CHAPTER – 3
REGIONAL INTEGRATION; CONCEPT, THEORIES 
AND DEBATES

Next to the concept of 'state', the concept of 'region' plays also an important role in understanding how the world is geographically, politically and economically organized.¹

Regional integration (RI) is a worldwide phenomenon of territorial systems that increase the interactions between their components and create new forms of organisation, co-existing with traditional forms of state-led organization at the national level. The processes of regional integration that emerged after WW II, were originally mostly about trade and economics, but it has become clear that, especially since the 1980s, with the so-called 'New Regionalism'² wave, regional integration can be seen as a multidimensional process that implies, next to economic cooperation, also dimensions of politics, diplomacy, security, culture, etc. Nevertheless, trade and economic integration remain a central aspect of ongoing integration schemes.

The growth of regional trade blocs has been one of the major developments in international relations in recent years. Virtually all counties are members of a bloc, and many belong to more than one. Over a third of the world trade takes place within such agreements- nearly two-thirds, if Asia-Pacific Economic Co-operation (APEC) is included. Regional agreements vary widely, but all have the objective of reducing

² The term 'new regionalism' was first introduced by Norman Palmer (1991).
barriers to trade between member countries. At their simplest, these agreements merely remove tariffs on trade in goods but many go beyond that to cover non-tariff barriers. At their deepest they have the goal of economic union and involve the construction of shared executive, judicial and legislative institutions. The last decade has seen an increased move towards regionalism. Of the 194 agreements that had been notified by the GATT/WTO, in the beginning of 1999, 87 dated from 1990 or after. The past decade also witnessed three major qualitative changes in regional integration agreements, which are as follows:

- The move from "closed regionalism" to a more open model, in line with prevailing views about national economic policy.
- The recognition that effective integration requires more than simply reducing tariffs and quotas, which can be defined as deep integration.
- The advent of North-South trade blocs in which high income countries and developing countries are equal partners.

New Regionalism

New regionalism theory integrates the dynamic effects of economic integration, the interaction between trade and investment, and the role of institutional arrangements as incentives for regional integration. New regionalism is a multi-faceted phenomenon, which touches therefore a much wider number of policies than the 'old trade-based regionalism' did. Regional integration initiatives are expected to fulfill nowadays at least eight important

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functions: the strengthening of trade integration in the region; the creation of an appropriate enabling environment for private sector development; the development of infrastructure programmes in support of economic growth and regional integration; the development of strong public sector institutions and good governance; the reduction of social exclusion and the development of an inclusive civil society; contribution to peace and security in the region; the building of environment programmes at the regional level; and the strengthening of the region's interaction with other regions of the world.

The New Regionalism differs from the old regionalism in a number of important ways.

• Typically, the new regionalism has a number of small countries, which are willing to link up with a large neighbouring country, which plays the role of regional hegemon.

• The small countries are involved in a process of unilateral liberalisation and they want to consolidate it by linking up with a large anchor country.

• The new regionalism is about deep integration. It goes beyond liberalisation of trade in goods and deals with services and investment issues.

• There is no big bang trade liberalisation but rather a slow gradualist approach.

• The new regionalism occurs between countries that are geographically close to each other.

The EU is a good example of the new regionalism as it has managed to develop a model of integration that incorporates political elements in deep economic integration. We now have in Europe a complex multi-level governance
system with a deep co-operation between states, with firm devolution of power within states and a strong international legal framework.

Regionalism, as defined in this chapter encompasses efforts by a group of nations to enhance their economic, political, social, or cultural interaction. Such efforts can take on different forms, including Regional Cooperation, Market Integration, Development Integration, and Regional Integration. The chapter begins with a brief introduction of different connotations and concepts of regionalism. The second section analyses various theories of regional integration such as federalist, functionalist, neo-functionalist etc. finally, the chapter focuses on different debates with regard to the functions of regional integration and its effects on international trade.

Various kinds of Regionalism

As previously noted, regionalism can be categorised into Regional Cooperation, Market Integration, Development Integration, and Regional Integration. This section will provide a brief overview of the main tenets of the concepts.

Regional Cooperation

Regional cooperation “is a collaborative venture between two or more partners, with common interests in a given issue.” Such ventures can include, for example, execution of joint projects, technical sector cooperation, common running of services, joint development of common natural resources, joint stand towards the rest of the world, joint promotion of production.

Market Integration

Market integration is the linear progression of degrees of integration beginning with a
Free Trade Area (or in some cases a Preferential Trade Area) and ending with total economic integration. The model for such integration is the European Union (EU). Market integration consists of a: Free Trade Area where tariffs are removed among member states, but each country retains its own tariffs against non-members; Customs Union where the Free Trade Area remains in place and member states impose a common external tariff against non-member states; Common Market where the customs union remains in place along with the free flow of the factors of production (capital and labor); Economic Union which consists of a common market along with the harmonization of monetary and fiscal policies; and total Economic Integration which consists of a common market along with the unification of monetary and fiscal policies.5

The welfare gains from integration are based on the notion of trade creation and trade diversion. The former takes place when there is a shift from a high-cost, less efficient regional producer to a low-cost, more efficient regional producer. Trade diversion, on the other hand, consists of a shift from a low-cost, more efficient non-member producer to a high-cost, less efficient regional producer. The potential gains from market integration include: Increased production arising from specialisation according to comparative advantage; Increased output arising from the better exploitation of scale economies; Improvements in the terms of trade of the group with the rest of the world; Forced changes in efficiency arising from increased competition within the group; Integration-induced changes affecting the quantity or quality of factor inputs, such as increased capital inflows and changes in the rate of technological

advance. While for these gains to be realised, the theory assumes that there exists: Perfect competition in transport markets; Free flow of labour and capital inside but not between countries; transport cost; Tariffs as the only trade restrictions and balanced trade between countries; Prices reflecting the opportunity costs of production.

Development Integration

According to this theory, the objective of integration becomes economic and social development, and it is therefore linked with development theories. Development integration requires more state intervention than market integration. States must first and foremost make a political commitment to integration, since such commitment is seen as laying the foundation for cooperation. It is anticipated that this will help member states work toward implementing policies that will help with problems created as a result of the unequal distribution of benefits.

Regional Integration

Regional integration is defined as “a process by which a group of nation states voluntarily and in various degrees” have access “to each other’s markets and establish mechanisms and techniques that minimize conflicts and maximize internal and external economic, political, social and cultural benefits of their interaction”. 6 Both the formal and informal market is taken into consideration. Regional integration differs from market integration in that, “while formal institutions are necessary to oversee the linear progression of the various phases of integration, regional integration does not necessarily require formal institutional structures, nor is there necessarily a linear

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progression of integration. In the case of the latter, integration is assessed by the amount of economic, political, social and cultural interaction that transpires between member states. It does not require all member states to share these activities simultaneously.

Inter-Regionalism and Trans-Regionalism.

While group-to-group dialogues without common institutions fall into the label of interregional relations, transregional fora are seen as having a more diffuse membership. More interestingly and innovatively, Hanggi (2000) distinguishes between (a) relations between regional groupings, (b) biregional and transregional arrangements, and (c) hybrids such as relations between regional groupings and single powers. The first relates to the tradition group-to-group dialogues between regional organizations (e.g. EU-Andean Community or SAARC-ASEAN), the second reflects the diffuse arrangements that bring together independent countries working under a geographical regional framework (e.g. APEC, ASEM, Africa-Europe Summit), and the third translates the meeting between regional groupings and independent countries (e.g. EU-China/Russia/India/Japan/United States or EFTA-Mexico). From the epistemological point of view the debate is poorer and less ground-breaking. States are replaced by regions as the central level of analysis and inter-regional relations are explained using the classic terminology of IR theory.

Regionalism in a Historical Context

The weaving of regional ties has been, historically dominated by five cycles.  

**Military Regionalism.** The earliest accounts of regional constructions reflect military dominions or strategic territorial possessions brought together by violence. To control territories that were economically advantageous or by the simple desire to expand power and rule, continental empires were a benchmark of political constructions up until the Napoleonic Wars.

**Nineteenth century.** With the Industrial revolution and the technological breakthroughs associated to it, the commercialization of goods outside national borders and the knitting of trade ties among different political units were made possible.

**Post First World War.** Unlike the second, this third cycle of regionalism had a clear discriminatory, preferential and protectionist nature.

**Post Second World War-1960s.** In this period the international system was characterized by the illusion of a collective security system embodied in the United Nations and by the dogmatic state-driven rationality of the Cold War. All over the world, regional political and military constructions as NATO, Warsaw Pact, SEATO, CENTO, the Rio Pact and ANZUS reflected the rationales of the Cold War.

**New Regionalism.** The 1980s saw a resurrection of regionalism. the 'most dramatic' and the 'most publicized' reasons for the return of regionalism were the new attitudes towards international cooperation and the decentralization of the international system brought about by the collapse of Communism and the end of the Cold War.

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Theoretical Approaches

Integration is a multi-dimensional social phenomenon and its study has generally been undertaken along disciplinary lines. That partly explains why various (sometimes complementary, sometimes competing) theories exist. Although regionalism is a long-standing feature in international relations only since the 1960s and more emphatically since late 1980s scholars have shown a dedicated interest in the phenomenon. Integration is a primary approach to international organization. Students of integration theory have oriented their work heavily toward the analysis of peaceful change in an anarchic system. Integration like its cousin, peace, is foremost a property of the international system viewed as a whole. The integrative process is seen as culminating in a community-like political form which embraces a group of people who, originally at least, were organized politically as a system of sovereign nation-states.

Integration is associated strictly with regional processes and the parts forming the whole were sovereign states. An international region is a limited number of states linked together by a geographical relationship and by a degree of mutual interdependence, while regionalism is a doctrine advocating the formation of interstate groupings or associations on the basis of regions. Integration occurs among countries or provinces whose geographic borders affected their mutual security, where economic and political processes coincided. Integration therefore is a political process fostered by economic processes.

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Theorising on Regionalism

In order to explain, describe or explore the subject of regionalism numerous approaches and theories were generated within International Relations/International Political Economy over the last sixty years from. The body of literature is so extensive that some authors have recently endeavored to compile and compartmentalize the theoretical landscape. Here we present the compilation of theories by Timothy Shaw.10 A first systematic attempt, done by Andrew Hurrell (1996) divides up all the approaches into systemic theories (neorealism, structural interdependence, globalization), regional theories (neo-functionalism, neo-liberal institutionalism and constructivism) and, finally, domestic theories (regionalism and state coherence, regime type and democratization). Schulz et al. (1999), in a more circumspect fashion, narrow down these approaches to four (neorealism, functionalism and institutionalism, regional economic integration and the new regionalist approach). Mattli (1999) moves along the same lines but categorizes them fairly differently. To him there are political science approaches (functionalism, neo-functionalism and intergovernmentalism) and economic approaches (customs union theory, optimal currency area and fiscal federalism). Another compilation, done by Finn Laursen (2003), overlooks several essential theories and focus exclusively on neofunctionalism, game theory perspectives, (liberal) intergovernmentalism, Mattli's comparative regional integration analysis (1999), and social constructivist critiques.

The finest piece of literature in compiling the main (new regionalism) theories was, however, edited recently by Fred Söderbaum and Tim Shaw (2003). In this edited

volume, ten renowned scholars on the new regionalism are condensed into rationalist and reflectivist views. Drawing on all these synthesizing attempts, where one registers eighteen theoretical approaches to regionalism, the mainstream (or old) theories of regionalism are functionalism, neofunctionalism, liberal institutionalism, intergovernmental, regional economic integration and neorealism.

Functionalism focused on the creation of a set of functional agencies that may socialize politicians, civil servants and the peoples into adopting less nationalistic attitudes (Mitrany, 1966). Neofunctionalism highlights, in a less normative way, how national interests may be achieved through functional spillover, political spillover and upgrading of common interests (Haas, 1958b; Lindberg, 1963). Liberal institutionalism underscore why states turn to institutions (Keohane, 1984; Ruggie, 1993). It argues that they do so as an attempt to solve cooperation problems (institutions provide information about other's preferences, intentions and behaviors; establish liabilities, reduce uncertainty and lower transaction costs). Intergovernmental argues that regional integration can be better comprehended if agency is attributed to top official politicians and if the process is studied as a set of political bargains that aim to maximize national power (Moravcsik, 1991; Taylor, 1983). Regional economic integration theory refers to the linear increase of economic interdependence through a stage process that starts with a preferential trade area and moves on to a free trade area, customs union, common market, economic union and political union (Balassa, 1962). Finally, neorealism argues that regional groupings are predominantly formed by states in response to an external security threat (Waltz, 1979). After the constructivist boom in IR theory (Wendt, 1999), and the resurgence of regional empirical activity in late 1980s, a second
A wave of theories emerged to complement (and sometimes compete with) the mainstream theories. Both developments were incorporated, at different degrees, by approaches to regionalism such as the world order approach (Gamble and Payne 1996), the NRA/new regionalism approach (Hettne et al. 1999-2001), the humane global governance approach (Falk, 2003) and the new regionalisms/post-modern approach (Boas, Marchand and Shaw 1999, Boas, Marchand and Shaw, 2003). The first two look at regionalism in a systemic and structured way, elaborating on the effects of globalization and the shaping of a regional order. In sharp contrast, the new regionalisms approach rejects any universalistic logic and draws attention to the contradictory and conflicting elements of regionalisation 'from below'. Falk's insights are somewhat different. In his writings, he tries to assess the potential contribution of regionalism to the achievement of crucial world order values like democracy, human rights and social justice. For him, regionalism is a positive trend as long as it contains negative globalism, copes with 'pathological anarchism' and confronts the 'empire-building' project of the United States.11

Multidimensionality of contemporary regionalisation warrants a new type of analysis, which transcends the dominant theories of regional integration, such as neorealism, functionalism, neo-functionalism, institutionalism, market and trade integration, development integration and so on. The mainstream theories in the field may still provide valuable and sensible insights, but the point of departure is that they are neither designed nor capable of capturing the diversity, fluidity, comprehensiveness and the way contemporary regionalisation processes are socially

11 Ibid, p-24
constructed by state as well as non-state actors it is argued that the analysis should avoid fixed and one-dimensional definition of regions as well as a 'narrow' and simplified focus on instrumental state strategies, regional organisations, security alliances and trading blocs. Instead research should be guided by a genuine concern with the processes of regionalisation in various fields of activity and combined. It is specifically necessary to analyse regionalisation in historical, multidimensional and multilevel perspective, and it furthermore seeks to transcend simple state-centric notions of regionalization and bring transnational actors into the analysis, taking into account the wide range of heterogenous linkages and interactions amongst market and civil society actors.¹²

Forty years after the initiation of inter-state integration as a cooperative process in Western Europe, regional initiatives continue to emerge in the international system. Have neighboring countries chosen to become more integrated, or, are regional initiatives simply a formal recognition of an on-going process? Does either an economic or political process initiate an integration process, or are they inextricably linked? And, if integration proceeds among countries with wide gaps in structural power and levels of GDP, does integration, as a cooperative process, require an expanded definition? The functionalist foundations of integration theory that preceded the arrival of the neofunctionalist interpretation lay its emphasis on regulatory, institution-based integration. It is here where economic and political integration can be outlined as two distinct processes, the convergence or divergence of which ultimately rests on security concerns of the state. Regional integration occurs among countries

¹² Rodrigo Tavares, cited in p. 7
whose borders affect their mutual security and where economic and political processes coincide.13

The study of political integration centers on a statist approach and a supranational institutionalist approach. The statist approach to integration theory does not foresee a change in the inter-state system as integration proceeds. The second approach to integration, as outlined by neo-functionalism and federalism, is a process whereby the international system ultimately supersedes the nation-state. As an alternative to the nation-state, integration, in the second approach, was a deterministic process leading toward establishment of a larger, supra-national institutional unit. The integration of states toward supranational institutions had been the focus of much of the earlier discussion of European regional integration. Approaches to Integrative Structures and Processes, outlines the four approaches to integrative processes: the pluralist emphasis on traditional inter-state diplomacy; the largely apolitical, welfare needs-based functionalism; the political development and elite formation characteristics of neo-functionalism; and lastly, the federalists’ negation of the nation-state in favor of an ever larger supranational institution. This four-dimensional model expresses the process of system-change as well as the open-ended and undetermined nature of integration.14

Economic integration, often described as a “market-led” process, is founded on a stable international system and proceeds by a multiplication of interdependent relationships in often geographically discontinuous economic sectors in global markets. The transnational consolidation of firms and interstate integration processes

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13 Keohane, Robert O. and Joseph Nye, Power and Interdependence.: Little Brown, Boston 1977, p.60
14 Ibid, p.63

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often overlap. But the extent to which they do depends on the geographical scope of the economic sector concerned, as well as the state’s foreign policy.

Integration and interdependence are theoretical approaches which hark back to the political science and economics literature during the early stages of regional integration in Western Europe. The terms integration and interdependence have been frequently used interchangeably. Many theorists’ points to the interdependence of economic and political factors in the integration process: Integration increases the interdependence of the national economies participating in a union through a rise in the interdependence of industries and capital markets. They described the European Economic Community (EEC) as a complex web of interdependences and described integration as both a process and an end state, and, like the condition of interdependence, on-going at any number of levels. Integration is a macro-level process and interdependence is a micro-level phenomenon.

A slowdown in the European integration during the 1960s and the failure of the dominant paradigms to explain this adequately tended to throw doubt on the general validity of integration theory. The impact of outside environmental factors had impeded the process of European integration. Just as the process of European integration faltered in the middle of the 1970s, regional integration theory too became a “dead” theoretical issue. A serious flaw of this theory was its assumption of the instrumental rationality and an underestimation of the difference between national

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governments and other 'interested' actors. It is suggested that the focus of the discussion should be adjusted in geographic scope and range of activities and that integration must be considered within an historical context and a changing international system. Policy integration within a limited scope and on an incremental basis has been a viable part of the European Union and helps to connect the literature on regional integration with that on interdependence.

In Europe, with the 'Empty Chair Crisis' of 1965 and the 'Luxembourg Compromise' of 1966 the integration process was dominated by a downturn in economic circumstances and subjected to intergovernmental. Regionalism outside Europe had not produced tangible results either. Too many inward-looking economic policies, too weak institutional settlements, the legacy of colonialism, and the weight of underdevelopment do explain the failure or the marginal impact of this wave of regionalism. Also of fundamental importance is the fact that the US channeled its energy in promoting not regionalism but economic multilateralism and non-discrimination. Attempts to create regional trading areas in Africa, North America and Latin America did not get off the ground or collapsed at an early stage. All this motivated Ernest Haas (1975) to declare that regional integration theory was "obsolete in Western Europe and obsolescent - though still useful - in the rest of the world".

**New Regionalism.** The 1980s saw a resurrection of regionalism. The body of literature on this last cycle of regionalism is immense, which reflects a renovated academic interest in the subject. This enthusiasm comes hand in hand with changes at the empirical level. As an illustration, the thirty-three regional trade agreements (RTA's) signed between 1990 and 1994 constitute the largest number for any five-period
since the end of World War II. The differences between the 'old' (the first four cycles) and the 'new' regionalism are discernible in terms of (1) agency, (2) vectors/motivation, (3) direction and (4) coverage. First, unlike previous regional constructions, which were state-led by nature, recent regional projects are driven by a wide range of different actors, from the individual to the community and from local to global agents. Second, as Bjorn Hettne points out "the new regionalism is a multidimensional form of integration which includes economic, political, social, and cultural aspects and thus goes far beyond the goal of creating region-based free trade regimes or security alliances." Several regions are currently multidimensional by nature dwelling upon economic and security pillars as, for instance, ECOWAS or ASEAN. Third, regions are no longer imposed from above obeying immutable structural imperatives. They are constructed spontaneously by human action and social practices (Grugel and Hout, 1999:9) in the wake of a permanent redefinition of processes and interests. Society and people make each other during an ongoing, two-way process. Fourthly, regional integration has moved beyond a strict European experiment and has become a truly universal phenomenon.

The driving forces of the new regionalism were, nevertheless, outside the regional frame and came from the global level. The 'most dramatic' and the 'most publicised' reasons for the return of regionalism were the new attitudes towards international cooperation and the decentralization of the international system brought about by the collapse of Communism and the end of the Cold War.

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18 Mansfield and Milner, 1999:601
At the end three main conclusions are worth mentioning. First, regionalisation is not a recent phenomenon. Spanning several centuries, it is a process that has had different outlooks and has been molded by different actors obeying different imperatives. Although since the 1980s regionalism entered into a new phase where new agents, directions and motivations came into play, military regionalism (regional empire) was a common feature in international relations until the First World War. Second, in terms of theory, the discipline of regionalism has witnessed a flurry of publications over the last years bringing in the postmodern apparatus and focusing on areas outside Europe. Thirdly, in empirical terms, as regionalism is by now a granted feature of global social relations new concerns are under discussion as micro-regionalism, the nexus regionalism/peace, or inter-regionalism.

Increased interest in integration in the underdeveloped countries may be attributed in part to a desire to imitate the European example and to deliberate efforts to counteract possible trade-diverting effects of the European Common Market. In many developing areas of the world integration was also a paradigm for industrialisation. Integration was expected to foster economic growth in Europe and Latin America through trade economies. Regional integration schemes in less developed areas may have been different processes in causal terms, in terms of important differences in infrastructure, market mechanisms, external dependence, administrative resources, political group structure, and interdependence of social sectors, national consciousness, and ideology. Integration among less-developed countries, such as those in Latin America, necessitated a high degree of government

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intervention at the early stages of integration which subsequently gave way to an increased role of private enterprise.\textsuperscript{21}

After the Cold War, political and economic integration continues in the European continent with the establishment in 1992 of the single market and the introduction in 1999 of a single currency. The issue-areas facing the European agenda also include the multiplication of countries on the continent following the dissolution of the Soviet Union.

The extraordinary events of the late 1980s and early 1990s, from the Urals to the Atlantic, have raised genuinely comprehensive questions about the future of Europe — questions that cannot be broken down neatly into security and economic categories. The new political map of Europe raises a host of questions directly linking economic and security issues for the first time in over forty years, it is easy to see that the biggest issues of economic and political organisation are once again on the table, subject to debate and redefinition.\textsuperscript{22}

Post-cold war security processes include integration among industrialised and developing countries. Strong interest in developing countries to strengthen regional ties among themselves, as well as with the leading economies, represents a significant departure from the 1950s to early 1970s, when many developing countries pursued regional integration among themselves, largely unsuccessfully, as a substitute for stronger ties with the North, rather than as a complement as is the case today.


Economic Integration Theory; beyond conventional integration theory.
Since the early 1960s, theorising about regional economic integration has been influenced by Bela Balassa's five step approach\textsuperscript{23}: from free trade area to customs union to common market to economic and monetary union and finally political union. But this typology was first articulated well over 40 years ago in a different historical context. In the 1960s tariffs, as the principal barriers to trade, were much more important than today. Financial flows across the boundaries of national economies were much less important. Most countries, including the United States, used controls to ensure that fixed exchange rates were not undermined by high inflows, or outflows, of capital. Trade integration offered an answer to the economic goals of many countries. They could prepare for the world market or, in a more radical but popular version, they could dissociate their economies from the global economy, which was obviously easier for a group than for individual countries.

But that was then. Today, the most problematic aspect of Balassa's approach is that it provides no link between the monetary policies and the financial sectors of the participating economies on the first three levels of integration. In an era of globalisation and liberalisation, reflected in growing capital flows and financial deregulation, this constitutes a major theoretical and policy deficiency. Furthermore, the introduction of monetary union is a change of tune from the first three steps, where the emphasis lay on trade.

Economic integration relies on economic growth and an ever-expanding perimeter of relationships to promote a stable international system. The avoidance of

\textsuperscript{23} Bela Balassa's 1961, cited in pp-5
future wars between France and Germany, the creation of a third force (the political
effects of economic integration) in world politics, and the reestablishment of Western
Europe as a world power are frequently mentioned as political goals that would be
served by economic integration. However, economic and political integration
processes are different, and economists and political scientists call upon different
criteria to measure integration. Political scientists argue that economic integration is
based largely on the political support of the nation-state for free trade. Balassa, on the
other hand, points to the effect of a “discipline of the market” to coordinate monetary
and fiscal policies between states in order to ensure economic growth emerging from
the increased transactions between them.24

Integration theorists often ignored the importance of economics, as an activity
and as part of the political process among states and other social units. This is based
on the premise that, the science of economics presupposes a given political order, and
cannot be profitably studied in isolation from politics.25

Balassa (1961) argues that political and economic factors are interdependent in
economic integration. Political motives may prompt the first step of economic
integration, but economic integration also reacts on the political sphere, similarly, if
the initial motives are economic, the need for political unity can arise at a later stage.26

Economists generally refer to three aspects of economic integration: liberalisation (free movement of resources), development (scale, capital and competition) and coordination of policies. In economics, integration is the process

24 Ibid pp-269
26 Balassa 1961: 7
which leads to the creation of the most desirable structure of international economy by removing artificial hindrances to optimal market operations and deliberately introducing elements of coordination or unification. The process of economic integration moves through clearly definable stages of integration toward market equilibrium, i.e. uniform prices and free factor mobility. Total economic integration presupposes the unification of monetary, fiscal, social, and countercyclical policies and requires the setting up of a supra-national authority whose decisions are binding for the member states. Balassa’s primary concern is with the price-cost effects of economic integration. Balassa proposes that there is no limit to the size of the market if the costs do not exceed the benefit of market-based exchanges.

The five successive stages succeed in defining a structural process of economic integration, thus adding a political variable to the economic process of integration. Economic integration theory emphasises the fusion of national markets without directly addressing issues of sovereignty. The union of national markets would end with policy integration but not necessarily with a unified institutional structure. Economic theory of customs unions was based on international trade theory and the problems of resource allocation in a static framework.

In traditional trade theory it is customarily assumed that trade takes place between countries which have no spatial dimensions. Correspondingly, locational problems have also been neglected in the theory of customs unions.

Economic integration is a dynamic process which relies on economic growth to proceed. While maintaining a focus on the economics of market size, economies of scale, competition, and Multiplan economies, economic integration theory proposes
conceptualising the effects of the size of the market transcending national borders. Economic integration would remedy distortions in the location of productive activity caused by the decomposition of an economic area into national units. Larger-scale economies in a wider market would also lessen the uncertainty in the intra-regional trade transactions and induce a faster rate of technological change. Economic integration is sustained by a process of deepening interdependence between firms (i.e., consolidation of firms by mergers, acquisitions and joint ventures); by the increasing number of these relationships, as well as the continuity and growth over time of existing interdependent relationships.

Where traditional economic theory ignored the locational aspects and concentrated on the domestic-international dichotomy, economic integration theory recognised the effect industry location had on integration processes. The location aspects of economic integration theory distinguish between the size and scope of markets in different economic sectors. More easily transportable goods and services can be traded across longer distances while less easily transportable goods and services are usually traded within a more limited geographic range. Economic integration weakens the tendency toward market agglomeration along national lines but, at the same time, intensifies agglomeration tendencies toward regional markets. Private enterprise is an example of this decentralisation process. An increase in the size of the sector-specific markets therefore is likely to create "growing points" that will permit the introduction of advanced technology in the supplier and buyer industries. Market location and investment transactions help to define the process of

political and economic integration. Through its effect on the homogeneity of tastes, on factor movements, etc., social integration has an important bearing on integration by expanding markets. The integration of adjacent countries amounts to the removal of artificial barriers that obstruct continuous economic activity through national frontiers, and the ensuing relocation of production. The assumption is that a region grows or decays as an entity rather than is effected by arbitrary changes in income haphazardly as occurs between states.

Critical overview
Integration is an on-going process less subject to the sensitivity-vulnerability of interdependence paradigm. Interdependence emerges in a secure international system as a differentiated process of individual relationships and the transactions between states. Integration is therefore, to some extent, a formal recognition of accumulated interdependent relationships. In political terms, integration is the more comprehensive and more enduring of the two. Integration is defined in economics, however, in much the same way as interdependence is defined in political science; the interconnectedness of interdependent relationships. A fully integrated economic area is one in which prices of all similar factors of production and goods and services within the area are equal. Hence, integration, i.e., the creation of one market is synonymous with perfect or complete interdependence.

The flow between interdependent relationships and integrative processes continues indefinitely in the international system. Integration and interdependence theories offer complementary perspectives to present-day inter-state relations as they did in the 1970s. Integration in regional contexts and levels of transactions present
new issues for integration theorists. Integration as a process of peaceful organization of interstate relationships is a difficult process to analyse both theoretically and empirically. It can be argued that integration is an on-going process and the formal recognition of integration processes does not necessarily occur. Institutionalist approaches to studying peace are various and by no means an orderly progression of prescribed steps toward the federalist end of a supra-national state. The combined effect of economic activity and political institutions are the foundation of both interdependent relationships and integrative processes. Rising interdependence, as a function of economic growth establishes formative structures and processes, i.e., the interests of economic actors. Integration builds on a growing number of issues and stakeholders.

The pattern of institutional development, the overriding concern of political theorists, is a stumbling block for integration theory. In practical and theoretical terms, integration is an on-going process, subject to intervening political and economic variables. While functionalist theory cannot describe a process, it can provide a truism for the basis for cooperation that the provision of welfare needs is a sufficient basis for international security at some stage of the integration process. It is then to this theoretical base, built before the neo-functionalists branched off from the functionalist school that integration theory may return. The neo-functionalist integration theory and interdependence are American theoretical constructs arising from its national development experience. The discussion of integration theory has been modified, reflecting the increasing emphasis on domestic institutions, as a result of the internationalization of the state and constructivism. Interdependence, on the other
hand, is often discussed in the context globalisation of market processes. For economists, confident in the continued smooth operation of market processes, regional markets are an almost foregone conclusion. The more reflective political scientist wrestles with implications of these market processes on political systems and security, both domestic and international. A gap between the economist’s emphasis market size and the political scientists concern with military security persists in study of the economic aspects of security. The gap is likely to grow with the emergence of regional markets, and points to the strengthening of interdependence-led processes of integration.

An interdependence-to-integration causality is in direct contrast to the integration process in post-war Western Europe, where integration began as a political process founded upon formal inter-governmental cooperation and the establishment of institutional and regulatory frameworks, preceded economic interdependence. Integration builds on a growing number of issues and stakeholders. Integration is the expansion and stabilisation of interdependent relationships, of which a key indicator is the expansion of stakeholder interests and increasing investment transactions. This type of integration may be described as ‘vested interdependence’ which adds a continuity feature not present in interdependent relationships. Where the number of interdependent relations has reached a critical mass, stakeholder concerns are addressed in policy decisions. Rising interdependence also establishes non-state organisational structures and processes across national borders. As the network of relationships expands it provides the incentive for policy cooperation, followed by the initiation of some type of formal integration process often between countries at
different levels of economic development. Hence, integration is as much a process of constructing a network of relationships as it is one of establishing formal institutions.

The most comprehensive integration occurs among countries with strong security ties. Countries which share borders in particular have a strong incentive to maintain stable relationships with their neighbors. It is here where economic and political integration processes coincide. Global integration is only loosely tied to a discussion of security because of the contradiction between global and security in statist terms. In functional and economic welfare terms, however, the distinction between global and security is not so clear. The extent to which they do depends on the geographical scope of the economic sector concerned, as well as the state’s foreign policy. Economic integration, often described as a “market-led” process, is founded on a stable international system and proceeds by a multiplication of interdependent relationships in often geographically discontinuous economic sectors in global markets. The extension of economic integration to a formal political process is due to the security concerns of participating states. The extent of the state’s military security relationships is reflected in the geographic scope of its economic sectors. And, the security provided by integration continues to have an economic basis.

Economic incentives for regional integration may include the need for technology intensive industries such as aeronautics or electronics, or the desire to develop domestic corporations to a level where they may be competitive with large multinational firms from other countries. Functionalist theory, on the other hand, emphasises that material welfare be provided by economic growth, i.e.,

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interdependence and market integration. The focus of integration at least initially, and even between countries with wide gaps in structural power and levels of GDP, is on the functionalist aspects of integration. It is imperative to critically assess the political naiveness of the functionalist approaches to peace which nurtures the assumption that integrated relationship may become so binding that welfare issues may never arise in a region-wide framework. This type of integration differs from integration among industrialised countries because it is potentially unidirectional in most, if not all, aspects of the process. A 'structure of interdependence' which outlines specific economic interests promoting integration is problematical. The integration of unequal powers, however, is possible. And, mutual dependence and the structural aspects of policy-sensitivity and policy framework-vulnerability of interdependence may include integrated relationships which may be unstable and asymmetrically interdependent.

Integration is a process of inter-state cooperation to maintain systemic peace which emerges from a general optimism about the economic benefits to be derived under the international system no matter how fraught it is with competing interests or relative structural weaknesses. Economic integration, often described as a "market-led" process, is founded on a stable international system and proceeds by a multiplication of interdependent relationships in economic sectors which transcend national and even regional borders. Markets are integrated by repeated transactions. Transaction-led integration is the product of the multiplication of international relationships, a function of the process of economic growth and expanding international relationships. Through the process of economic growth and the outward expansion of the production possibilities frontier, international transactions grow in
proportion to the output of the domestic economy. Hence, individual countries become increasingly dependent on external markets and transnational organisations. Over time, the effect of the process of economic growth and development makes the question of market interdependence, economic integration and ever more salient. A key consideration is the integrative effect of organisational networks, particularly the consolidation of firms. Transactions are fundamental to networks among transnational organizations and economic processes, and as we have seen before, in generating a political community. In contrast, where transactions between economic and political actors are minimal, autarky and isolation prevail.

The causality between interdependence and integration is mutual in the process of economic growth and development. A growing number of interdependent relationships over time lead the way toward economic integration. As the network of cooperative relationships increases, providing the incentive for policy cooperation which is then followed by the initiation of a formal integration process between geographically proximate states or regions. The key distinguishing feature of investment relationships is that integration is a process, which grows out of an increasing number of interdependent relationships between countries. Policy integration is also promoted by interdependent, time-based investment relationships. This is particularly true of countries undergoing economic development and growing international relationships.

Integration is a process on which all parties are in agreement. The implication is that integration, insofar as it is a peaceful process, occurs among countries of roughly equivalent economic and political size, or with the assurance that the process
equitably serves both parties in areas of inequality. Considering regional integration outside the context of the industrialised countries of Western Europe presents a whole new menu of issues. In North America, Central America, South America, East Asia — North and South, South Asia, Central Asia, Central Europe and the former Soviet states at various times have found regional integration to be a mechanism to address a set of common problems, such as maintaining international security and domestic stability, and a step toward cementing transnational economic relationships particularly through investment.

The preeminence of political factors over economic factors, or vice versa, affects how integrative processes emerge. Integrated relationships need not be institutionalised. But institutionalisation may occur *ex post* to the development of an integrated relationship. In any case, the causal relationship between interdependence and integration is reversed in an integration paradigm among states at different levels of development. While the more powerful state in the integration process may have no pre-determined plans to integrate the less powerful state in its entirety, the compromise of both domestic and foreign policy decision-making of the smaller state and the adjustment process that state faces points to a different set of uncertainties.

29 The implication is that an integration process, once set in motion, is irreversible and there is no guarantee that the end result will not be the incorporation, whether officially or de facto, of all or part of the less-developed country into the more powerful state. If the integrated relationship is not recognized by a broad-based political consensus as mutually beneficial and instead is disproportionately bilateral,

the integration process will be subject to the same fits and starts as characterises the interdependence paradigm.

What implications do the newly emerging issue-areas pose for integration theory? First and most importantly, one must recognise that an integration process has no uniform definition, nor a prescribed outcome, not even the avoidance of violent conflict. The concept of integration may provide a theoretical framework, but the organisational characteristics of the process vary widely. An understanding of the complexity of international relations and, the diffusion of power is essential to understanding if integrative processes promote international cooperation and security. The theoretical survey emphasises that integration is not limited to one interpretation or a specific region. These points to a multiplicity of sectors and levels of analysis in the study of integration and interdependent processes. What is of interest is not only to compare the organisational parameters of integration and interdependence under varying circumstances, but also, within a single, loosely defined framework, to describe integrated relationships to reduce risk. The security aspects of integration that have to do with binding as well as on-going interdependent relationships are an important factor to consider given the changing issue parameters of regionalism.³⁰

Debates

While multilateral trade negotiations inch forward, agreements between groups of nations have achieved ambitious trade liberalisation on a regional level. Free trade blocs formed by agreements such as the North American Free Trade Agreement (NAFTA) and customs unions such as the European Union (EU) have allowed

countries to lower trade barriers among neighbors and political allies while still retaining some control to protect domestic markets. Recently, the number of regional trade agreements (RTAs) has surged. RTAs also liberalise trade outside of traditional regional boundaries such as preferential trade agreements between the EU and Latin American nations, and negotiations between the US and the Association of South East Asian Nations. The boom in RTAs and their increasingly expansive scope spark new debate on the effect of regionalism on multilateral trade negotiations. Furthermore, the question arises as to what role the WTO should play in moderating RTAs.

**The WTO as Moderator of RTAs**

As a major component of global trade, RTAs fall under the WTO's jurisdiction. In general, the WTO mandates that each member accord Most Favored Nation (MFN) status to all other members. RTA's appear to be at odds with MFN status by allowing members to extend different terms of trade to nations not participating in the agreement. However, the WTO allows regional trade initiatives as a regulated exception. It stipulates that an RTA must comply with certain requirements outlined in the GATT Article XXIV.  

There are two main conditions: first, the agreement must lower trade barriers within the regional group; second, the agreement cannot raise trade barriers for non-participating members. To handle the examination of each RTA, the WTO established a Committee on Regional Trade Agreements. In examining an agreement, the Committee tries to reconcile the rules of the specific RTA with those governing multilateral trade agreements. The process becomes difficult in areas where WTO rules are vague and inconsistent to begin with, particularly those regarding

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dispute settlement and retaliation measures. Therefore, the WTO has placed great emphasis on the need to tighten up its own policies in the face of ever-increasing RTAs. Yet, how the WTO moderates RTAs overlooks a greater debate on how RTAs effect multilateral trade negotiations and if they are in accord with WTO objectives.

The Great Debate: Do PTAs help or hinder?
The debate focuses on the effect that RTAs have on multilateral trade negotiations and whether or not the WTO should encourage them. The side in favor of RTAs sees them as stepping blocks to full global free trade. Regional initiatives allow countries to gradually liberalise by slowly increasing the level of competition and allowing domestic industries time to adjust. In addition, RTAs can be valuable arenas for tackling volatile trade issues such as agricultural subsidies and trade in services. Political pressures and regional diplomacy can resolve issues that cause deadlock in multilateral negotiations. Proponents of RTAs describe them as circles of free trade that expand until they finally converge.

Opponents of RTAs describe them as a complex web of competing trade interests that hinder any multilateral agreement. Especially as RTAs create preference systems that transcend regional boundaries, political and economic tensions will lead to hostility and increased retaliation. Opponents fear that anti-dumping charges will increase and dispute settlement will become more confusing as the RTA tangle grows.\(^3\) Some disagree with RTAs because they assert that regional preferences and rules of origin distort production by making location of production or source of raw materials a driving incentive. Others fear that RTAs yield incomplete liberalisation.

These opponents worry that some countries that benefit from regional trade agreements will be reluctant to expose themselves to the potentially grave risks of opening their markets completely if they expect relatively insignificant returns. Lastly, some argue that RTAs complicate WTO efforts to unify dispute settlement procedures, thus hampering global trade talks.

Recent RTAs

Most of the recent RTA activity has been in the Americas and in Asia. Mexico has recently concluded seven RTAs, four of which are bilateral agreements with other Latin American countries. It is also in the process of negotiating bilateral agreements with Japan and Singapore. The US is involved in over eight RTA negotiations, mostly with Latin American and Asian nations. The US/Central American RTAs will hopefully springboard negotiations for a Free Trade Agreement of the Americas (FTAA). Additionally, the US has extended invitations to all countries in the Association of South East Asian Nations (ASEAN) to form bilateral agreements, using the US/Singapore RTA as a model. ASEAN's larger neighbors have also taken an interest in negotiating trade agreements: Singapore has completed an RTA with Japan and is currently working on one with China.

Other RTA activity includes EU agreements with South Africa, Croatia, and Macedonia and proposed EU agreements with Chile, the Gulf Cooperative Council, Mediterranean countries, and the African Caribbean Pacific (ACP) countries. The US has also initiated trade talks with the South Africa Customs Union, Australia, and


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Morocco. Australia has also taken the initiative for a number of RTAs with ASEAN countries like Singapore, and is currently negotiating with the US.

One explanation for the ambitious RTA policy of the US is Trade Promotion Authority (TPA) that Congress passed in August 2002. TPA, previously known as fast track, grants the President the authority to directly negotiate trade agreements. Many of the critics of TPA represent sectors of the economy that are traditionally reluctant to remove trade barriers. Those sectors are indicative of the issues that continue to stymie progress in regional and multilateral trade agreements. Agriculture, steel, automobile, and textile sectors pose obstacles in almost all of the RTA negotiations underway.

Aside from those politically sensitive sectors, other issues such as investment capital controls, trade in services, and dispute settlement can slow RTA negotiations. With some countries simultaneously negotiating over three agreements and participating in the Doha rounds, they have difficulty standardizing agreements and maintaining continuity with the multilateral talks. Another concern is that the volume of RTA activity has stretched negotiation capacities to their limit and in the case of developing countries, beyond their limit. All of these factors affect both the success of RTAs and their impact on the WTO's main focus, multilateral trade liberalisation.

**Regionalism vs. Multilateralism**

The literature on "regionalism vs. multilateralism" is burgeoning as economists and a few political scientists grapple with the question of whether regional integration arrangements (RIAs) are good or bad for the multilateral system as a whole. Are RIAs

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35 US Congressional Records, United States.2002

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“building blocks or stumbling blocks,” in Bhagwati’s (1991) memorable phrase, or stepping stones towards multilateralism? As we worry about the ability of the WTO to maintain the GATT’s unsteady yet distinct momentum towards liberalism, and as we contemplate the emergence of world-scale RIAs—the EU, NAFTA, FTAA, APEC and, possibly, TAFTA—this question has never been more pressing.

“Regionalism vs. multilateralism” switches the focus of research from the immediate consequences of regionalism for the economic welfare of the integrating partners to the question of whether it sets up forces which encourage or discourage evolution towards globally freer trade. The answer is “we don’t know yet.” One can build models that suggest either conclusion but to date these are sufficiently abstract that they should be viewed as parables rather than sources of testable predictions. Moreover, even if we had testable predictions we have very little evidence.36

Arguably the European Union is the only RIA that is both big enough to affect the multilateral system and long-enough lived to have currently observable consequences. The EU allows one convincingly to reject the hypothesis that one act of regionalism necessarily leads to the collapse of the multilateral system. But it is difficult to go further: the antimonde to EU creation is unknown and one does not know to what extent the EU is special. Thus any discussion of the evidence is necessarily judgmental. The majority view is that the advent of the EU aided multilateralism.37


Regional Integration Agreements: a force for convergence or divergence?

The way in which the benefits – and costs – of a free trade area are divided between member countries depend on the comparative advantage of member countries, relative to each other and relative to the rest of the world. The free trade agreements between low income countries tend to lead to divergence of member country incomes, while agreements between high income countries will cause convergence. These comparative advantage induced changes may be amplified by agglomeration effects. Results suggest that developing countries are likely to be better served by 'North South' than by 'South-South' free trade agreements.38

How does the formation of a free trade area or customs union affect the distribution of activity within the area? Are the gains (or losses) divided between members, or do some gain while others lose? Do the real incomes of member countries tend to converge or diverge? The standard theory of economic integration tells us that the effects of membership are ambiguous, but gives little guidance on the answers to these questions.39

In this section we use two strands of research to address these questions. The first involves identifying underlying characteristics of economies that make them more or less prone to trade creation or trade diversion. In particular, we look at the comparative advantage of member countries, relative to each other and relative to the rest of the world, and show how this provides a basis for predicting who gains and who loses. Typically the country in the free trade area (FTA) that has comparative


39 Ibid, 23
advantage most different from the world average is most at risk from trade diversion. Thus, if a group of low income countries form an FTA, there will be a tendency for the lowest income members to suffer real income loss due to trade diversion. In contrast, if an FTA contains a high income country (relative to other members and to the world average) then lower income members are likely to converge with the high income partner.\textsuperscript{40}

The second strand of research analyses the importance of agglomeration forces, which tend to lead to the spatial clustering of activities. We argue that the tendency for these forces to lead to large concentrations of economic activity will be more pronounced in FTAs amongst low income countries than for those containing high income countries. This will be a further force for divergence of income levels in developing country FTAs.\textsuperscript{41}

Taking these arguments together, the main conclusions are that there are economic reasons for thinking that an FTA between developing countries might lead to divergence of their income levels, with the richer countries benefiting at the expense of the poorer. However, FTAs that contain high income members are more likely to lead to convergence rather than divergence of income levels. There is therefore a case for developing countries to forge trade links with high income countries.

The analytical arguments about the effects of FTAs are consistent with at least some experiences of convergence and divergence within FTAs. The experience of the


European Union is one of considerable convergence of per capita income levels of member countries. The historical record from 1947 (when the BeNeLux Customs Union was created), through 1957 (creation of the EEC), 1968 (when internal tariffs were finally eliminated) and to the early 1980s, shows that per capita income differences narrowed more or less steadily, falling by about two thirds over the period, due mainly to more rapid growth of the lower income countries.\footnote{Dinan, D. 'The European Community, 1978—93', Annals of American Academy of Political and Social Science, vol. 531, (1994). pp. 10-24.} The most interesting features of the more recent experience are the strong performance of Ireland, Spain and Portugal, which have made substantial progress in closing the gap with richer members of the EU. Whereas in the mid 1980s these countries’ per capita incomes were, respectively, 61%, 49% and 27% of the income of the large EU countries, by the late 1990s the numbers had risen to 91%, 67% and 38%.\footnote{Jonung, Lars, "EMU and the Euro: The First Ten Years," European Commission, Directorate-General for Economic and Financial Affairs, Economic Paper, No. 165, February 2002.}

The experience of a number of developing country FTAs paints a very different picture, and suggests some instances at least in which integration has promoted divergence. Perhaps the best documented example of this is the concentration of manufacturing in the old East African Common Market. Uganda and Tanzania contended that all the gains of East African Common Market were going to Kenya, which in the 1960s steadily enhanced its position as the industrial center of the Common Market, producing more than 70% of the manufactures and exporting a growing percentage of them to its two relatively less developed partners.\footnote{Mattli, Walter, The Logic of Regional Integration: Europe and Beyond. Cambridge University Press, Cambridge 1999. p. 286} The Common Market collapsed in 1977 as it failed to satisfy the poorer members that they
were getting a fair share of the gains. More recent examples include the concentration of industry, commerce and services in and around Guatemala City and San Salvador in the Central American Common Market, and Abidjan and Dakar in the Economic Community of West Africa. Guatemala and El Salvador now account for over 80% of manufacturing value added in the Central American Common Market, up from 68% in 1980. And in the Economic Community of West Africa the combined share of Cote d'Ivoire and Senegal in manufacturing value added has risen from 55% in 1972 to 71% in 1997.

The analysis contained in this section has not covered all the forces that might drive convergence or divergence of income levels between member countries of an FTA, and in ‘north-south’ FTAs in particular additional forces for convergence are likely to operate. For example, a country may be able to use the agreement as a commitment mechanism to lock in economic reforms. This seems to have happened in Mexico with NAFTA, and in the agreements between the European Union and East European economies. An FTA may also promote technology transfer from the high income country to lower income members. Although the mechanisms of technology transfer are not fully understood an important body of work argues that it is promoted by trade flows. Thus an FTA might promote technology transfer via its effect on trade. Similarly, FTAs typically promote foreign direct investment, another likely source of technology transfer. These considerations probably reinforce the argument that a ‘North-South’ FTA may promote convergence of income levels.45

What is shown in this section is that the distribution of the benefits of an FTA can be linked directly to the comparative advantage of member countries – comparative advantage relative to each other and to the rest of the world. This leads to the strong result that FTAs between low income countries will tend to cause divergence of their income levels, whereas FTAs between high income levels will lead to convergence. We have argued that aggregation forces might amplify divergence forces in FTAs between low income countries. The analysis suggests that developing countries are likely to gain more from FTAs with high income countries, where there are better prospects for convergence with the other – high income – members.