

## The Political Economy of Regional Integration

THE MOVEMENT toward economic regionalism or regional trade agreements (RTAs), which accelerated in the mid-1980s, produced a significant impact on the shape of the world economy.<sup>1</sup> This new regionalism differed in fundamental respects from an earlier regional movement in the 1950s and 1960s; it had much greater significance for the world economy. The earlier movement, whose only survivor is the European Union, was limited largely to trade and just a few other areas. The new regionalism is more global in scope and involves integration not only of trade but also of finance and foreign direct investment. Also, the goal of the movement toward regional integration in Western Europe became political unification as well as creation of a single unified market. In Western Europe and elsewhere, trade has become increasingly regionalized, and this development has caused concern that the international economy may be moving in the direction of regional economic blocs.

The European Single Market Act (1986) triggered the “new regionalism” and stimulated development of other similar efforts. In the early 1980s, European reticence to join the American-initiated Uruguay Round of trade negotiations, fear in the United States that Europe was turning inward, and impatience with the slowness of the General Agreement on Tariffs and Trade (GATT) negotiations led to the American decision to support North American economic regional-

<sup>1</sup> The writings on economic regionalism and preferential trading arrangements have greatly expanded in recent years. Among the numerous writings on this subject, the following are especially noteworthy: Jagdish N. Bhagwati and Arvind Panagariya, eds., *The Economics of Preferential Trade Agreements* (Washington, D.C.: AEI Press, 1996); Richard Gibb and Wieslaw Michalak, eds., *Continental Trading Blocs: The Growth of Regionalism in the World Economy* (New York: John Wiley, 1994); Vincent Cable and David Henderson, eds., *Trade Blocs? The Future of Regional Integration* (London: Royal Institute of International Affairs, 1994); Paul De Grauwe, *The Economics of Monetary Integration*, 2d rev. ed. (New York: Oxford University Press, 1994); Jaime De Melo and Arvind Panagariya, eds., *New Dimensions in Regional Integration* (New York: Cambridge University Press, 1995); Miles Kahler, *Regional Futures and Transatlantic Economic Relations* (New York: Council on Foreign Relations, 1995); and Jeffrey A. Frankel, *Regional Trading Blocs in the World Economic System* (Washington, D.C.: Institute for International Economics, 1997).

ization. Once launched, the slow and drawn-out Uruguay Round as well as the regional movements in Western Europe and North America undoubtedly also contributed to the spread of regional trade agreements elsewhere in the world. Many nations, fearing that the Round would never succeed or that they would be shut out of other regional arrangements, initiated regional efforts, and regional trade agreements proliferated. By the late 1990s, there were approximately 180 regional agreements, and almost all members of the World Trade Organization (with the notable exception of Japan, Hong Kong, and Korea) were included in one or more formal regional arrangements.

Previously, initiatives toward development of regional free trade areas had been followed by new rounds of multilateral trade negotiations. The United States had responded to the Treaty of Rome (1957) and the subsequent creation of the European Community by initiating multilateral trade liberalization within the GATT; the Kennedy Round (1963–1967) of trade negotiations was a response by the United States to the creation of the European Community (Common Market) and the Tokyo Round (1973–1979), a response to the first enlargement of that Community. However, the multilateral American approach to the movement toward European integration changed in the 1980s. When it became clear that the Single Market Act in the mid-1980s could create a united and possibly closed West European market, the United States followed Canada's lead and shifted its policy toward development of a regional arrangement of its own: the North American Free Trade Agreement (NAFTA).

In Pacific Asia, largely in response to European and North American regional developments, Japan intensified its own efforts to create and lead a regional economy. As more and more developing countries liberalized their economies unilaterally to achieve greater efficiency and abandoned import-substitution strategies in favor of a greater emphasis on export-led growth, they too began to perceive the advantages of regional initiatives that would promote economies of scale for their industries and provide some counterbalance to regionalization in Europe and in North America. This expanding movement toward regional integration can be characterized as a response to what political scientists call a "security dilemma" in which each regional movement attempts to enhance its own bargaining position vis-à-vis other regions.

Albert Fishlow and Stephan Haggard have made a useful distinction between market-driven and policy-driven regional integration; certainly both political and economic considerations are involved in

every regional movement.<sup>2</sup> However, the relative importance of economic and political factors differs in each. Whereas the movement toward integration of Western Europe has been motivated primarily by political considerations, the motivation for North American regionalism has been more mixed, and Pacific Asian regionalism has been principally but not entirely market-driven. Attainment of such political objectives as ending French-German rivalry and creating a political entity to increase Europe's international standing and strengthen its international bargaining position has been of vital importance in European integration. North American regionalization, on the other hand, has been primarily market-driven; establishment of the free trade area reflected the natural integration of the three North American economies (Canada, Mexico, and the United States) by market forces. However, some political motives, such as strengthening North America's position vis-à-vis Western Europe and reducing illegal Mexican migration into the United States, have also been factors. And in Pacific Asia, although market forces have been the most important factors in integration of the economies, political considerations and Japanese policies have also played significant roles.<sup>3</sup>

Moreover, even though economic regionalism has become a universal phenomenon, regionalism has also assumed quite diverse forms.<sup>4</sup> In addition to the differing mix of political and economic goals, regional arrangements vary in their institutional form. For example,

<sup>2</sup> Albert Fishlow and Stephan Haggard, *The United States and the Regionalization of the World Economy*, Development Centre Documents (Paris: OECD, 1992).

<sup>3</sup> Although the Asia Pacific Economic Cooperation (APEC) organization could be considered an example of regional integration, its achievements have been quite modest.

<sup>4</sup> Ali M. El-Agraa, ed., with contributions, *The Economics of the European Community* (London: Harvester Wheatsheaf, 1994), provides a useful discussion of the various types of regional integration. These arrangements include the following in order of the stage of integration: (1) *Free trade area*: Members eliminate all trade restrictions against each other's goods; an example is the North American Free Trade Agreement (NAFTA). (2) *Customs union*: Although similar to a free trade area, participating countries adopt uniform tariffs and other trade restrictions vis-à-vis countries outside the union; the most prominent example was the European Economic Community or Common Market created by the Rome Treaty (1957). (3) *Common market*: Extends a customs union to include the free movement of the factors of production (goods, services, people, capital). (4) *Economic union*: The highest form of economic integration incorporates the previous stages of integration and adds monetary and fiscal policy harmonization; the only example is the movement toward European economic integration. (5) *Political Union*: Moves beyond economic union to supranational decision-making beyond the purely economic; a political union is the ultimate goal of the movement toward European unity.

## CHAPTER THIRTEEN

whereas Western Europe is attempting to create an integrated political/economic entity, has erected an external tariff, and has become highly institutionalized, Pacific Asian regionalization has no external tariff, a very low level of institutional development, and every economy in the region has retained high tariffs. North American regionalism stands somewhere between the other two. The North American Free Trade Agreement created a free trade area without an external tariff, does not have a common market, and has only a few formal institutions. The movement toward greater unity as Europe seeks to achieve both economic and political integration is the only example of what scholars call *deep* regional integration.

The diversity of regional arrangements makes broad generalizations and overarching theories or explanations of regionalism impossible. One cannot confidently assess these regional efforts or predict their effects upon the world economy. It is nonetheless desirable to present a summary and critique of the principal attempts by economists and political scientists to develop theories or explanations regarding economic and, to a lesser extent, political regionalism. In general, economists have been interested in the welfare consequences of regional arrangements for members and nonmembers, and political scientists have been more concerned with ways to explain economic and political integration. While writings thus far have provided important insights into many aspects of economic regionalism, they leave many questions unanswered.<sup>5</sup>

### ECONOMIC THEORIES

Integration of formerly self-contained economic areas into larger economic entities has been important in modern history. The modern era has been characterized by integration of small and relatively distinct territories into larger nation-states and into national economies surrounded by trade barriers. Despite this process of economic integration, when Fritz Machlup conducted an extensive review of the economic literature in 1976, he learned that prior to 1947 economists

<sup>5</sup> It is worth noting that the subject of political fragmentation has received very little attention from scholars of political economy. One exception is Patrick Bolton and Gérard Roland, "The Breakup of Nations: A Political Economic Analysis," April 1995 (unpublished).

had written little about economic integration.<sup>6</sup> Such neglect is startling because of the obvious importance of the integration of national markets to the nature and evolution of the world economy. Beginning with the European movement toward economic integration in the early post-World War II period, the economics profession began to pay more attention to international integration. Yet theoretical results have been sparse and have not significantly advanced our understanding of the actual process of economic integration or of its consequences. In fact, the subject of economic integration remains largely empirical rather than theoretical.<sup>7</sup>

The principal approaches that economists have taken in their efforts to explain regional integration or free trade areas arise from neoinstitutionalism and the new political economy. The *new institutionalism* approach assumes that international, including regional, institutions, such as those of Western Europe, are established to overcome market failures, solve coordination problems, and/or eliminate other obstacles to economic cooperation. These institutions create incentives for states to cooperate and, through a variety of mechanisms, to facilitate such cooperation. Although the new institutionalism provides valuable insights, it does not consider the political reasons for regional arrangements. The *new political economy* explanation emphasizes interest group politics and the distributive consequences of economic regionalism; it assumes that such regional trade arrangements as customs unions and free trade agreements have significant redistributive consequences that are usually harmful to nonmembers and create both winners and losers among the members themselves. Indeed, economists frequently explain economic integration as resulting from efforts of domestic interests to redistribute national income in their own favor. This approach provides important insights into the domestic politics of economic integration but fails to explain the costly efforts by Europeans to achieve regional integration.

<sup>6</sup> Fritz Machlup, ed., *Economic Integration: Worldwide, Regional, Sectoral* (London: Macmillan, 1976), 63. Studies by economists on economic integration include Bela Balassa, *The Theory of Economic Integration* (Homewood, Ill.: Richard D. Irwin, 1961); and Peter Robson, *The Economics of International Integration* (London: Allen and Unwin, 1987). Two pioneering studies of economic integration are W. M. Corden, *Monetary Integration*, Essays in International Finance no. 93, Princeton University, Department of Economics, International Finance Section, April 1992 and J. E. Meade, H. H. Liesner, and S. J. Wells, *Case Studies in European Economic Union: The Mechanics of Integration* (London: Oxford University Press, 1962).

<sup>7</sup> A discussion of economic theories of integration is found in Bhagwati and Panagariya, eds., *The Economics of Preferential Trade Agreements*.

The Marxist theory of economic and political integration is another economic approach to an explanation of integration. According to Belgian economist Ernest Mandel, economic integration in general, and the movement toward European economic and political integration in particular, are explained by the efforts of transnational capitalist classes to increase the scale of capital accumulation.<sup>8</sup> Over the course of modern history, the requirements of capital accumulation have driven the world toward ever larger economic and political entities. According to this point of view, technological developments and international competition are forcing the dominant European capitalist class to overthrow the narrow confines of national capitalism and forge a regional economy that will strengthen the international competitiveness of European capitalism. However, as I shall point out later, economic determinism omits certain important political and strategic motives responsible for economic integration.

Economic theories do not provide a satisfactory explanation of economic integration. This is because economic analysts generally assume that a political decision has been made to create a larger economic entity, and that economists need only analyze the welfare consequences of that decision and concern themselves with just a few aspects of the process of economic integration. Another theoretical subject of interest to economists has been the theory of an "optimum currency area" (OCA); this theory specifies the conditions necessary for establishment of a common currency within an economic region. This theory is of special relevance to the effort to achieve the European Economic and Monetary Union (EMU). There is also a small literature on the "optimum regionalization" of the world economy; and attention is given to comparison of the political and economic consequences of a world containing two regionalized economies with the consequences of a world of three or more integrated regions.

An important body of economic literature deals with the welfare consequences for nonmembers of such regional arrangements as customs unions (the European Common Market) and of free trade areas (NAFTA). The classic work on the welfare consequences of regional trade agreements is Jacob Viner's *The Customs Union Issue* (1950), a study stimulated by growing concerns in the United States and elsewhere about the accelerating movement toward a Western European common market.<sup>9</sup> Prior to Viner's analysis, the conventional wisdom

<sup>8</sup> Ernest Mandel, *Europe versus America?: Contradictions of Imperialism* (London: N.L.B., 1970).

<sup>9</sup> Jacob Viner, *The Customs Union Issue* (New York: Carnegie Endowment for International Peace, 1950).

of the economics profession—based on the theory of comparative advantage—had been that regional agreements were beneficial to members and nonmembers alike, and that they produced much the same consequences as did global trade liberalization. In other words, the pre-Viner position was that the economic gains to both members and nonmembers were similar to those produced by free trade and included the benefits of specialization, improved terms of trade, greater efficiency due to increased competition, and increased factor flows among members. In his study, Viner not only challenged this optimistic assumption but also analyzed customs unions' implications for nonmembers.

Viner's analysis pointed out that a common external tariff would have trade-diverting as well as trade-creating effects. The initial or static consequences of an external tariff, say, around the European Common Market, would divert trade from foreign suppliers to suppliers located within the Common Market. However, as Viner also pointed out, the long-term or dynamic effects of a common market would lead to creation of a larger and more wealthy European market that would benefit not only local firms but also the market's external trading partners. Whether the trade-diverting or the trade-creating effects of a customs union would ultimately predominate, Viner concluded, was an empirical question that could be answered only from actual experience. Likewise, the welfare consequences for nonmembers could not be determined theoretically but only by observing the specific actions and policies of the European Economic Community or other regional arrangements.

Viner's pioneering analysis has been extended and modified by subsequent research; yet his insight into the basic indeterminacy of the welfare effects of economic regionalism remains valid.<sup>10</sup> Indeed, Viner's conclusions have been supported by a report in 1997 from a group of international experts.<sup>11</sup> Although these experts could draw upon theoretical developments and actual experience accumulated subsequent to Viner's study, they, too, concluded that neither economic theory nor empirical evidence can inform us whether or not

<sup>10</sup> See Alfred Tovias, "A Survey of the Theory of Economic Integration," in Hans J. Michelmann and Payayotis Soldatos, eds., *European Integration: Theories and Approaches* (Lanham, Md.: University Press of America, 1994).

<sup>11</sup> Jaime Serra et al., *Reflections on Regionalism: Report of the Study Group on International Trade* (Washington, D.C.: Carnegie Endowment for International Peace, 1997). See also Paul J. J. Welfens, "Economic Integration Theory," in Desmond Dinan, ed., *Encyclopedia of the European Union* (Boulder, Colo.: Lynne Rienner, 1998), 153–58.

a specific regional arrangement will harm nonmembers. No general conclusions can be drawn because of the very different and specific aspects of each regional arrangement. Indeed, economists answer the question of whether regional arrangements will lead to trade diversion or trade creation with the classic answer of economists and other scholars to difficult issues: “more research is needed.”

Since Viner’s early work, the new trade and growth theories have strongly influenced economists’ thinking about regional integration. Whereas Viner’s analysis was based on the neoclassical theories of trade and economic growth that assumed perfect competition, constant returns to scale, and diminishing returns, new thinking about economic integration is based on economies of scale and other favorable consequences of integration, such as R & D spillovers within the region. This means that firms within a regional arrangement can gain competitive advantages from which firms outside the arrangement are excluded. This theory implies that countries could and probably would support regional trade barriers and trade diversion so that firms within the region would have exclusive access to technological advances, economies of scale, and other advantages. External barriers could also protect such firms from external competition and enable them to achieve economies of scale and international competitiveness as well. Regional trade barriers could enhance the bargaining position of local firms and governments in their dealings with outside firms and governments. Evidence suggests that such strategic advantages of economic regionalism have played a role—but not a determining role—in the movement toward European integration.

#### POLITICAL THEORIES

Political scientists have had an interest in political and economic integration for a relatively long time, but before the movement toward European unity no one attempted to formulate general theories or explanations of regional integration.<sup>12</sup> Political scientists have emphasized institutional solutions to the problems of war and international political instability and have focused on the idea of federalism and political integration of the world. From the early postwar period on, the thinking of those interested in integration has been influenced

<sup>12</sup> An important volume on the ideas of political scientists regarding economic and political integration is Edward D. Mansfield and Helen V. Milner, eds., *The Political Economy of Regionalism* (New York: Columbia University Press, 1997). See also Andrew Moravcsik, “Integration Theory,” in Desmond Dinan, ed., *Encyclopedia of the European Union* (Boulder, Colo.: Lynne Rienner, 1998), 278–91.



by federalism, neofunctionalism, neoinstitutionalism, intergovernmentalism, and realism.

### *Federalism*

Throughout modern history, idealists have set forth schemes to solve the problem of war by building federalist institutions to which parties will consciously and voluntarily surrender their political autonomy and sovereign rights. In the twentieth century, Woodrow Wilson's proposal for a League of Nations, and the later establishment of the United Nations, inspired additional federalist solutions to prevent another great war. Following World War II, the World Federalist movement, whose appeal arose from its emphasis on persuasion, converting public opinion, and building of institutions, expanded. Although the federalist idea had some influence on the movement toward European integration, it appealed most of all to those interested in the global level.

Despite its intellectual appeal, federalism has never proved to be a successful route to political integration, and its successes have been achieved only under unusual political circumstances. The few examples of successful federal experiments have been motivated primarily by national security concerns. Indeed, the two most successful federal republics—Switzerland and the United States—were created in response to powerful external security threats. And in the United States, full political and economic integration were attained only after the victory of the North over the South in the Civil War. The German federalist state resulted from conquest by one nation (Prussia) of other German political entities. Historically, political integration of independent political entities has resulted from military conquest or dynastic union, and neither of these methods will necessarily lead to creation of an integrated economy.

### *Functionalism and Neofunctionalism*

The theory of neofunctionalism was very influential in the 1950s and 1960s. Closely associated with the writings of Ernst Haas, neofunctionalism is the most important effort by political scientists to explain political integration in general and European political integration in particular.<sup>13</sup> Drawing upon the social sciences, Haas's theory of neofunctionalism, elaborated and extended by his students and other scholars, argued that economic, technological, and other develop-

<sup>13</sup> Ernst Haas, "The Challenge of Regionalism," *International Organization* 12, no. 3 (1958): 444–58.

ments during the twentieth century have driven peoples and nation-states toward peaceful economic and political integration at both the regional and global levels.

The theory of neofunctionalism had its roots in pre-World War II functionalist theory that had appeared in response to the failure of the League of Nations to maintain the peace after World War I. Collapse of the League made people aware that something more than voluntary federalism was needed to ensure world peace. The British social democrat David Mitrany took up this challenge and systematically set forth his functionalist theory as a solution to the problem of war in his highly influential monograph *A Working Peace System* and other writings.<sup>14</sup> According to Mitrany, modern economic, technological, and other developments made political integration of the world possible and necessary. Technocratic management of an increasingly complex and integrated global economy and social system had become imperative.

The problem of war could be solved and the war-prone system of nation-states could be escaped, Mitrany argued, through international agreements in such specific functional or technical areas as health, postal services, and communications. Even though the political system remained fragmented into jealous and feuding nation-states, such functional and technical international institutions were feasible because the world in the twentieth century had become highly integrated both economically and physically by advances in communications and transportation. As functional international institutions succeeded and promoted social and economic welfare, they would gain legitimacy and political support and would over time triumph over the nation-state.

Mitrany assumed that an economically and technologically integrated world had given rise to many complex technical problems that individual competing states could not deal with effectively. If functional problems in the areas of health and postal services were to be solved, nation-states should, in their own self-interest, establish international organizations to carry out the required activities. Then, as the new organizations proved their effectiveness in dealing with various technical problems, states would delegate more and more tasks to international institutions. As new functional arrangements were put into place, the realm of independent political action, and hence also of international conflict, would become more and more circumscribed. In time, states would learn the advantages of peaceful

<sup>14</sup> David Mitrany, *A Working Peace System* (Chicago: Quadrangle, 1966).

cooperation, and the importance of political boundaries would diminish. Political integration of the world would thus result from economic and other forms of international cooperation.

Inspired by Mitrany's insights, Ernst Haas developed what he called "neofunctionalism" and applied this theory to both international institutions and the process of European integration.<sup>15</sup> Drawing on literature in social science, Haas produced *The Uniting of Europe* (1957) and *Beyond the Nation-State* (1964). Like Mitrany, Haas believed that modern democratic and, especially, welfare states required rational management of the economy and centralized technocratic control. However, for Haas, Mitrany's functionalism was too unsophisticated politically and lacked a theory of how integration actually took place. Whereas Mitrany had emphasized the deliberate actions of national leaders to create international institutions, Haas's focus was on domestic interest groups and political parties promoting their own economic self-interest. He also stressed the unintended consequences of previous integration efforts, which he called "spillover"; as groups realized that integration could serve their self-interest, there would automatically be spillover from one area of integration to another. In time, the process of spillover would lead to political cooperation and a transnational political community favoring more extensive and centralized regional or international governing mechanisms.

Haas was not especially interested in the reasons for initiating integration efforts; however, once an integration effort had been launched, Haas foresaw pressures for further integration. He expected that social and economic groups would demand additional economic integration, and that that would create new political actors interested in and ready to promote further integration. Political integration would be carried out by the actions of both domestic interest groups and international civil servants or entrepreneurs. Domestic interest groups, especially in business, would pressure their home governments to create regional institutions to perform particular tasks that would promote their economic interests. International civil servants, like the staff of the European Commission, would, as they fulfilled their assigned tasks,

<sup>15</sup> Haas was also influenced by the writings of Karl Deutsch. According to Deutsch, modernization leads to increasing levels of social interaction and communication among politically separated peoples, which in turn leads to a convergence of individual and group values in the direction of more cosmopolitan norms. This development results (at least among democratic societies) in the formation of a security community in which no state poses a threat to any other. Karl W. Deutsch, "Communications Theory and Political Integration," in Philip E. Jacob and James V. Toscano, eds., *The Integration of Political Communities* (Philadelphia: Lippincott, 1964).

develop a loyalty to the international institution rather than to their home governments. As powerful domestic interests and individual states learned the utilitarian value of international organizations, and as international civil servants transferred loyalty from their own states to international organizations, the role of international institutions in managing regional and global affairs would grow. Over time, the regional or global organization would be transformed from a means into an end itself. Thus, neofunctionalist theory, like functionalist theory, believed that economic cooperation would lead to political integration at either the regional or global level.

The idea that economic and technological forces are driving the world toward greater political integration is at the core of neofunctionalism. Forces leading to economic and political integration are embedded in the modern economic system and tend to be self-reinforcing, as each stage of economic integration encourages further integration. Neofunctionalism assumes that economic and other welfare concerns have become, or at least are becoming, more important than such traditional concerns as national security and interstate rivalry. Underlying this assumption is a belief that industrialization, modernization, democracy, and similar forces have transformed behavior. The theory assumes as well that the experience of integration leads to redefinition of the national interest and eventual transfer of loyalty from the nation-state to emerging regional or global entities.

It is worth noting several ways in which neofunctionalism modified functionalism. Whereas functionalism assumed that conscious political decisions would accelerate political integration, neofunctionalist theory assumes that, once the process of economic and technical integration has been launched, unanticipated consequences, spillovers from one functional area to another, and the effects of learning will propel the process toward eventual political and economic unification. One of neofunctionalism's core propositions is that the logic of functional spillovers would push political elites inevitably from economic cooperation toward political unification. Neofunctionalism concentrates on the process of regional integration itself and, unlike economic theory, does not attempt to evaluate explicitly the economic welfare consequences of regional integration. Yet, there is an unstated assumption that economic and political integration are beneficial to members and nonmembers alike.

Neofunctionalist ideas have strongly influenced the thinking of scholars and public officials about European regional integration. For example, Western Europeans, in their concerted effort to create both a single market and a single European currency (the euro), have assumed that

economic and monetary unity would eventually force further steps toward economic and political unification. However, especially following the French veto in 1967 of Britain's effort to join the European Community, it became obvious that the neofunctionalist logic of spillovers and feedbacks was not working. And in 1975 Haas repudiated his own neofunctionalist theory.<sup>16</sup> Few scholars have been equally honest and courageous in rejecting their own theories when faced with contrary evidence.

*Neoinstitutionalism, Domestic Politics, and Intergovernmentalism*

Since scholars have recognized that functionalist and neofunctionalist thinking about regional integration has proved inadequate, new approaches—neoinstitutionalism, domestic politics, and intergovernmentalism—have influenced the writings of political scientists interested in economic and political integration.<sup>17</sup> Neoinstitutionalism emphasizes the role of institutions in solving economic and other problems; it maintains that institutions could help ameliorate market failures and solve collective action problems in economic and political integration. The most prominent scholar in this school of thought is Robert Keohane who, along with others, has emphasized the need for international institutions to deal with market failures, reduce transaction costs, and counter other problems. Scholars argue that international institutions (or regimes) assist states to solve collective action problems, promote cooperation through facilitation of reciprocity (tit-for-tat strategies), and link various issue areas. In such ways, regional international institutions increase the incentives for states to solve their disputes and cooperate with one another. Although this position has been very influential in the development of thinking about regional institutions, it has not led to a specific theory of economic and political integration.

Political scientists have also studied the effects on economic and political integration of such factors as the pressures of domestic economic interests and the interests of political elites. Their literature,

<sup>16</sup> Ernst Haas, "The Obsolescence of Regional Integration Theory," Institute of International Studies, University of California, Berkeley, Research Series no. 25, 1975.

<sup>17</sup> Intergovernmentalism is discussed in Robert O. Keohane and Stanley Hoffmann, eds., *The New European Community: Decision Making and Institutional Change* (Boulder, Colo.: Westview Press, 1991). Also, Hans J. Michelmann and Panayotis J. Soldatos, eds., *European Integration: Theories and Approaches* (Lanham, Md.: University Press of America, 1994). A critique of intergovernmentalism is Geoffrey Garrett and George Tsebelis, "An Institutional Critique of Intergovernmentalism," *International Organization* 50, no. 2 (spring 1996): 269–99.

emphasizing the importance for domestic groups of the distributive consequences of integration, has noted that winners support integration and losers oppose it. It has also recognized that political leaders will be guided by the consequences of integration for their own political survival and that domestic interests and institutions may facilitate or discourage integration. Many writings produced by political scientists in this area are very similar to those of economists. Although this literature supplements explanations that focus on the international level, by the year 2000 the literature had not been developed into a coherent theory or approach to economic and political integration.

The most significant approach by political scientists to economic and political integration since neofunctionalism is intergovernmentalism or, more specifically, liberal intergovernmentalism. This approach, derived from neofunctionalism, neoinstitutionalism, and other earlier theories of political integration, shares with neofunctionalism an emphasis on economic interests as the principal driving forces of regional integration. Like neoinstitutionalism, it stresses the importance of international, that is regional, institutions as a necessary means of facilitating and securing the integration process. However, intergovernmentalism differs from earlier approaches in its concentration on the central role of national governments, on the importance of powerful domestic economic interests, and on bargaining among national governments over distributive and institutional issues.

The most ambitious effort to develop a theory of economic and political integration based on intergovernmentalism is found in Andrew Moravcsik's *The Choice for Europe* (1998)<sup>18</sup> which concentrates on the pivotal responses of national governments to the increasing interdependence of national economies and emphasizes the importance of international institutions in solving problems generated by increasing economic interdependence. In Moravcsik's words:

My central claim is that the broad lines of European integration since 1955 reflect three factors: patterns of commercial advantage, the relative bargaining power of important governments, and the incentives to enhance the credibility of interstate commitments. Most fundamental of these was commercial interest. European integration resulted from a series of rational choices made by national leaders who consistently pursued economic interests—primarily the commercial interests of powerful economic producers and secondarily the

<sup>18</sup> Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina and Maastricht* (Ithaca: Cornell University Press, 1998).

macroeconomic preferences of ruling governmental coalitions—that evolved slowly in response to structural incentives in the global economy. When such interests converged, integration advanced.<sup>19</sup>

Thus, private economic interests and short-term macroeconomic policy preferences are considered responsible for European integration and, as Moravcsik is proposing a general theory of regional integration, for other integration efforts as well.

Moravcsik's belief that political motives, such as French-German reconciliation and the integration of West Germany into a denationalized European political structure, have played only a minor or secondary role in European political integration constitutes a serious weakness in his argument. The statements of European leaders about the political imperative of economic and political integration make Moravcsik's disregard of the political motives quite astounding. If Moravcsik is correct that regional integration efforts around the world are due to national responses to increasing international economic interdependence, then one would expect similar movements toward political integration elsewhere. As he argues, European integration differs only in that Europe has been "touched more intensely" by global economic developments.<sup>20</sup>

If one accepts Moravcsik's reasoning, one would expect that North America would also be moving toward political integration. After all, the three North American economies—the United States, Canada, and Mexico—are far more closely integrated in trade, financial flows, and foreign direct investment than are the economies of Western Europe. Although intra-European trade has certainly increased greatly since World War II, trade flows among the three North American economies, especially between the United States and Canada, are still considerably larger. North American corporate linkages across national borders dwarf those among European firms; and services, finance, and manufacturing in North America are more closely integrated than are those in Western Europe. Transnational European corporate integration, in fact, is just beginning, and progress toward economic integration has led to corporate integration, rather than vice versa. European national financial markets also remain highly fragmented and separated from one another. Yet, despite the higher level of North American economic integration, there is no pressure whatsoever for political unity. Political integration is not occurring, because the North American nations have no political motive to inte-

<sup>19</sup> *Ibid.*, 3.

<sup>20</sup> *Ibid.*, 5.

grate with one another as the nations of Western Europe have. Surely, the geopolitical concerns of the major West European powers should be given greater attention.

### *Realism*

Although a number of realists have written on political integration, there is no generally accepted realist theory. However, the realist approach does emphasize the importance of power, national political interests, and interstate rivalries in the integrative process. Realism regards regional integration, especially political integration like that taking place in Western Europe, as a political phenomenon pursued by states for national political and economic motives. Realism, which I have labeled state-centric realism, assumes that a successful process of economic and political integration must be championed by one or more core political entities that are willing to use their power and influence to promote the integration process. In West European integration, regional leadership has been exercised by France and Germany.

Perhaps there is no better example of the realist approach to political integration than the following passage from Viner's *The Customs Union Issue* on the unification of Germany in the mid-nineteenth century:

It is generally agreed that Prussia engineered the customs union [*Zollverein*] primarily for political reasons, in order to gain hegemony or at least influence over the lesser German states. It was largely in order to make certain that the hegemony should be Prussian and not Austrian that Prussia continually opposed Austrian entry into the Union, either openly or by pressing for a customs union tariff lower than highly protectionist Austria could stomach.<sup>21</sup>

The realist approach to economic regionalism also calls attention to several factors that limit peaceful economic and political integration. Joseph Grieco, for example, stresses the importance of relative gains and of distributive issues in state calculations; these inevitably make the type of long-term cooperation necessary to integration efforts very difficult to achieve.<sup>22</sup> States, for example, are unlikely to willingly compromise their national security for economic gains in a regional arrangement; thus far, the European Union has experienced little

<sup>21</sup> Jacob Viner, *The Customs Union Issue*, 98–99.

<sup>22</sup> For a realist discussion of regional integration, consult Joseph Grieco, "Systemic Sources of Variations in Regional Institutionalization in Western Europe, East Asia, and the Americas," in Edward D. Mansfield and Helen V. Milner, *The Political Economy of Regionalism* (New York: Columbia University Press, 1997).



progress in reaching agreement on common security or foreign policies. In addition, the economic concessions required to achieve regional integration may be granted to allies but certainly not to potential adversaries. Therefore, economic and political integration may require a powerful leader that has an interest in and a capacity to promote a regional arrangement. Ready examples are Germany in Western Europe (EU), the United States in North America (NAFTA), Japan in Pacific Asia, and Brazil in South America (Mercosur).

The historical experience in national development reveals that despite neofunctionalist assertions, economic unification has followed rather than preceded political unification. Once a political decision has been made to achieve economic and monetary union, neofunctionalist logic and the solution of technical issues may propel deeper integration. However, at least to my knowledge, there is no example of spillover from economic and monetary unification that has led automatically to political unification. Indeed, in some ways, even the movement toward economic and political unification of Europe thus far has been historically unique. Integration by peaceful means of such a large region has never before been attempted, and there simply are no precedents to provide guidance regarding the future of European regionalization. Whether or not Europe will ultimately succeed depends more on political than on economic developments.

Every regional arrangement represents cooperative efforts of individual states to promote both national and collective objectives. Some believe that economic regionalism, and especially the effort to achieve European political unity, signals a movement away from a state-centric world and the beginning of a postnational international order. To the contrary, this effort and economic regionalism in general have been a response by nation-states to shared political and economic problems. As the world economy has become more closely integrated, regional groupings of states have increased their cooperation in order to strengthen their autonomy, increase their bargaining position in disputes about distributive issues, and promote other political or economic objectives. Regionalization is a means to extend national concerns and ambitions rather than an alternative to a state-centered international system.

Economic regionalism has spread because nation-states want the absolute benefits of a global economy at the same time that they seek to increase their own relative gains and protect themselves against external threats to their economic welfare and national security. Concerns over distributive issues and worries over national autonomy reflect the belief of national political and economic leaders that eco-

## CHAPTER THIRTEEN

conomic competition must necessarily be a central concern in world politics. Furthermore, international economic competition necessitates large domestic markets that enable domestic firms to achieve economies of scale. In order to survive and prosper in an uncertain and rapidly changing world, individual states and groups of states are adapting to the evolving economic, technological, and political environment, as they have done many times in the past. In the 1990s, states have responded to intensely competitive and threatening globalization by forming or extending regional economic alliances or arrangements under the leadership of one or more major economic powers.

Economic regionalism has become an important component in the national strategies of the major economic powers to strengthen their respective domestic economies and their international competitiveness. They attempt to achieve at the regional level what they are no longer able to achieve at the national level.<sup>23</sup> The Maastricht Treaty was intended to create a politically and economically unified European Union (EU) that would be the economic equal of Japan and the United States. In North America, ratification by Canada, Mexico, and the United States of the North American Free Trade Agreement (NAFTA) established a free trade area intended to create a strong North American, and perhaps eventually a Western Hemisphere, integrated economy. The third important regional movement, in Pacific Asia, has been led by a Japan determined to strengthen its regional and global position. Although this Asian Pacific movement has been made manifest primarily through bilateral trade and investment linkages between Japan and other economies in the area, an effort to increase political integration of the Asian Pacific region began with the founding of the Asian Pacific Economic Cooperation (APEC) community. These three movements toward regional integration and the interrelationships among them will have a profound impact on the nature and structure of the world economy for some time to come.

### AN ECLECTIC APPROACH

Efforts to develop a general theory of regional integration are unlikely to succeed. The realist approach also has serious limitations. There are too many different factors involved in regional movements around

<sup>23</sup> Gibb and Michalak, eds, *Continental Trading Blocs: The Growth of Regionalism in the World Economy*, 1.

the world, the differences among various regional efforts are too great, and too many assumptions that cannot be tested are necessarily involved in analysis of regional efforts. My realist bias is to stress the political and strategic sources of regional efforts; yet I acknowledge that this approach cannot fully account for every example of regional integration and/or for the important differences among these efforts. For example, although political considerations have certainly been important in NAFTA and in Japan's efforts to create an Asian Pacific economic bloc, the principal motive in those cases has been fulfillment of private and national economic interests. The dozens of efforts to create regional economies do possess one or more common elements: an economic motive, establishment of an external tariff of some kind, and/or a leader or leaders interested in promoting integration of the region. Yet, further generalization is difficult, if not impossible. Motives, external tariffs, and the role of leadership differ from one regional arrangement to another, and for this reason one must take an eclectic approach to understanding regional integration.

A universal theory or explanation of such a diverse and wide-ranging phenomenon is undoubtedly impossible to formulate. An eclectic approach is reasonable and should stress a number of factors. First of all, every regional effort involves some political motive, sometimes one that is very ambitious, as in European regional integration, and sometimes quite modest, as in North American regionalism. Although the interests and pressures of powerful domestic groups may shape regional arrangements, those arrangements are produced primarily by national interests as defined by the ruling elites of the states involved.

An eclectic approach should also incorporate recognition that regionalism is stimulated when there is no strong international leadership.<sup>24</sup> As the United States became less willing to continue the leadership role that it once performed, groups of states framed their own solutions to international economic problems. Weakening of the Bretton Woods System of rule-based trade and monetary regimes encouraged the search for regional solutions. Growing numbers of participants and the increasing complexity of the problems in international negotiations also encourage the movement toward regional arrangements. For example, the large number of participants in GATT/WTO trade negotiations has led groups of states to seek other solutions frequently easier to find at the regional than at the global level.

<sup>24</sup> Paul R. Krugman, "The Move Toward Free Trade Zones," in *Policy Implications of Trade and Currency Zones: A Symposium Sponsored by the Federal Bank of Kansas City* (Jackson Hole, Wyoming, 22–24 August 1992), 28.

Additional important factors in the spread of economic regionalism include the emergence of new economic powers, intensification of international economic competition, and rapid technological developments. The increased pace of economic change makes the choice between adjusting to new developments or resorting to protectionism even more vital. In the 1970s, nation-states usually responded to such challenges with New Protectionism; that is, the use of nontariff barriers. As that approach became less effective, states in Western Europe, North America, and elsewhere formed customs unions and free trade areas to slow the adjustment process and protect themselves from the rapidly industrializing and highly competitive economies of Pacific Asia. In the late 1990s, protectionist efforts increased once again.

There are other factors that should be recognized in a new approach. Economic regionalism is also driven by the dynamics of an economic security dilemma. For example, the movement toward European unity became a factor in the U.S. decision to support the North American Free Trade Agreement. Japan, fearing exclusion from both of those regional blocs, stimulated Asian Pacific regionalism. Other regional efforts around the world were also responses to earlier regional movements. In effect, nations have been trapped in a rather traditional Prisoner's Dilemma of mutual distrust from which escape has become very difficult.

Finally, additional factors influencing the movement toward economic regionalism have included the increasing importance for world trade of oligopolistic competition, the theory of strategic trade, and economies of scale. Earlier postwar economic thinking about regionalism emphasized the trade creation and diversion consequences of regional trading arrangements, but more recently the focus has been on the importance of internal and external economies of scale that could be achieved through economic integration.<sup>25</sup> In principle, of course, the best route to promote economies of scale would be through free trade and completely open markets. However, many business and political leaders believe that protected regional arrangements enable local firms to achieve such economies and thereby to increase their competitiveness vis-à-vis foreign firms. Then when the firms are sufficiently strong, they will be able to compete more successfully against established oligopolistic firms in global markets.

<sup>25</sup> As noted earlier, the term "internal economies of scale" refers to the decreased average costs enjoyed by a single, large firm over a smaller firm. The term "external economies of scale" refers to the fact that firms near one another can benefit from technological and other spillovers from neighboring firms. Desmond Dinan, ed., *Encyclopedia of the European Union* (Boulder, Colo.: Lynne Rienner, 1998), 153–58.

Such reasoning and efforts to increase international competitiveness have certainly been factors underlying the movement toward regional integration.

#### CONCLUSION

In Western Europe, North America, and Pacific Asia as well as elsewhere, dominant powers and their allies within a region have joined forces to solve regional problems and increase their bargaining leverage in global economic negotiations. The countries of the European Union already participate in international trade negotiations as a regional bloc. Economic regionalism has also become a means to increase the international competitiveness of regional firms. Various forms of economic regionalism (customs unions, free trade areas, and single markets) provide, to some extent, such advantages of free trade as increased competition and economies of scale while simultaneously denying these advantages to outsiders unless they invest in the internal market and meet member-country demands for local content, technological transfers, and job creation. Regionalism also facilitates pooling of economic resources and formation of regional corporate alliances. For all these reasons, regionalism has become a central strategy used by groups of states to increase their economic and political strength and therefore has become an extremely important feature of the global economy.