1 A Retrospective on Regional Integration Arrangements

Introduction

Even with the limited objective in mind of using resources more efficiently by reconfiguring the geography in which they are deployed, the "urge to merge" has afflicted an overwhelming majority of countries throughout the world. At present, almost every member of the Organisation for Economic Cooperation and Development, and virtually every developing country as well, is either engaged in, or flirting with, some form of regional integration.

Regional integration arrangements (RIAs) are not new. Many of their features, e.g. free trade areas and monetary unions, emerged and were continually refined under colonial rule between 1850 and 1950 in much of what is now the developing world. The genesis of RIAs in Europe is ascribed to the Anglo-French accord of 1860. That agreement impelled other European countries to sign similar accords with France in a fashion reminiscent of the recent rush on the part of countries to emulate Mexico and Israel in signing free trade agreements with the United States. RIAs existed under the British and French empires in South and East Asia, the Middle East, in sub-regions of Africa and in the Caribbean.[1] These were predated by arrangements which bound together the former colonies of Spain in Central and South America. In Asia, such arrangements also existed between colonial Japan, and colonised Korea and Formosa (now Taiwan) between 1890 and 1945.[2]

Perhaps the most successful form of RIA that evolved and culminated in full economic and political union on a voluntary, democratically determined basis, was the progressive expansion and formation of the United States of America between 1820 and 1920. This unique experience, however, is not usually seen as an example of an RIA among sovereign nations as such but as exemplifying the evolution and expansion of a federation welding together fractious, semi-sovereign, constituent provincial states.

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1 The structures of the British, French and Spanish imperial arrangements were, in their early stages, essentially incomplete RIAs and the countries included were not geographically contiguous. In these arrangements the economic concept of a region was different from one that cartographers would normally employ; extending to all territories of empire but with differences in different areas. Yet they had many of the features of RIAs: e.g. monetary unions, common currencies, common fiscal administrations, customs unions, convergent fiscal policies, internal conventions on cross-border investments and the like.

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Between 1915 and 1945 colonial RIAs, which had become entrenched world-wide, gradually became looser and less pervasive. That period witnessed two World Wars, a global depression and the breakdown of the British and French empires. The aftermath of the Second World War saw a different economic order emerge. It was characterised, between 1945 and 1975, by: the economic hegemony of the United States; the establishment and consolidation of the *East Bloc* as a countervailing military – if not economic – power; and the emergence of a raft of independent nation states obsessed with exercising their new sovereignty and, unfortunately, much less concerned about the efficiency of resource use. Many RIAs evaporated under the heat of US vs. Soviet competition to draw emerging developing countries within their respective spheres of political, military and economic influence as *Pax Americana* and *Pax Sovietica* replaced *Pax Britannica*.

A Tour d'Horizon of RIAs Around the World

In the aftermath of the Second World War, the world has been characterised by several different types of RIAs in developed and developing regions. These are discussed briefly below according to the geographical (and economic) parts of the world in which they occurred.

First World

In the *first world*, the most ambitious and successful RIA, of course, is the still evolving European Union (EU). Beginning humbly as a coal and steel community between six countries, it is now virtually a full economic union involving fifteen developed Western European countries. Four of these (Greece, Ireland, Portugal and Spain) acceded when they were still classified as middle-income developing countries. Their economies and standards of

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2 Various attempts at regional integration, though not necessarily achieved through cooperation, date even much further back in history, to the time of ancient empires whose relatively superior technology permitted conquests of terrain beyond their borders and resulted in relatively quick, if somewhat brutal, economic integration (largely because life was not quite so complicated or politically correct then). They were not driven explicitly by the needs of popular democracies aiming to improve their standards of living through the benefits of comparative advantage, market expansion, rationalised industrialisation, efficient import-substitution, static and dynamic trade creation, externalities and scale-economies. Perhaps for that reason, these endeavours are not generally viewed as falling into the category of respectable RIA efforts by economists, even though they are by historians; especially military historians. Insofar as recorded history can be relied on, few of these initiatives were triggered by voluntary efforts on the part of the states involved at achieving economic integration; except in the rare cases of a successful arranged marriage among royal families leading to the durable cementing of dowry-endowed territories. This quaint approach to RIAs has, alas, disappeared in modern times.

living have progressed rapidly since they joined the European Union although their absorption, as is often supposed, has not been a matter of easy digestibility. Together these four accounted for 20% of the European Union's population when they joined, but for only 8% of its total GDP. They now account for about 11% of regional GDP. With its recent enlargement (in 1995) through the entry of Austria, Finland and Sweden, the European Union now embraces 375 million people and a total GDP (1994) of around US$8 trillion.

The North American Free Trade Agreement (NAFTA) embracing the US, Canada and Mexico has aroused even more interest in the developing world than the European Union with regard to the potential of RIAs. NAFTA has excited imagination because it is perceived as an unprecedented bonding arrangement between highly developed and developing states in the same region, presaging a different future with new possibilities for such arrangements. While NAFTA is certainly unusual in that respect it is not unprecedented. As observed, the European Union achieved the same conjunction a decade earlier when Southern European countries joined it. Like the European Union, NAFTA embraces about 370 million people with a collective 1994 GDP of about US$7.5 trillion. In this arrangement, Mexico accounts for about 23% of NAFTA's total population but only 4% of regional GDP. The development disparity between Mexico and its partners in NAFTA is thus much greater than that between the Southern and Northern European countries when the former became members of the European Union.

The key characteristic of both the European Union and NAFTA, and the reason why these two blocs may eventually succeed in evolving towards some form of economic union, is the relatively high proportion of intra-regional trade, investment and capital flows already occurring in both blocs relative to their total trade. In NAFTA, however, the question of unimpeded labour mobility across internal borders may prevent full labour market integration for some time, even as other factor markets integrate. The same could be true of the European Union if it were to widen, by embracing new Eastern European members, before it deepened. Recent events suggest that the prospects for further deepening under the timetable of the Maastricht Treaty, especially in achieving monetary union, may be set back and be achieved much later than was earlier anticipated.

Second World

In what was formerly the *second world*, members of the former East Bloc were bound together under the Council for Mutual Economic Assistance (CMEA). Though CMEA was primarily an arrangement among geographically contiguous countries in the Soviet Union and Eastern Europe, it

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embraced three (non-regional) *third world* members, i.e. Cuba, Mongolia and Vietnam. CMEA's role as an RIA in the post-war world has perhaps been understated because it was a statist rather than a market arrangement. Even so, for nearly thirty years CMEA engendered reasonably rapid growth in its member economies. Its usefulness came to an end when the limitations of rigid command economies – in responding to technological developments, meeting evolving domestic consumer demands, and holding their own under rapidly changing global product-market conditions – became painfully manifest.

CMEA was clearly not an RIA voluntarily entered into by free, democratic states exercising free choice. Its role in the former Soviet empire was not so different from the trade, exchange and monetary regimes which prevailed in the former British, French and Spanish colonial empires. The only difference was that *laissez faire* market economics played no role at all in determining CMEA's design.

Four former CMEA members (The Czech Republic, Slovakia, Hungary and Poland) – commonly known as the *Visegrad* countries – are presently attempting a new form of RIA among themselves before joining the European Union, which is their ultimate aim. So are the three Baltic Republics which are simultaneously developing associated RIAs with the European Union and the Nordic community.

Third World

The developing, *third world* has experimented with a number of RIAs of varying looseness. Some existed prior to the independence of many young countries which were colonies for a longer period than they have been sovereign. Pre-independence RIAs in former colonies of Southeast Asia (Malaysia-Singapore and Indo-China), Africa, the South Pacific (with Antipodean linkages) and the Caribbean were quite successful in terms of their limited objectives.

Certainly these RIAs supported a reasonable domestic macroeconomic policy framework for growth and prosperity in the individual colonies. But the gains derived from these arrangements did not necessarily lead to equitable growth in these economies, nor to effective or appropriate industrialisation. Even less did they benefit indigenous populations, though they yielded substantial benefits for owners of plantations and mines who were mainly metropolitan investors in imperial capitals.

A few pre-independence RIAs continued in a different form although they were viewed by post-colonial governments as part of the unwanted baggage of an exploitative, market colonialism which had no place in new societies. The new governments – mostly inexperienced and prone to populist policies –

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closed their economies, while continually relaxing their fiscal and monetary regimes in the face of successive external shocks. Consequently, economic resilience and adjustment response capacity were systematically destroyed over a prolonged period, resulting in inefficiency and uncompetitiveness of productive structures throughout the developing world.

The RIAs – especially the monetary arrangements – previously in force, if properly administered, might have exerted a brake on such excesses. In retrospect, and with the benefit of hindsight, such a brake might have been quite useful, given what has happened in too many developing countries, especially in Africa, South Asia and the Eastern Caribbean. Some newly independent governments, believing that aspects of these colonial RIAs were beneficial, tried to replicate particular features under new voluntarily agreed RIAs. But because of a lack of political will few of the post-independence RIAs were long-lived.

Africa and the Middle East

Of the seventeen RIAs which existed in 1990 around the world, eight were in Africa where experiments with first-generation RIAs yielded desultory results; with the exception of the *franc zone* (the Communauté Financière Africaine, CFA) and the Southern African Customs Union (SACU). The monetary unions of the franc zone were stable and enforced sound monetary policies. But they became overly rigid in resisting parity adjustment for too long, thus impairing the adjustment and growth prospects of their members through the 1980s. A long-delayed devaluation of the CFA franc finally occurred in early 1994 after much damage had been done. SACU was based on keeping smaller satellites in orbit around the South African apartheid regime. It was more successful than the franc zone RIAs, perhaps because South Africa under apartheid was willing to pay a visible budgetary price[3] to acquire a modicum of political respectability in its immediate neighbourhood.

The Indian Ocean Commission (IOC), a loose RIA among islands off the East African coast, has also had modest success. But other African arrangements in East and Central Africa and in Southern Africa outside of SACU, heavily backed by donors, have proven ineffectual. Some have

3 Recently, the South African government has drawn attention to the high price it has paid for supporting the SACU arrangement. That is only true in a visible budgetary sense although that is a partial and distorted perspective. In an overall economic sense South Africa's private, heavily protected manufacturing sector has gained much by retaining these captive markets under SACU with South African transfer payments to its captive neighbours often amounting to little more than hidden export subsidies for its own relatively inefficient manufacturing industries.

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subsequently come apart. Their net economic benefits, in terms of incremental economic and developmental gains derived by the member states, probably did not offset even the cost of the large and elaborate bureaucracies set up to administer them.

After their demise, new arrangements were put in place in the form of a Preferential Trade Area for Eastern and Southern Africa (PTA) and the Southern Africa Development Coordination Conference (SADCC). Neither of these arrangements has achieved very much despite substantial donor support. Yet both have recently transformed themselves into more ambitious economic communities. PTA has now become the Common Market for Eastern and Southern Africa (COMESA) while SADCC has evolved into a Southern African Development Community (SADC) with South Africa joining in early 1995. Both hope to achieve more in the future although their widely overlapping membership has generated concerns about whether two organisations are needed to achieve much the same purpose.

Despite the obvious failures and limited successes of first-generation RIAs in Africa there is, in the 1990s, a renewal of interest – fostered to some degree by the example of the European Union – in strengthening these arrangements through efforts at widening and deepening them.

Further north, optimistic aims for the Mahgreb Customs Union set up in 1960 and for the even wider Arab Common Market have not materialised. Still, even more ambitious plans for achieving closer economic integration among the Arab countries of North Africa, the Arabian peninsula in West Asia and the Middle East remain alive. The financial and labour markets of the Gulf countries are closely intertwined. But given the nature of their oil economies there is little intra-regional trade among them, although they cooperate actively on regional issues within the framework of the Gulf Cooperation Council.

The Middle Eastern peace accord opens new vistas for economically beneficial regional cooperation in an area where that was inconceivable just a short while ago. With the emergence of a Palestinian state, RIAs involving Israel with its former neighbouring enemies are now being seriously discussed. Despite the unexpected longevity of present regimes in Iran and Iraq, such developments could transform the economic scene in West Asia and Arabia, as could the inevitable pressures for democratisation and political liberalisation in the Gulf kingdoms. But the translation of economic potential into political reality in this volatile, combustible cauldron may take some time yet.

Latin America and the Caribbean

Prior to the Second World War, there were no RIAs among the independent countries of Latin America and the Caribbean (LAC). Now nearly all of them are involved in one type of RIA or other; indeed some are involved in several. The development of RIAs in LAC was based on philosophical underpinnings which provided the foundation for most of the first-generation RIAs in developing countries. In 1960, Raoul Prebisch envisaged RIAs in LAC as being aimed at building inward-looking, protected trade blocs with barriers to the outside world. Regional integration was to be a means of undertaking more complex import-substitution on a regional scale in establishing industries that were too large and complex for smaller domestic markets to develop or absorb.[4] Such thinking led to a spate of RIAs in the 1960s with the formation of the Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM) in 1960, the Caribbean Free Trade Association (CARIFTA) in 1968, and the Andean Group in 1969.

In 1971 Bela Belassa took a different view.[5] Arguing that market enlargement through integration could bring benefits to LAC over and above those obtainable through trade liberalisation alone, he suggested combining RIAs with *unilateral* trade liberalisation and recommending policies that would ensure full exploitation of the benefits of both. Belassa's thesis was that trade liberalisation would enhance the benefits of RIAs by reducing the prospects for inefficient industrialisation in LAC countries. That view was not immediately popular; partly because as has been suggested,[6] the early protectionist RIAs in LAC achieved substantial growth in *intra-regional* trade.[7]

Between 1960 and 1980, such trade grew by a multiple of: (a) 20 in LAFTA where members' trade with the rest of the world (RoW) grew by a factor of 10; (b) 40 in CACM compared with growth in trade with RoW by a factor of 9; (c) 17 in CARIFTA compared with an increase in total trade by a multiple of 10; and (d) 50 within the Andean Group compared with only an 8-fold growth in exports to RoW. All these arrangements were supported by payments and settlements facilities to economise on the use of scarce foreign exchange in settling intra-regional trade accounts. But even with high growth

4 Prebisch, R. (i) *The Economic Development of Latin America and its Principal Problems*, UN-ECLAC, New York, 1950 and (ii) *Towards a Dynamic Development Policy for Latin America*, UN, New York, 1964, p. 69.

5 Belassa, B., *Regional Integration and Trade Liberalisation in Latin America*, World Bank, Economic Staff WP No. 120, Washington DC, 22 October 1971.

6 Massad, C., *A New Integration Strategy*, CEPAL Review No. 37, CEPAL, Santiago, April 1989.

7 Although intra-regional trade expansion is necessary for significant advantages from integration to accrue, such expansion by itself is not an adequate criterion for judging the success of RIAs. Judgements based on intra-regional trade expansion alone can: (a) be misleading if such expansion occurs from an extremely low base, as it did in most of LAC; and (b) reflect both trade creation and trade diversion.

in intra-regional LAC trade in the first two decades, these arrangements did not endure.[8]

All the RIAs in Latin America set up between 1960 and 1970 unravelled in the mid-1970s and virtually disintegrated during the 1980s in the face of adverse external circumstances, a regional debt crisis of cataclysmic proportions, fading political will, violent intra-regional conflict (especially in Central America), and a changing ethic of open competition. As Carlos Massad (1989) noted, in the 1980s it became '... a matter of each individual country's seeking integration with the outside world rather than with its neighbours, and financing the process with external indebtedness.'

All the LAC arrangements were resuscitated and reinforced in the late 1980s and early 1990s under different names with different rules and aims. These RIAs: (a) have become more ambitious and comprehensive in aiming at closer integration rather than being limited only to cooperation; (b) are outward-looking, and aimed at promoting efficiency and competitiveness; (c) carry greater political commitment and conviction; and (d) are more robustly designed and constructed. Chile and Mexico have entered into an economic cooperation agreement, while Argentina, Brazil, Paraguay, and Uruguay (i.e. the Southern Cone countries) have formed a common market (MERCOSUR) which by 1995 had integrated at a rate much faster than first envisaged.

Asia

Two examples of formal RIAs were attempted in opposite corners of Asia. The first was the Regional Cooperation for Development arrangement among Iran, Pakistan and Turkey. This quickly became defunct and was succeeded by the Economic Cooperation Organisation (ECO), which also proved to be of little value. The second was a more successful and durable arrangement involving the Association of South-East Asian Nations (ASEAN) in 1969.

From being a *security-focused* arrangement ASEAN is now evolving towards an *economic* Asian Free Trade Area which is being widened with the inclusion of Vietnam. Also in East Asia a *Greater China region* has emerged through free flows of trade and investment between the People's Republic of China, Hong Kong and Taiwan under non-formal RIAs among these territories. Of course the smaller two are not recognised as sovereign states by the People's

8 At the end of the day, in 1983 intra-bloc trade as a proportion of total exports was only 22% in CACM, 10% in the Latin American Integration Association (LAIA, the successor to LAFTA) and 9% in the Caribbean Community (CARICOM), which succeeded CARIFTA (Robson: 1993).

Republic of China despite their independent profiles as trading entities of global significance.

ASEAN is deemed to have been successful, at least partially, because it was not geared to achieving free trade or economic union objectives at the outset. It focused instead on being a regional *political* platform for: (a) increasing the bargaining power of its member states in international negotiations; and (b) intra-regional conflict resolution on a peaceful basis. ASEAN took nearly a decade after its formation to act on achieving any serious form of regional *economic* cooperation. Interestingly, as RIAs in other parts of the world were beginning to unravel, ASEAN in its slow and cautious way gained gradually in strength year by year mainly by setting low expectations and invariably exceeding them.

Intra-ASEAN trade has grown dramatically, faster than in any other developing region. This has happened largely as a result of close inter-linkages between businesses owned in its member states by the overseas Chinese community, without ASEAN as a regional body doing all that much to accelerate or encourage it. Intra-ASEAN trade growth is, of course, somewhat distorted by the unusually large amount of trans-shipment, entrepot trade that occurs through Singapore for various reasons. Other members have now agreed to Thailand's proposal to create the ASEAN Free Trade Area (AFTA) which may have very high potential for generating intra-regional efficiencies and growth because its members meet all the requisite preconditions for successful economic integration.

South Asia has been slower than East Asia to develop effective RIAs mainly because of the unresolved conflict between India and Pakistan over Kashmir. Yet the South Asian Preferential Trade Arrangement (SAPTA) among members of the South Asian Association for Regional Cooperation (SAARC) is lurching hesitantly towards becoming a South Asian Free Trade Area (SAFTA).[9] The opportunities for SAARC and SAFTA to realise their full economic potential will remain constrained until the Indo-Pakistani dispute is definitively resolved. When that happens regional economic arrangements will probably revert to the state which existed prior to 1947, when virtually the entire sub-continent was a single economic (and politically united) area.

Pacific, Indian Ocean and North Atlantic

Though negligible compared to other developed country groupings, a free trade area also exists in the *Antipodes* between Australia and New Zealand under the Australia-New Zealand Closer Economic Relations Trade Agreement

9 See: The Economic Times of India, *India likely to offer more tariff reliefs under SAPTA*, Bombay, India, Thursday, 15 June 1995.

(ANZCERTA), which has been the most successful example of an RIA in the Southern Pacific.

Perhaps as a defensive response to emerging trade blocs in the two largest markets of the world (NAFTA and the European Union), there was early concern that the formation of another giant trade bloc might be triggered in Asia; a market which promises to become even larger than the European Union and NAFTA in the not-too-distant future. Indeed, precisely such a trade bloc was suggested by the Prime Minister of Malaysia in 1992.

Partly to forestall such a possibility, a new type of *inter-bloc* RIA has emerged to link the Asian and NAFTA regions with the formation of the Asia Pacific Economic Cooperation Forum (APEC). Its main purpose is to advance GATT-consistent trade liberalisation between NAFTA members and their cohorts including Japan as well as the other East Asian, Antipodean and Latin American countries bordering the Pacific Rim.

Following the creation of APEC, the Gulf Cooperation Council has proposed a similar arrangement with the European Union. In a related vein, an interesting new initiative involving the Indian Ocean Rim has also emerged in early 1995 which may provide an umbrella RIA among the countries of South Asia, Eastern and Southern Africa, East Asia and Australia.

More recently, the concept of a North Atlantic Free Trade Area (a kind of super-NAFTA) between NAFTA and the European Union is gaining momentum among European and American politicians.

The Role of Regionalism in the Emerging World Order

As a result of a number of dynamic forces, countries around the world are at a cross-roads as the next millennium approaches. The 1990s evoke disconcerting shadows of the 1890s. A century ago instability and flux prevailed over the crumbling of an established order of national and global governance, defined by competitive tensions among waning (imperial European) and emerging global powers (the US and Japan). As is happening now, that order was eroded by innovations in technology, transport, munitions and communications. In the 1990s it is becoming clear that innovations in the same fields have enabled the continued globalisation of markets for ideas, money, commodities, other goods and services (but not yet for labour) on a scale and at a pace which has far outrun the capacity of established political and social systems to cope.

A global production and marketing structure is now taking shape with increasing rapidity and pervasiveness. Global products and brands produced by transnational corporations are becoming entrenched in a global consumption culture. That culture is, in turn, being supported by emerging, but still imperfect, global markets in information, technology, commodities,

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services, media, communications, transport and finance. The emerging international system requires effective overall governance; ideally it demands a framework for stimulating and regulating not just trade and capital flows but other forms of economic and non-economic interaction as well.

The construction of such a framework is proceeding in an inefficient and unsatisfactory manner. While national governments lack the political will to address global issues in an appropriate way, the framework for governance is being left to a patchwork quilt of existing supranational institutions. These institutions – the United Nations, the World Bank, IMF, GATT/WTO, NATO, etc. – have proven unable to evolve responsively in ways that reflect emerging global shifts in economic and political power. That structural weakness is leading to a drift away from a multilateralism that does not work, and toward a less structured system of global governance which appears as if it may, for an interregnum of unknown duration, be based on interactions among regional blocs rather than among nation-states. In that sense the emergence of the *new regionalism* may well be an intermediate step towards the evolution of a *new multilateralism*.

What is becoming clear is that nationally oriented institutional structures and systems of governance, created through the last two centuries to guide, regulate and channel productive human endeavour, are no longer adequate. Nation-states are undergoing kaleidoscopic changes of the kind that the former Soviet Union, Yugoslavia, Ethiopia, Somalia and the Sudan may be precursors to, although the temptation to over-interpret what has been happening in these countries and simplistically extrapolate it to the rest of the world should be eschewed.

What is equally clear is that the horizons of economics and finance are widening, i.e. going *meso* and *macro*, while the focus of polities and societies seems to be narrowing, i.e. going *micro*, along precisely the ethnic lines which nation-states were, for unfortunately too short a while, successful in suppressing. The nation-state as shaped through the 19th and 20th centuries is being squeezed by the opposing forces of *macro*-markets and *micro*-ethnicity. Consequently, the *raison d'être* that justified its formation and maintenance is coming increasingly under question.

Successful regional integration among nations, carried to its logical conclusion, may inevitably spell the end of constituent nations as sovereign, or even as relevant, entities if their distinct ethnic groups prefer devolution. Conversely, the future of presently large and ethnically diverse states in the developing world (India, Nigeria, even China) is in question. They may only have a viable future as more loosely federated economic unions of ethnically distinct states, which are permitted to exercise more independent political decision-making on a far wider range of matters than they can under their present constitutional structures.

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Fibrillations, tremors and aftershocks of different intensities keep being generated after the end of the Cold War in various parts of the world, not least in the erstwhile *second world*. How that formerly integrated politico-economic system will eventually settle is as yet unclear with the shape of its future steady-state remaining difficult to define. Some parts of it (the Visegrad four, the Baltic three and some of the independent republics of former Yugoslavia) will probably integrate with the European Union in the distant future. Other parts may come together under reconfigured RIAs among members of the former Soviet Union. Yet others may become members of RIAs in West, Central and East Asia.

Elsewhere, new geopolitical realities – e.g. the emergence of post-apartheid South Africa as an acceptable member of the African sovereign community, and similarly of Vietnam, Laos and Cambodia in Southeast Asia – have combined to create major external challenges and new regional opportunities in the developing world. All of these developments point to a new and enhanced role for regionalism to play in the future evolution of international economic and political relations. Yet that role is often seen as a threat rather than the opportunity which it actually may be.

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