multidimensional Regional Integration Index

Regional economic integration is a multidimensional process extending beyond the efforts to liberalize trade. Considering only one dimension in empirical analysis, such as trade, may not fully capture the impact of regional integration in promoting economic growth and reducing poverty and inequality. Moreover, a better understanding of the dimensions of regional integration and how they impact development goals provides meaningful policy advice on how best to pursue regional integration as a development strategy.

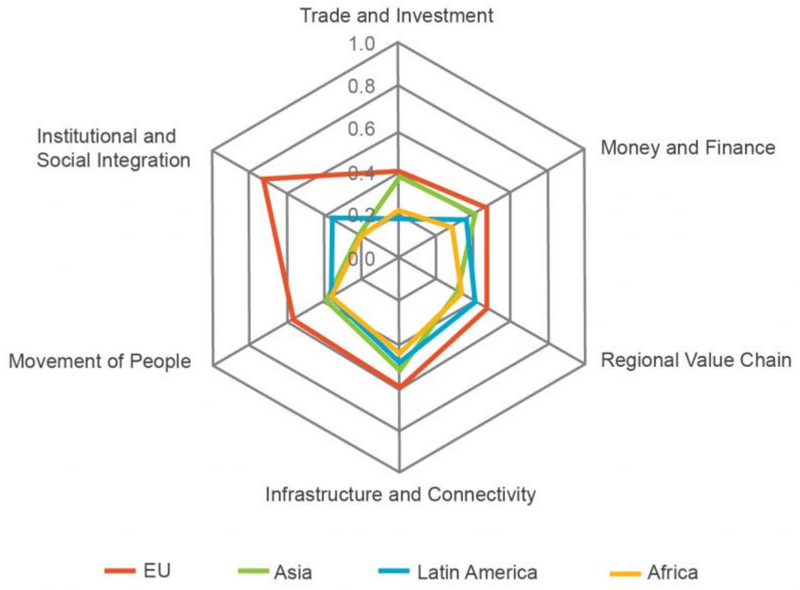
The study constructed a Multidimensional Regional Integration Index series for 2006–2016, covering 156 economies from Africa, Asia and the Pacific, the EU, and Latin America. The index embodies six socioeconomic dimensions that are fundamental to the dynamic regional integration process. These are: (i) trade and investment, (ii) money and finance, (iii) regional value chains, (iv) infrastructure and connectivity, (v) movement of people, and (vi) institutional and social integration.

The study apportioned 26 indicators to measure different aspects of regional integration across the six dimensions in two steps: (i) to compute six dimensional subindexes and (ii) to utilize these subindexes to construct the overall index.

Analysis

The Multidimensional Regional Integration Index confirms that the EU is the most advanced (and consistently highest) in regional integration (Figure 1). Asia comes second, while showing an upward trend. Importantly, in recent years, the region's trade and investment dimension has surpassed that of the EU and several Asian economies have broken into the top tier in overall regional integration, dominated by the EU economies. Latin America follows, while Africa comes last (albeit surpassing Latin America in 2009). The EU likewise scores highest on all dimensional subindexes, with only Asia's trade and investment integration comparable in magnitude to the EU's. The most significant contributors to regional integration have been infrastructure and connectivity for Asia, institutional and social integration for Latin America, and regional value chain for Africa, while dimensional contributions are broadly balanced for the EU.

Figure 1: Regional Integration Index, 2016



EU = European Union.
Source: Authors' calculations. Available in Asia-Pacific Regional Cooperation and Integration Index Database.

The study showed how the different dimensions of regional integration, individually and collectively, impact on key development variables, such as growth, inequality, and poverty. Empirical analyses revealed that the dimensions of regional value chain, movement of people, and institutional and social integration have been significant drivers of economic growth. A series of robustness tests confirm that building regional value chains have significant and positive impact on growth. Results of the study also show that enhancing infrastructure and connectivity lead to improved income distribution with its inequality-reducing effect stronger at low income levels.

Regional integration appears to hold greatest promise in reducing poverty. The study finds that overall integration and the dimensions of trade and investment, money and finance, and institutional and social integration are significant and robust drivers of poverty reduction. Their impact in curbing poverty is even more pronounced for lower-income countries. In addition, the overall degree of regional integration seems to exert more influence on poverty alleviation compared to more functionally and structurally focused regional integration efforts.

While regional integration proves to be an important factor for economic growth and development, the role of country-specific institutional and governance factors should not be overlooked.

Regression results likewise show that in conjunction with certain dimensions of regional integration and with overall integration, investment in human capital, macroeconomic stability, and institutional quality (as measured by secondary education, inflation, and control of corruption index, respectively) impact significantly on economic growth, income distribution, and poverty reduction.

In summary, the development impact of regional integration is significant and positive. The study's findings support that regional integration can be an effective development strategy. The findings are in line with the recognition by the United Nations of regional integration as an important tool to support national efforts in implementing the 2030 Agenda for Sustainable Development. Yet, they also highlight the importance and significance of national efforts to promote growth, narrow inequality, and reduce poverty. Continued structural reforms and institutional improvements at the country level would maximize the potential of regional integration in achieving sustainable development goals.

Resources

Asian Development Bank. ADB's Focus on Regional Cooperation and Integration (RCI).

CY Park and R Claveria. 2018. Does Regional Integration Matter for Inclusive Growth? Evidence from the Multidimensional Regional Integration Index. Manila: Asian Development Bank.

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Cyn-Young Park is director of the Regional Cooperation and Integration Division of the Economic Research and Regional Cooperation Department. During her progressive career within ADB, she has been a main author and contributor to the Asian Development Outlook, and participated in various global and regional forums including the G20 Development Working Group, as well as written and lectured extensively about the Asian economy and financial markets. She managed a team of economists to assess the socioeconomic benefits of ADB programs and projects and provide country diagnostic studies for effective ADB support to its developing member countries. Prior to joining ADB, she was an OECD economist.

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