The functionalist and the neo-functionalist schools of thought have provided the theoretical basis to the concepts of international cooperation and regional integration that evolved in the post-World War II era.

‘International economic integration’ is one aspect of international economics which has been growing in importance in the past four decades. The term itself has a rather short history – prior to 1942, there was hardly any record of its use in academic or official circles. Since then, the term has been used at various times to denote a state of affairs or a process involving the amalgamation of separate economies into larger regions. More specifically, international economic integration is concerned with the discriminatory removal of all trade barriers between the participating nations and, with the establishment of certain elements of cooperation and coordination between them.

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2 ibid, p. 10.
Economic integration is defined as a process and as a state of affairs.\(^3\) Regarded as a process, it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies.

In interpreting this definition, it is important to make the distinction between integration and cooperation. The difference is qualitative as well as quantitative. Whereas cooperation includes actions aimed at lessening discrimination, the process of economic integration comprises measures which entail the abolition of some forms of discrimination. For example, international agreements on trade policies belong to the area of international cooperation, while the removal of trade barriers is an act of economic integration.\(^4\) Regional economic integration has also been defined as the process of reducing the economic significance of national political boundaries within a geographic area.\(^5\)

There are other definitions of regionalism and regional economic integration which do not take geographical factors into account. In this

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\(^4\) ibid, p. 4.

\(^5\) Kym Anderson and Richard Blackhurst (eds.), *Regional Integration and the Global Trading System* (Hampstead, 1993), p.1. The authors point out that international economic integration could be unilateral, bilateral, regional or multilateral. This study is concerned with trade and policies at the regional and multilateral levels.
context, regionalism can be loosely defined as any policy designed to reduce trade barriers between a subset of countries regardless of whether those countries are actually contiguous or even close to each other.\(^6\)

However, it must be mentioned here that since this study concerns regionalism, encompassing regional trade arrangements, in the context of the multilateral trade arrangement, the WTO-defined term is adhered to. Regional trade agreements (RTAs) are defined as all bilateral, regional, and plurilateral trade agreements of a preferential nature which are required to be notified, as the case may be, under Article XXIV of the General Agreement on Tariffs and Trade (GATT) 1994, Article V of the General Agreement on Trade in Services or the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (otherwise known as the Enabling Clause).\(^7\)

Hypothetically, a completely integrated world economy can be defined in terms of the existence of a single set of prices for both factors

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\(^7\)This definition is in accordance with the terms of reference of the Committee on Regional Trade Agreements (CRTA) which was established within the WTO to examine and monitor RTAs. The CRTA and its role has been dealt with in detail in Chapter IV.
and commodities for all countries of the world. However, there never has been a time when the world economy has been completely integrated.\(^8\)

**APPROACHES TO THE STUDY OF ECONOMIC INTEGRATION**

Theories of economic integration developed primarily as a consequence of the attempt of Western European countries to form an economic union. Of course, theories such as functionalism, which have an important bearing on regional integration, were developed earlier. The theories can be classified as those which were developed by political scientists to understand and explore regional integration in the context of international organizations and sovereign states; and those which view the integration process primarily within the economic framework. Part I of this section would discuss the theories belonging to the first category and Part II of this section would be devoted to theories based on economic perspectives.\(^7\)

**PART I: POLITICAL SCIENCE PERSPECTIVE**

Functionalism and neo-functionalism (integration theory) are labels that cover an array of research activities in this field. International integration is concerned with the process whereby decisions formerly made by officials of separate nation-states come to be made by officials at

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a new centre (international organization). International functionalism is concerned with the process whereby specific activities (functions) come to be performed by international organizations rather than by separate nation-state authorities.⁹

The theory of functionalism and integration have significantly enriched the study of international organizations along several dimensions:¹⁰

- They have drawn attention to the national and transitional social contexts out of which international organizations arise, and the relationships between these contexts and specific organizational forms;

- They have directed attention to the process of organizational growth across time. This overcomes tendencies to neglect the pre-charter development of international organizations and the post-charter processes of growth never adequately reflected in charters.

- They have placed earlier preoccupations with military forces, both as causes of war and instrumentalities for ensuring peace, in more

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balanced perspective. This overcomes tendencies in many works on international organizations to give secondary attention to the economic and social causes of war and to overemphasize the possibilities for military (collective security and peace-keeping) solutions to the problems of war;

- They have used regions as laboratories for inquiry. This has made research more manageable and has permitted study of organizational phenomena not relevant to the globe as a whole; and

- They have extended the perspective of inquiry in ways that make it possible to draw on different bodies of social science knowledge that were earlier removed from international organization research — socialization, learning, attitudes, organizational behaviour, etc. This has overcome tendencies to treat international organizations as a unique domain.

Functionalism and integration developed out of earlier thought, debate, and experience with balance of power, collective security and world government as approaches to international peace. The perceived failure of balance of power — based on alliances among national military forces to counter potential aggressors — led to the development of collective security.\textsuperscript{11} In collective security, the form of organization is

radically different from balance of power, but the means to be used remain the same -- military force. Collective security has had limited success partly because big powers opted out, largely because of their ability to fend for themselves through unilateral use of the same military power that might have been utilized for the collective security of the entire community. Some have proposed world government as a solution to this problem; but proponents of this ideal have failed to offer plausible prescriptions on how to reach this goal.\(^1\)\(^2\)

Inquiry focused on functionalism and integration has usefully confronted the limitations of these approaches and significantly enriched understanding of processes related to the development of international organizations.

FUNCTIONALISM

While it is usually a futile exercise to try to attribute to any one writer the development of theory which is regarded as seminal, David Mitrany’s development of functionalism is an exception. In his classic essay *A Working Peace System*,\(^1\)\(^3\) first published in the inter-war period, Mitrany provided a major impetus to the functionalist school of thought.


\(^{13}\) David Mitrany, *A Working Peace System* (Chicago, 1966). The ideas on functionalism were first published in 1943.
Karl W. Deutsch spurred a complementary line of effort in his works on integration.  

MITRANY'S APPROACH

As set forth by Mitrany, the concept of functionalism is based on certain assumptions about the causes of war and peace:

1. Social and economic maladjustments are the basic causes of war.

2. Social and economic welfare is the precondition of peace.

It is further assumed that:

3. The nation-state system cannot deal with basic social and economic problems because global society is arbitrarily divided into units based on territory rather than units based on problems to be solved.

This leads to the proposal that:

4. Institutions based on function, not territory, would be appropriate for solving basic social and economic problems.


These assumptions of functionalism represent a radical departure from balance of power, collective security and most world-government thinking, which assumes that military force is required to prevent war.

Functionalism presumes to offer means for overcoming suspicion and distrust which have often prevented the building of peace systems.

5. Functional cooperation can begin with non-political, more technical problems.

6. Cooperative experience gained in one functional area can be transferred to another.

These two assumptions have stimulated extensive debate and inquiry. The sixth assumption is often referred to as "spill over" which consists of a complex of social and psychological processes.¹⁶

First, there is the assumption that patterns of cooperation in one function will provide examples that can be duplicated in other sectors.

Second, there is the assumption that social and economic functions are not independent (example, trade and banking) and that functional cooperation in one will generate a need for cooperation in another.

Third, there is the notion that participants in functional cooperation will have experiences to dissipate suspicion and distrust on the part of

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their counterparts in other nation-states and even develop new loyalties to the new institutions in which they work. It is also expected that this eroding of distrust and new loyalties will spread to people at large who derive benefits from functional institutions.

Functionalism also assumes that:

7. Cooperation will extend to more and more functions to the point that a "web of international activities and agencies" will 'overlay political divisions'.

8. Ultimately these agencies will require coordinating bodies, which will eventually require planning agencies, which will eventually evolve into a general authority for overall coordination.\(^\text{17}\)

Although the ultimate aim of Mitrany's functionalism was the construction of a viable administrative structure to insure world peace, he concentrated on the means to this end:

"The task that is facing us is how to build up the reality of common interest in peace... Not a peace that would keep the nations quietly apart, but a peace that would bring them actively together; not the old static and strategic view of peace, but a social view of it... We must put our faith not in a protected but a working peace; it would indeed be nothing more nor

\(^{17}\) Mitrany, n.9, p.51.
less than the idea and aspiration of social security taken in its widest range".  

It was thought that functionalism could cope with change because it worked from the particular problem and the relations suggested by it, rather than from some constitutional system, or idealized set of political or social relationships which were imposed upon it.

The proponents of the theory have argued that institutions based on functions and not territories would be imperative in solving international economic and social problems. The theory suggests that functional cooperation among countries of the world could begin in non-political, economic, social and other technical areas, where disagreements amongst nations would be the least. This approach allows the view that there is no point at which the state would necessarily lose its sovereignty. It holds, rather, that the issue of sovereignty becomes irrelevant to the important issues in the emerging world society.  

As the state is not thought to be necessarily losing its sovereignty, so there is to be no single place in international society which is necessarily gaining it. “Functionalism is not, however, either Utopian or

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18 ibid, p. 51
19 These views were held forth at a conference on the subject, the proceedings of which are recorded in A.J.R. Groom and P. Taylor, (rapporteurs), Functionalism (New York, 1969).
teleological in its view of international integration: rather it stresses central principles in the attainment of a more effective ‘working peace system’.\textsuperscript{20} International society was seen as being made up of an increasing number of international institutions with competence, in particular functional areas, the territories of which interact and overlap with each other. No ideology or political scheme must be allowed to impose a co-extensiveness upon these territories: \textit{the function must prevail}. It is because of this that David Mitrany opposed movements towards regional political unification such as that in Western Europe. There were many functions which had to be organized on a regional basis, such as coal and steel in European Coal and Steel Community; but according to him, there were many others which were best organized on a continental or a universal basis: the nature of the function determines this.\textsuperscript{21}

\textbf{DEUTSCH’S APPROACH}

Karl Deutsch tackled the issue of functionalism from an angle quite different from Mitrany. Basing his perspective on international political communities, he focused his inquiry on the conditions that account for the “absence or presence of significant organized preparations for war or large-scale violence...”\textsuperscript{22} Deutsch defines a security community (i.e. one with a

\textsuperscript{22} Karl Deutsch quoted by Alger, n.10, p.128.
central government) as one where such conditions are absent. In his terms, integration is the creation of “those practices and machinery — those habits and institutions which actually result in the establishment of a security community”. He deepened his analysis by not only addressing kinds of linkages between nation units, but also their internal characteristics, and similarities and differences between these units.

According to his theory, linkage between units is concerned with mobility of persons as well as messages, the range of subjects of communications, balance in two-way flows and mutual predictability produced through these communication links. Similarity of units is concerned with compatibility of main values and sharing of a distinctive way of life. Internal characteristics include factors such as economic growth, increasing political and administrative capability, broadening political elites, and expectation of economic gain from integration. This array of variables provides an important context for inquiry into the development of international organizations.

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To sum up:

- Functional institutions created to meet specific welfare needs are supposed to gradually wean individual loyalties away from sovereign nation-states and transfer them to a variety of institutions.

- Functionalists believe that the 'welfare functions' can be separated from the political functions, and that the economic welfare sphere can be taken over by new institutions. They hold that politics and economics are the separate functions of the state.

- Functionalism does not aim to create a new centre of sovereignty and political power, but rather to diffuse the functions of, and therefore disarm the nation-state. Its adherents argue that welfare needs are not coterminous with national boundaries, that a specific welfare need may be coterminous with one set of states, but that a closed regional system does not have the flexibility to meet all welfare needs of the group's populace.

- By identifying specific technical and 'non-controversial' aspects of governmental conduct, and weaving an ever-spreading web of international institutional relationships, the countries would expand practical cooperation. Just as when a person throws a stone in a pond, it generates concentric circles of the ripples of water, similarly, collaborative effort by countries in specific policy issues of
common interest will spill over into other policy areas, thus establishing a stable and working peace system.

CRITICISM

A number of inconvenient questions pertaining to the functionalist theory have cropped up:25

1. What is the guarantee that the functional agencies performing practical tasks, would be free from political tensions and conflicts?

2. Even if cooperation in the functional areas was established, what are the possibilities of the spill-over of this positive cooperation in the political field?

3. Ideological and political disagreements first expressed in the political bodies could, as well, spill over into the functional agencies, thereby damaging the prospects of establishment of an international cooperative arrangement, and reducing the global efforts into a charade. Just as a storm can disrupt the concentric circles on the water surface, a war on any issue can disrupt the whole framework of cooperation that may have been built.

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25 Claude, n.16, p. 254.
**NEOFUNCTIONALISM**

Neofunctionalism is the label given to a substantial body of thought on integration which has been developed since the late 1950s. Neofunctionalists rely on the method of pure functionalism, but apply it to a new arena: the regional political system. This body of writing is not a theory in the formal sense of the term, but rather a group of hypotheses about how a regional system can come to be integrated. Its chief proponents have been American political scientists, most notably Ernst B. Haas and his student Leon Lindberg. The neo-functionalists conception of international organization finds direct expression in the European Community. The Community in its early stage was the inspiration for the thesis in the form in which it was originally offered by E.B. Haas in his study *The Uniting of Europe.* In another pioneering work,* he has applied this approach to the study of the International Labour Organization (ILO).

**REFORMULATION OF FUNCTIONALISM BY HAAS**

Ernst B. Haas reformulated the thrust of Mitrany’s system in three ways:

First, he sought to bring it down from the level of pure theory to the actual

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27 Ernst B. Haas, *Beyond the Nation State* (Standford, 1964).
application to regional groupings or existing international organizations.

Second, he attempted to integrate functionalism and general systems theory.

Finally, Haas tried to produce a set of hypotheses that could be tested in the light of empirical evidence to determine the actual impact of functionalism on international affairs.

Haas restated four basic principles of the functionalist heritage as they applied to the contemporary world:

- According to him, Mitrany's claim that 'power is separate from welfare' was misleading in its applications. He believed that power was a means of describing a particular ability to coerce and to satisfy a set of welfare aims.

- He reevaluated Mitrany's assertion that governments whose policies are conceived in terms of power will develop welfare concerns easily, and that the lessons of functionalist cooperation in one area will be applied in others.

- He modified Mitrany's assertion that integration is maximized by the cooperative efforts of international experts and voluntary groups. The smaller the group, Haas asserted, the better were the chances

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28 ibid, pp. 6-10.
of integration – universal participation was thus considered a hindrance to cooperation.

- Finally, he questioned Mitrany’s insistence that there can be a gradual transfer of political loyalties to international organizations when global institutions become more successful in fulfilling functions formerly assumed by national governments.

CONTRIBUTION OF THE NEOFUNCTIONALISTS

Haas’ pre-eminent role as a neofunctionalist is related to his study of the impact of functionalism in the ILO’s attempt to further integration of the world community. Throughout Beyond the Nation State, Haas remains sceptical of functionalist claims and at times actually rejects them. He concludes that any cooperation that has occurred has been based not on calculations of the benefits involved for humanity, but rather on a convergence of separate interpretations of patterns of national interest.

This approach to regional integration assumes that actor behaviour in a regional setting is analogous to that in a modern pluralist nation-state and takes for granted that these actors are motivated by self interest. The central proposition can be summarized as follows:29

There exists a continuum between economic integration and political union: the two areas are linked by an automatic ‘politcization process’ — the spill-over effect. Actors are involved in an incremental process of decision-making, beginning with economic and social matters — welfare maximization — and gradually extending to the political arena (Grosspolitik).

Ernst Haas, having identified the political community as his terminal condition, defines ‘integration’ as a process whereby political actors in different countries are gradually persuaded to shift their loyalties, expectations and political activities towards a new larger centre whose institutions possess or demand jurisdiction over the nation states.30 His findings and speculations on functionalism and international organizations are the basis of another study31 by a former student, James Patrick Sewell. This work attempts to develop a coherent neo-functionalist view of the financing of economic development through the United Nations system, with particular emphasis on the programmes of the International Bank for Reconstruction and Development (IBRD). Like other neo-functionalist analyses, Sewell’s is an endeavour to develop a conceptual framework to complement an empirical evolution of the performance of a particular international organization operating, theoretically at least, on the basis of

functionalist principles. Sewell considers ‘attitudinal change’ a measure of progress towards integration:

“Functional efforts are dedicated to the solution of problems, not the raising thereof, of organizational monuments. The efficacy of functional efforts is to be gauged less by quantitative indications than by solutions to these problems, and by the closely related consequence which is to accompany participation in the problem-solving process - the change of attitudes by participants.”

Another former student, Leon N. Lindberg, emphasized on Haas’ investigation of the European Community. His study begins with the analysis undertaken in Haas’ *The Uniting of Europe*, and specifically attempts to apply functional theory to the level of analysis that seems most promising: regionalism, specifically the European Economic Community (EEC). He argues that an initial contribution to the success of the EEC was the flexible framework provided by the Treaty of Rome. Following Haas’ example, Lindberg conceives of political integration as a process rather than as a condition. The process is characterized by a gradual evolution toward a legitimate mechanism for the resolution of

32 ibid. p.189.
conflict for the making of authoritative decisions involving the majority of interests.

Lindberg explained the pattern in regional cooperation thus: a commitment based on perception of national as well as international gains stimulates the development of national interest groups that benefit from integration. Such groups then form natural pressure groups autonomous of national elites and are able to lobby for continued integration no matter what the policy of a particular regime.34

His additions to neofunctionalism suggest that, if certain elites stand to benefit and can convince their counterparts that everyone's future growth depends upon continued compromise and integration, one could theoretically construct a transnational system to fulfill the needs of an increasingly interdependent world. Closely knit, voluntary, and regional functional groups are more likely to achieve integration than are organizations that have representatives from across the globe.

Lindberg teamed with S.A. Scheingold to expand earlier studies of functionalism at the regional level.35 They have found that functional economic cooperation has rebuilt European economies by ignoring larger concerns and by reconstructing instead the political foundations of

34 ibid, p.114.
individual European nations. They identified a new type of decision-making process in which bargaining has replaced the bickering of individually defined interests.

SHORTCOMINGS

The original neofunctionalist approach, represented by the writings of Haas, Lindberg, Scheingold, among others, were criticized by other students of integration on several counts.36

- The first point dealt with the purported neglect of exogenous factors as contributing variable to regional integration.
- The second concerns the "Europe-centric" nature of neofunctionalist research and propositions, which are perhaps tailored to the European setting and stage of development and are often peripheral to integration processes in developing regions or to the former socialist countries.
- The third point centers on the basic neofunctionalist assumption that there is a continuum between the economic and political sectors of nation states permitting functional integration to spill over from the

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36 This critical assessment has been summarized from the writings of: (i) Stanley Hoffmann, "Obstinate or Obsolete? The Fate of the Nation-State and the Case of Western Europe", in Joseph S. Nye, ed., International Regionalism (Boston, 1968), pp. 177-230; and (ii) Roger D. Hanson, "Regional Integration: Reflections on a Decade of Theoretical Efforts", World Politics, vol. 21(2), January 1969, pp. 242-71.
welfare area into the domain of *Grosspolitik* in an automatic fashion, resulting in the emergence of a new regional unit. This is a historical status quo argument which does not take evolutionary forces working in each society into consideration.

**THE CONFIGURATIVE APPROACH TO THE THEORY OF INTEGRATION**

This approach to the study of integration at the international level is the most comprehensive one for the analysis of regional socio-political systems because it takes a broader view by considering both internal and external factors of integration. The principal representative of this school is Amitai Etzioni whose work on political unification\(^3\) can be regarded as the contemporary classic in this field.

In contrast to Haas, Etzioni uses 'integration' to refer to a condition rather than to a process, explaining that a political community is a community that possesses three kinds of integration:\(^4\)

a) It has an effective control over the use of the means of violence (though it may delegate some of this control to member units);


b) it has a centre of decision-making that is able to affect significantly the allocation of resources and rewards throughout the community; and

c) it is the dominant focus of political identification for the large majority of politically aware citizens.

Another student of comparative regional integration is Joseph S. Nye, who established himself as a persistent critique of the 'Europe-centric' neofunctionalist school. In his attempt to compare integration movements in Central America, East Africa and Western Europe, Nye paid attention to both the internal and external forces at work in these areas, thus following the 'configurative approach'. Having defined 'integration' as 'forming parts into a whole or creating interdependence', Nye establishes a three-tier concept: economic integration (the formation of a transnational economy), social integration (the formation of a transnational society), and political integration (the formation of a transnational political interdependence). 39

REVISED THEORY OF INTEGRATION

In reflecting on the achievements and problems of research on regional integration in 1970, Ernst Haas came up with a fundamental

reconceptualization of what he calls a 'dependent variable'.

In 1958 he had spoken of integration as a "process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations, and political activities towards a new and larger centre, whose institutions possess or demand jurisdiction over the preexisting national states." In his revisionist theory in 1970, he offers a new definition: "regional integration is concerned with explaining how and why states cease to be wholly sovereign, how and why they voluntarily mingle, merge, and mix with their neighbours so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflict between themselves." Thus emphasis is shifted from the creation of a new and larger centre to a shift of authority and legitimacy out of old centres.

PART II: ECONOMIC PERSPECTIVES

Economists over the century had taken the free trade model as the ideal towards which the nation states should move. There was not much emphasis in theory about the role of regional economic integration. But when the Western European countries began having a vision of an

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41 Ernst B. Haas quoted in Alger, n.10, p.136.

42 Haas, n.40, p.610.
integrated Europe built on the integrated economy, economists began examining theoretically various aspects of economic integration.

**THEORY OF PREFERENTIAL REDUCTIONS OF TRADE BARRIERS**

In the still-evolving theoretical paradigm of regional integration, the *Theory of Preferential Reductions of Trade Barriers* is of primary significance. This theory consists of four related, yet distinct, sets of analytical approaches.

(a) **VINER-LIPSEY-MEADE APPROACH**

(Also categorized as the mainstream customs union theory, most of the analysis in this approach is conducted in terms of the central concepts of trade creation and trade diversion. The seminal distinction between the two concepts was introduced by Jacob Viner in his classic *The Customs Union Issue*. The former term relates to newly created trade between the member countries of the union, the latter to trade diverted from a foreign country to a member country, both consequent upon the abolition of tariffs within the union.)

Despite the title of the book, Viner emphasizes that customs union is but one of a number of possible preferential trading arrangements. The key

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passage that concerns his explanation of the trade-creating and trade-diverting effects of a customs union:

“There will be commodities, which one of the members of the customs union will now newly import from the other but which it formerly did not import at all because the price of the protected domestic product was lower than the price at any foreign source plus the duty. This shift in the locus of production as between the two countries is a shift from a high-cost to a lower-cost point... There will be other commodities which one of the members of the customs union will now newly import from the other whereas before the customs union it imported them from a third country, because that was the cheapest possible source of supply even after payment of duty.”

Under the assumption of pure competition, constant costs, and zero transportation costs, the world market price of any commodity will be equal to the cost of production in the lowest-cost country. It follows that countries whose production costs are higher than the sum of the tariff and the world market price will import the commodity in question from the lowest-cost source, while other countries will produce it domestically.

**TRADE CREATION vs TRADE DIVERSION: AN OUTLINE**

Suppose a customs union is formed between countries A (home country) and B (partner country) which excludes country C (non-member). Five possible cases can be distinguished:

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44 ibid, p.43.

(1) Both participating countries produced the commodity in question prior to the formation of the customs union, and the union includes the lowest-cost producer. After the union is established, the inefficient producer – A – will cease to produce this commodity, and its entire demand will be satisfied through importation from country B (trade creation). The same result would follow if tariffs against all countries were abolished.

(2) Both countries produced the commodity in question under protection, and the union does not include the lowest-cost producer. The removal of tariffs between the participating countries will again create new trade, since the exploitation of cost differences, which was previously prevented by the tariff, will now become possible. This new position is however, inferior to universal free trade, since under this condition neither member country would produce the commodity, but both would import it from the lowest-cost source.

(3) Country B is the lowest-cost producer, A did not produce the commodity under tariff production. No change takes place after the union is formed (same as under free trade).

(4) B produced the commodity under protection, while A imported it from C, the lowest-cost source. Removal of tariffs between A and B shifts A's entire import demand from C to B, since – under the assumption of uniform tariff levels – production costs in B are less than the sum of the tariff and the cost of production in C (trade diversion). The
resulting situation is less efficient than that existing prior to the union’s establishment, and less efficient than universal free trade.

(5) Neither A nor B produced the commodity under tariff protection. No change takes place after the union is established; both countries will continue to import the commodity from the lowest-cost source C (same as under free trade).

Trade creation, then represents a movement toward the free-trade position, since it entails a shift from high-cost to low-cost sources of supply, while trade diversion – a shift of purchases from lower-cost to higher-cost producers – acts in the opposite direction. According to Viner, the beneficial effects of the union will predominate, if trade creation outweighs trade diversion.

The analyses from Viner has been extended by J.E. Meade and R.G. Lipsey, adding consumption effects to the production effects. They came up with the propositions that:

(i) a customs union is more likely to raise welfare the higher the proportion of trade with the country’s union partner and the lower the proportion with the outside world;

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(ii) a customs union is more likely to raise welfare the lower the total volume of foreign trade is relative to domestic purchases prior to the formation of the union.

Viner's main contribution was to destroy the common fallacy that a preferential move towards free trade was necessarily welfare improving.

(b) KEMP-WAN APPROACH

An alternative theoretical approach, has been proposed by Murray Kemp and Henry Wan. It shows that any group of countries could form a customs union with a common external tariff, given two desirable properties: (i) The non-members would have their welfare unchanged, and (ii) The members would improve their own welfare.

Theoretically, this is an important contribution because it shows that preferential groupings can always be devised, in principle, for any given subset of countries, such that they are a Pareto-improvement over the initial pre-union situation. Pareto-improvement means that no country within the union is worse off and at least one is better off. The question then is whether the specific grouping proposed satisfied the sufficiency conditions for such Pareto-superior welfare-improving unions. However, the theorists merely provide proof of the theoretical existence of such

unions but do not provide any guidance as to the necessary and sufficient conditions that such unions might satisfy.

(c) COOPER-MASSEL-BHAGWATI APPROACH

Another approach to customs union theorizing, reflective of the concerns of small developing countries, was taken by Charles A. Cooper and B.F. Massel, and Jagdish N. Bhagwati. They argued that if a given target level of aggregate import-competing industrialization were the objective, the cost of it to developing countries with small markets could be reduced by unions that permitted trade and mutual exchange of industrial production among themselves (with scale economies exploited within the union) while maintaining protection against the manufacturers of the developed countries.

This argument builds on economies of scale; but specialization in manufactures within the union would be profitable even without invoking scale economies. While it treats any given degree of overall industrialization as a "non-economic" objective, it holds that the proposed union achieves gains for member countries subject to given import

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substitution for the aggregate union vis-à-vis the non-member (developed) countries, which therefore leaves non-member countries’ welfare unchanged.

(d) BRECHER-BHAGWATI APPROACH

The previous approaches consider either the welfare effects of forming arbitrarily specified customs unions (the Viner-Lipsey-Meade view) or the judicious formation of customs unions so as to achieve Pareto-better outcomes (the Kemp-Wan and Cooper-Massel-Bhagwati approaches). An alternative approach introduced by Richard Brecher and J. Bhagwati, provides the mechanism to analyse the welfare effects of parametric and policy variations in customs unions with common external tariffs and with freedom of intraunion factor movements.

In analysing the effects of changes in tariffs, transfers, etc., on specific groups of productive factors within a country, these theorists argue that their theory has a perfect analogue in the analysis, within the European Community, of the effect of changes in the external tariff on, for instance, the welfare of Britain (i.e., the British factors of production), France, Germany, etc. This analytical approach provides, as the European Community moves to full integration, the necessary tools to analyse

related issues, such as the effect of the Common Agricultural Policy on individual countries’ welfare, by providing a scientific basis for calculating costs and benefits.

THE NEW REGIONALISM

Starting in the mid-1980s, new ideas began to be developed which challenged traditional customs union theory. The main intellectual spur was the ‘new trade theory’ based on models of imperfect competition.\textsuperscript{52} This kind of thinking downplays the significance of trade diversion in a world in which tariffs have become less important than non-tariff barriers to trade. The new regionalism also draws on the new trade theories which integrated scale economies and imperfect competition into mainstream trade theory. Thinking on new regionalism has a more positive vision of discriminatory trading arrangements than traditional customs union theory.

OPEN REGIONALISM

The concept has been formulated with respect to the current phase of regionalism, in contrast to the closed, import-substituting regionalism of the 1950s and 1960s. ‘Open Regionalism’ has been adopted as a fundamental principle of the Asia-Pacific Economic Cooperation (APEC) from its creation in 1989.\textsuperscript{53} In an effort to pave the way for defining the

\textsuperscript{52} Pomfret, n.45, p. 148.

concept, an APEC-centred definition was attempted only in 1994 by the Eminent Persons' Group (EPG) appointed by the APEC.\textsuperscript{54} A clearer definition of the term was outlined by the Council of Economic Advisors to the President of the United States in 1995:\textsuperscript{55}

Open regionalism refers to plurilateral agreements that are non-exclusive and open to new members to join. It requires first that plurilateral initiatives be fully consistent with Article XXIV of the GATT... Beyond that it requires that plurilateral agreements not constrain members from pursuing additional liberalization either with non-members on a reciprocal basis or unilaterally. Because member countries are able to choose their external tariffs unilaterally, open agreements are less likely to develop into competing bargaining blocs. Finally, open regionalism implies that plurilateral agreements both allow and encourage non-members to join in.

The staunchest advocate of open regionalism, Fred Bergsten, offers five criteria for adhering to the concept:\textsuperscript{56}

i) Open membership with positive encouragement to non-members to join;

ii) Unconditional MFN treatment;

iii) Conditional MFN extension, whereby an RTA would generalize its reductions of barriers to all non-members that agreed to take similar steps;

\textsuperscript{54} APEC, Achieving the APEC Vision: Free and Open Trade in the Asia-Pacific: Second Report of the Eminent Persons' Group to APEC Ministers (Singapore, 1994), pp. 54-56.


iv) Global liberalization, whereby members of an RTA would continue reducing their tariffs while pursuing their regional goals, continuing with unilateral liberalization and multilateral negotiations in the WTO;

v) Trade facilitation through non-tariff and non-border measures, such as customs harmonization, mutual recognition of product standards, cooperation in enforcing national competition policies, and deregulation of key domestic markets.

CRITICISM

Critics of open regionalism find the very term inherently contradictory: arrangements that are open cannot be regionally confined and those that are regionally confined cannot be open. One of the most vocal critics of the idea goes so far as to call ‘open regionalism’ an oxymoron.57

Critics further point out that the ‘open membership’ policy can include several unpleasant ‘side payments’ which are essentially unrelated to trade. These include acceptance of a stronger intellectual property rights regime, investment rules, and higher labour and environmental standards.58

57 T. N. Srinivasan has criticised the concept in the strongest terms in “APEC and Open Regionalism”, (mimeographed), (Yale, 1995), p. 59.

This term has been used most frequently to describe the developments in Asia; and Asian regionalism has been truly 'open' in that liberalization undertaken by members of Asian regional groups has been essentially non-discriminatory. APEC has created no trade preferences. However, regional trade arrangements in North America, Latin America, or Europe do not conform to the standards of openness laid out in the definition of the concept.\(^59\)

FORMS OF ECONOMIC INTEGRATION

Economic integration can take several forms that represent varying degrees of integration. These are: free-trade area, customs union, common market, economic union, and complete economic integration.\(^60\)

(i) Free Trade Area (FTA) : If the members of participating countries eliminate or reduce all tariffs and quantitative restrictions among themselves, then they form a free trade area. Typically, they retain varying levels of tariffs and other barriers against the products of non-members. Examples include the US-Israel FTA, the Canada-US FTA, and the European Free Trade Association (EFTA).


\(^60\) Balassa, n.3, pp. 9-10.
(ii) **Customs Union**: The next level of integration occurs when the members of an FTA go beyond removing trade barriers among themselves and set a common level of trade barriers vis-à-vis outsiders. This at a minimum entails a common external tariff. A full customs union would also harmonize quantitative restrictions, export subsidies, and other trade distortions. It would set all trade policy for its members as a unified whole. Example, the EEC-Accession of Portugal, Spain, Austria, Finland and Sweden was presented as a customs union to the GATT. Another example is the Andean Group comprising Bolivia, Colombia, Ecuador, Peru and Venezuela.

(iii) **Common Market**: Beyond the free exchange of goods and services among members, a common market entails the free movement of factors of production - labour and capital. The free movement of capital applies to foreign direct investment (FDI). Example, the European Community.

(iv) **Economic Union**: Going beyond the free movement of goods, services, and factors, economic union involves harmonizing national economic policies, including taxes and a common currency, in order to remove discrimination due to disparities in these policies. The decision of the European Community to evolve to the European Union in 1994 represented a determination to proceed to this higher stage of integration.
(v) **Total Economic Integration**: This stage presupposes the unification of monetary, fiscal, social, and counter cyclical policies and requires the setting up of a supra-national authority whose decisions are binding for the member states. A full unification of economic policies would in turn require political federation.

The first two stages, FTAs and customs unions fall within the range of shallow integration efforts, while the latter two more advanced stages constitute deep integration.

Country groups often choose names that are far too ambitious for the kind of integration that they are prepared to undertake. Neither the members of NAFTA or the ASEAN FTA expect to literally eliminate all interior barriers to trade, as the definition of ‘free trade area’ would imply. The Central American Common Market is yet to become an FTA, let alone a customs union or common market.

It is important to note that each of these forms of economic integration can be introduced in its own right: *They are not stages in a process which eventually leads to complete political integration.*

The above mentioned forms of regional groupings have been classical forms. There are a few departures to this strict categorization. These are specially found in the post-Cold War period regional groupings. These groupings do not go very far to seek complete integration of the
economies. Nevertheless, they encompass more than mere trade liberalization. They include technology, labour, and investment agreements along with trade liberalization which also includes trade in services. An outstanding example of this type of regional integration is the North American Free Trade Agreement (NAFTA). 61

International economic integration can be positive or negative. The term ‘negative integration’ was coined by Jan Tinbergen 62 to refer to the removal of barriers on trade between the participating nations or to the elimination of any restrictions on the process of trade liberalization. The term ‘positive integration’ relates to the modification of existing instruments and institutions, and to the creation of new ones so as to enable the market of the integrated area to function properly and effectively and also to promote broader policy aims of the union. Within this framework, it can be stated that free trade areas are forms of international economic integration which require only ‘negative integration’, while the remaining types require ‘positive integration’, since

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61 The NAFTA which entered into force in January 1994 between Canada, the USA, and Mexico, has agreements covering a range of subjects over and above trade liberalization - elimination of all border measures applying to agricultural products, MFN treatment in financial services, energy, intellectual property protection, investments, labour, and environmental regulations. A distinctive feature of the agreement are the extensive provisions for dispute settlement. NAFTA, Agreement Establishing the North American Free Trade Agreement (December 1992), 32, I.L.M.289 and 32 I.L.M.605.

they all require the positive act of adopting common external relations, or as a minimum, a Common External Tariff (CET).

Summing up, the most significant contribution of the literature on functionalism and integration has been the development of conceptual frameworks placing regional integration agreements in the national, transnational, and global contexts.