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**Wirtschaftswissenschaftliche Fakultät
der Eberhard-Karls-Universität Tübingen**

**Regionalisation in a Global Economy
Some Lessons from the European Experiences**

Heinz Gert Preusse



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Some Lessons from the European Experience**

Heinz Gert Preusse

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1. Introduction

In the 1980s, the term "globalisation" has become a catchword in international economics. The 1990s, in turn, have witnessed a wave of new regional agreements. Some observers see this "new regionalisation" as a promising strategy to foster multilateral free trade while others believe that it might hinder or even reverse the emerging globalisation of world markets along the lines of GATT/WTO principles.¹ It has become a challenging question, therefore, whether the new wave of regional agreements should be opposed or promoted.

In this paper, I will discuss this question with special emphasis on the European experience. The European Union (EU)² qualifies for an interesting case study because of two reasons. First, it has been founded more than 40 years ago in 1957. Second, its ongoing process of deep integration (Lawrence, 1996) is appropriate to demonstrate quite different (positive and negative) aspects of regionalisation.

In order to analyse the European case, it is necessary to take into account the changing international economic environment, that is, globalisation. Following this line of reasoning, the paper will be organised as follows: First, I shall highlight some central features of globalisation. Second, I will analyse whether the EU can be considered a successful economic group of "open regionalisation". This analysis also tackles the question if Europe (the European Union) has become a "fortress". The widely held belief outside Europe, that

¹ There is a growing literature on this subject. See Hine (1992), Anderson/Blackhurst (1993), Bhagwati (1993), Bhalla/Bhalla (1997).

² The EU started as the "European Economic Community" (EEC) in 1957, later it became the European Community (EC) and ultimately the EU.

the European Union has indeed become an inward looking region had considerable impact on the formation of NAFTA, APEC, MERCOSUR and other new integration areas. On top of that, it will be of considerable importance in the future. Finally, I shall draw some conclusions for regional policies elsewhere.

It is important to mention that the central idea of the formation of the European Community was a political one: the integration of Germany into a scheme of close political co-operation in order to avoid further violence in Europe after World War II. Economic integration has been instrumental to this political goal and it still is today.³ Thus, the economic analysis in this paper does not cover the entire discussion of European integration.⁴

2. Globalisation

The term globalisation has been subject to different interpretations in public discussions as well as in professional contributions. In this paper, I define globalisation as a set of four general characteristics of international economic relations in the 1990s⁵:

1. High and increasing trade flows which define a high degree of openness across nations (Tables 1 and 2).

³ The Treaty of Maastricht is a visual outcome of this political aspect.

⁴ For a detailed presentation see Borchardt (1995); El-Agraa (1997).

⁵ For a more detailed discussion of globalisation see: The World Bank (1997), UNCTAD (1997).

2. High and increasing international flows of portfolio capital. International transactions of bonds and shares increased from 4.2% (1975) to 135.5% (1995) of GDP in the USA and from 5.1% to 168.3% in Germany. Data for other major European countries show a similar increase (Beyfuss et al., 1997, p. 48). While these gross capital flows largely overestimate movements of real capital across borders they clearly indicate the tremendous potential impact on stabilisation policies on the national level (Siebert, 1997, pp. 3).
3. A high and increasing level of real capital flows which stimulate international production. Thereby, specialisation according to comparative advantage increases as well as the penetration of foreign markets world-wide (Table 3 and 4).
4. High and increasing flows of knowledge and technology. Payments for fees and royalties, e. g., rose from 12 to 48 billion US \$ between 1983 - 1995. Most of these flows take place within Multinational Corporations (MNCs) and between only a few highly industrialised countries (see The World Bank, 1997, pp. 37; UNCTAD, 1997).

The combined effect of these developments leads towards an international economic system that is characterised

- by quickly changing comparative advantages due to new international actors such as Japan (since the 60s), the so-called "newly industrialising countries" since the 70s and an increased number of newly emerging growth economies in Asia since the 1980s and (more recently) in Latin America. These new global players exploit comparative advantage in labour-intensive industries, invest heavily in both physical and human capital and adapt to new technologies. As a consequence, they quickly up-

grade industrial production and exports, thus competing successfully in an increasing number of industries world-wide.

- by the implementation of new basic technologies (information and communication, computer) which cut prices for transportation and the global exchange of information. Seafreight unit costs in real terms, e. g., dropped about 70% between 1980 - 1996, and the decline in airfreight rates was at least as high (see UNCTAD, 1997);
- by an extensive exploitation of economies of scale through intra-industry trade between high income countries with strongly differentiated demand schemes,
- by the growing importance of knowledge as an asset that generates competitive strength, especially in highly industrialised countries.

Globalisation offers gains from trade and more efficient international allocation of resources and know-how for those who are ready to respond quickly to the changing economic environment. Those, in turn, who are unable or unwilling to adapt will be punished by globalisation, and are likely to suffer from a relative (if not absolute) decline of income and wealth (see Nunnenkamp, 1996; UNIDO, 1997, pp. 2). This inherent tension between the economic opportunities created by increasing international interrelatedness and the threat of economic decline for those falling behind in international competition is at the core of the discussions of globalisation in Europe (and elsewhere).

3. The European Community and the Global Market

The EU is not just a customs union, but developed into a regional group that goes far beyond specific trade arrangements (Lorenz, 1992). Free flows of capital and labour as well

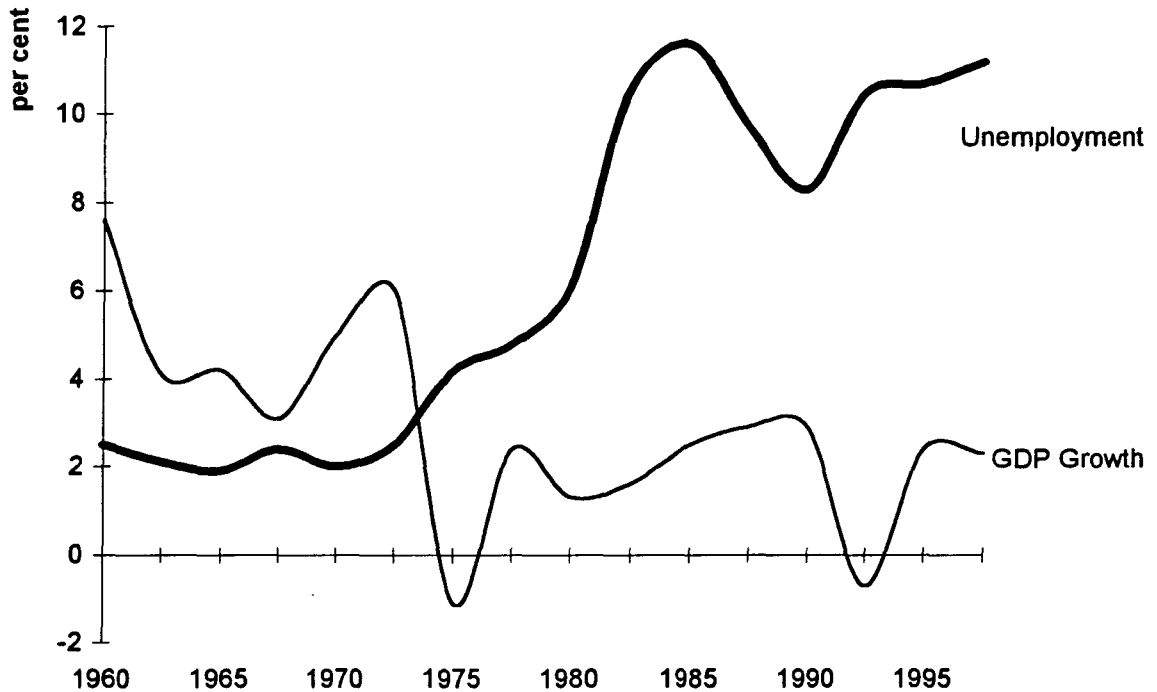
as different elements of coordinated economic policies have been established among its members. Most notably, the implementation of a single European Currency in 1999 will lead to a single monetary and exchange rate policy and close coordination of fiscal policies. This type of "deep integration" is expected to offer especially favourable conditions for growth. If this expectation will turn into reality, the EU may become a driving force towards multilateral free trade for three reasons: First, specialisation will intensify trade on an intra- *and* an inter-regional level and stimulate dynamic trade creation with non-member states. Second, a prospering integration area is also likely to attract new members, a process that eventually ends up in multilateral free trade⁶. Last but not least, Europe as a prospering common market may also be better prepared to cope with the challenge of globalisation.

A look on past growth performance of the European Community casts doubt on this positive view of European integration - at least as far as the 1980s and 90s are concerned. In fact, growth rates have been high for the original EC of 6 during the 1960s and 70s but diminished thereafter. Unemployment rates grew correspondingly with each successive cycle or external shock (Figure 1). It has become clear since the early 1980s that these developments have, to a large extent, to be attributed to a more and more inflexible regulatory system and the increasing financial burden of the growing welfare state (Lindbeck, 1981; Olson, 1982). At that time, European integration, too, suffered from a (near) standstill.

⁶ This hypothesis is implied in the GATT/WTO Article 24 on trade unions. However, it is criticised, on both theoretical and empirical grounds (see Bond/Syropoulos, 1996; Goto/Hamada, 1995; Winters, 1996).

Figure 1

Unemployment Rate and GDP Growth in the EU (1960 - 1970)



Source: Eurostat Review, 1970 - 79, 1976 - 85

Europäisches Jahrbuch 1996

Europäische Wirtschaft, 1980,7; 1989,42; 1997,63

The situation altered with a set of comprehensive reforms which were initiated in 1986 by the Single European Act. The Single European Act paved the way towards the Common Market and it also initiated the process of even deeper integration brought under way along with the Treaty of Maastricht (1992). According to this treaty, the Community will alter its character considerably by introducing a number of important supra-national policy devices which go beyond the purely economic sphere⁷. There is hope that this new round of European integration will revive the Community, cure "Eurosclerosis" and ultimately turn the EU into a political union.

⁷ On the Agenda are, among others, a common foreign and security policy and close cooperation in the fields of justice and domestic affairs (see El-Agraa, 1997 pp 116).

In the field of economics, this optimistic view of the new drive towards European unification has found intellectual support from the new literature on endogenous growth and dynamic aspects of integration. The so-called "Cecchini report", for example, (a semi-official paper on the expected effects of the Common Market) argues that the Common Market will increase the Community's social product by 127 - 187 Billion ECU, i. e. from 4.3 - 6.4%. The implementation of growth inducing economic policies would add another 2 - 3%. In total this growth impulse would generate 1.8 - 5 Million new jobs⁸. Baldwin, who considers the (potential) dynamic effect of increasing investment estimates that Cecchini et al. still underestimate the growth effect of the Common Market by 30 to 80% (Baldwin, 1992).

These studies (among others) are based on different theoretical concepts emphasising different aspects of integration. However, three assumptions are central for the positive effects of deep integration to materialise:

1. A truly common market will provide additional gains from trade on the regional level by trade creation (in the traditional sense), economies of scale, diminishing transaction costs and increasing competitive pressure.
2. The implementation of new regional institutions will substitute for inferior national settings and add to the growth potential of the Common Market.

⁸ For a critical discussion of the Cecchini report see Melchior, 1990.

3. A modernised and growth oriented institutional framework of the EU will also guarantee an open external regime (in terms of trade and capital flows) and openness towards newcomers.

Subsequently, I will elaborate on these topics by discussing some of the institutional reforms in the Common Market and the development of external openness.

3.1 Institutional and Policy Reforms

According to proponents of economic integration, institution building and economic policy making on the regional level should improve the functioning of markets throughout the Community. The implicit assumption for this to happen is that single nation states are unable to implement substantial reforms within their own boundaries but may respond to external pressure from the Community and agree to superior rules. It is beyond the scope of this paper to analyse this hypothesis for the EU at any satisfactory level. However, some remarks may be appropriate to show that the results of European institution building to date are quite arbitrary. I will concentrate on the functioning of the Common Market and some characteristic elements of the "Treaty of Maastricht".

A. The Evolution of the Common Market

When the EC was founded in 1957, trade barriers between the member states were high and complemented by a range of NTBs such as quantitative restrictions and political and administrative discrimination. Tariffs and most of the quantitative restrictions were dis-

mantled relatively fast and became negligible by 1968⁹. Administrative discrimination was harder to come by, however, because the Community was unable to harmonise long-lived national standards, sanitary regulations etc. This "Gordian knot" of administrative protection was cut by the pathbreaking judgement of the European Court on the "Cassis de Dijon" case in 1979.

The Court became active in response to a French claim: its famous Cassis was not allowed to enter the German market because it did not meet the German criteria for "sweet liquor" (lack of alcohol). The European Court decided in favour of France and argued that within the Community any product that qualifies for anyone of the member countries must be allowed to enter freely into all other member country markets. This judgement worked according to a "snowball effect" because it was directly applicable to quite a number of similar cases (such as German beer, Italian pasta and French cheese) and thus spurred market integration considerably.

In 1986, a further and decisive step towards market integration was initiated. The Single European Act proclaimed the definite realisation of the Common Market in 1993. Meanwhile, the Common Market has, indeed, overcome almost entirely the remaining barriers to trade, investment and migration of labour. Empirical data on trade and capital flows show that economic agents have responded to the new situation rapidly and intensively. Thus, intra-regional trade flows further increased and a re-allocation of production within the area began already with the announcement of the Common Market.

⁹ The Customs Union had been scheduled for 1970 but could in fact be completed 2 years in advance on July 1st, 1968.

Intra-regional specialisation was accompanied both by further intra-industrial specialisation of production and trade among the economically advanced members and by inter-industrial specialisation between the old core members and the Mediterranean newcomers plus Ireland. Thus, both specialisation and the exploitation of economies of scale have contributed to growth in the Community, while product differentiation has increased consumers' possibilities to choose among an increasing variety of products and services. By and large, these developments support the view that the Community today has realised a truly "common market" with a high degree of market integration and competitive pressure.

B. The Treaty of Maastricht

The institutional reforms proclaimed in the Treaty of Maastricht will have further impact on economic policies of and within the EU¹⁰. In fact, the principles of the Economic Union reiterate the goals of a common market based on a free market system, but go beyond these general principles and also emphasise closely co-ordinated macroeconomic policies, a common industrial and technology policy as well as a social union.

The most striking innovation in the sphere of macroeconomics is the foundation of the European Currency Union (ECU) which will unify monetary policies in the hand of the European Central Bank (ECB). In Europe, there are controverse discussions about the currency union at present. Officials of the European Commission and the national governments, most parts of the industry, the banking sector and also some well-known economists (de Grauwe, 1997) consider the gains of the currency union (e. g. decreasing transaction costs and increasing competitive pressure) big enough to outweigh any inher-

¹⁰ This term EU has been chosen because the Maastricht Treaty laid ground for the implementation of new mechanisms of deeper political coordination which eventually should lead to a "political union". I will only concentrate on the economic aspects.

ent dangers for the Euro (the new European currency). Others are deeply concerned with its inherent dangers. They claim that different cultures of economic stability among the members may soon end up in political dissent and overburden the disciplining power of the new ECB (especially, if disciplining of national financial policies fails)¹¹. In that case, a higher average rate of inflation of the Euro is expected even if the ECB has about the same degree of (formal) independence as the German Bundesbank has had. If the European currency union becomes an inflationary community, however, the currency union might end up as an instrument of disintegration rather than integration.

While the discussion of the Euro is predominantly concerning macroeconomic effects, it is, in essence, a dispute on the Community's future concept of the market economy. Critics of the Euro, for example, are especially concerned with the latent dangers of the enlarged scope for selective industrial, regional and social policies agreed upon in the Treaty of Maastricht.¹² They are not only sceptical about the growth promoting power of a technology policy trying to "pick up the winners" but are also deeply concerned that these policies may be abused in order to delay adjustment.¹³ This danger is considered espe-

¹¹ Before Maastricht most experts favoured the so-called "crowning theory". It claims that there has to be a political union first in order to introduce a common financial policy. Only then, the currency union should be implemented. The crowning theory was overthrown by the Treaty of Maastricht on the grounds of high politics. It is, nevertheless, still quite popular among German academics and central bankers.

¹² There has always been disagreement on industrial policy between France and the Mediterranean States on one hand and Germany and the Benelux States on the other. While France and the Mediterranean States favour a relatively strong and selective industrial policy, the more liberal position of Germany and the Benelux States puts emphasis on a non interventionist framework. The dissent on the role of industrial policy is still visible in the interpretation of the respective paragraphs of the Treaty of Maastricht.

¹³ Industrial and technology policy have since long been part of the economic philosophy of the commission of the European Community. It proclaimed that technology and industrial structures should be promoted actively and selectively in order to keep up with or even overcome the competitive strength of the USA and Japan (Starbatty/Vetterlein, 1994). Essentially, the Commission (and some of the national governments) suggest that technological leadership under the new global conditions can only be gained if industrial and competition policy are geared to acknowledge the "special conditions" in innovative "high tech" markets. From this point of view, it is inevitable to subsidise innovation markets and protect rather than observe big companies. This view has never been accepted officially as part of the Union's economic strategy until the end of the 1980s. However, it penetrated EC policies slowly but constantly, and became part of the official doctrine with the introduction of articles 130 pp of the Treaty of Maastricht.

cially acute in view of increasing competitive pressure exercised by the Common Market and the single European currency. As a result of increased interventionism, the much proclaimed adjustment deficits may become even more binding and the growth effect of deeper integration will not be realised. In that case, unemployment rates will further increase (especially in the peripheric regions), compensatory monetary and regional policies will be called for and higher inflation rates are inevitable.

Under these conditions the external environment turns into an important factor in the discussion of the Common Market because of its disciplining power. Globalisation is indeed a disciplining mechanism for inflationary policies of nation states since portfolio capital responds sensitively to changes in interest rate differentials and expectations. One of the last experiences with expansionary monetary and fiscal policies in Europe has been Mitterrand's Keynesian approach to foster employment and growth in 1983. This policy had to be quickly reversed as inflation increased, the current account deteriorated and the French Franc devalued substantially within the European Currency System. Since then, European macroeconomic policies have become, in fact, more sensitive to inflationary effects of expansionary macroeconomic policies. So far, even fundamental political changes like those in Great Britain and France this year have not changed this view substantially¹⁴.

The disciplining power of global markets is apparent in international macroeconomics. It is not restricted to this area, however, since, in global markets, international investors in real capital, too, react sensitively to differences in supply conditions between countries or re-

¹⁴ It should be mentioned, however, that there are still different views on the interpretation of independence of the European Central Bank. It is France, in particular, who pushes politically for a "European Council on Growth and Employment Policies". This Council should become a counter part of the European Central Bank and thus influence its monetary policy.

gions. This can be seen most clearly by looking at the distribution of FDI *within* the European Union. While Germany, for example, is suffering a severe decrease in FDI inflows since the end of the 1980s due to relatively poor investment conditions (high cost of labour, a rigid regulatory system and exceptionally high marginal tax rates), Ireland and Great Britain in the north and Portugal and Spain in the south are presently estimated as relatively attractive locations for investment (Table 4).

Concerning *EU external capital flows* the situation is more complex, because supply and demand conditions will be the dominant guide for FDI flows only if openness is guaranteed. In that case, foreign investors may vote against a misguided policy of selective interventionism by slowing down FDI inflows.

However, if openness is not guaranteed, this disciplinary effect of globalisation will be weakened. In that case protectionism against third countries introduces a barrier against the free flow of goods and factors and, to a certain extent, immunises the integration area against the world market. Also the motives for inter-regional capital flows are changing. FDI, for example, may no longer be undertaken in order to exploit local competitive advantage but to secure presence in the protected market. Consequently, the global market cannot serve as a reliable insurance against a mistaken concept of common market formation if external openness diminishes. Thus, increasing external protection enlarges the hidden danger of the interventionist economic policies. Eventually, the expected growth effects of deep integration might not materialise. Much of the positive outcome of economic integration, therefore, depends on openness vis-à-vis the rest of the world. I will turn to this point in the next section.

3.2 Fortress Europe?

Integration theory claims that *two kinds of openness* must be guaranteed for regionalisation to exercise its growth promoting power in the long run. First, openness towards newcomers is indispensable in order to broaden the regional approach and ultimately end up in multilateral free trade. Second, an integration area has to keep external economic relations open in order to minimise discrimination of non-members and keep internal competitive forces alive.

3.2.1 The European Union - an open club?

Openness towards newcomers has been widely realised since the foundation of the EC of six in 1957. In 1973, Denmark, Great Britain and Ireland joined the Community, in 1981 Greece entered, thus starting the so-called "Southern enlargement" (Süderweiterung) which has been continued with the entrance of Spain and Portugal in 1986. In 1995, the Community of 12 was joined by three new member states: Sweden, Finland and Austria. The next round of accession talks is to start in 1998 with Cyprus. Meanwhile, ten Middle and Eastern European countries applied to enter admission talks. Two of them are considered to be candidates in the near future, three are medium term candidates (Figure 2)¹⁵. Apart from the extension of the Community within Europe there are talks on broader free trade arrangements with the USA and NAFTA, considering the Transatlantic Free Trade Agreement (TAFTA) (see Piazzolo, 1996) and with the MERCOSUR. According to this evidence the EU qualifies as an open club.

¹⁵ The criteria for accession are a stable democratic system and a sufficiently "functioning market economy" which enables the new members to face the competitive pressure of the Common Market. Hungary and Poland are expected to meet these criteria in the near future. The Czech Republic, Slovenia and Estonia are likely to follow.

There are reasons to consider, though, that an inherent contradiction between the goals of deep integration and the enlargement is emerging. This tension had already become visible with the entrance of the Southern European countries which differ fundamentally in terms of income, economic structure and political culture (i. e. the interpretation of macro

Figure 2

Members and possible Applicants of the European Union

	Members					Applicants		
EUROPE	6	9	10	12	15	16	21	26
	1957	1973	1981	1986	1995			
	France Germany Italy Belgium Netherlands Luxembourg	Denmark Great Britain Ireland			Austria Sweden Finland			
		Greece						
			Spain Portugal					
						Cyprus	Poland Czech Rep. Hungary Slovenia Estonia	Bulgaria Romania Latvia Slovenia Lithuania

Source: Institut der Deutschen Wirtschaft, 40/1997

economic policy goals and the relative importance of selective interventionism). The need to incorporate these heterogeneous positions has made it more difficult to reach a common position in quite a number of economic and political fields. To resolve this problem

politicians proposed an approach which would allow for a different speed and/or scope of integration in different political and economic fields (this approach is most visible in the case of the ECU and the extensive discussion on convergence criteria). The idea of "concentric circles" holds that integration should be speeded up for those willing to accept the new rules of deep integration, while leaving the door open for those remaining behind. However, the concept of different speeds of integration is not without problems either because it might end up in a Community with different classes of integration. Economically, it may create an even more complex and inconsistent system of incentives and disincentives. In this case, transaction costs would again rise and counteract the initial integration process¹⁶.

All these problems are widely recognised in Europe. There have been several efforts on sectoral as well as on the community level to establish in time a new political framework for policies in an enlarged community. The summit conference in Amsterdam (June 16th and 17th, 1997) concentrated on these topics without substantial progress. While the "Treaty of Amsterdam" identifies new fields where a "qualified majority" applies (employment, research, social standards) the scope for further political integration appears to be limited. The main problem is easy to single out: in order to increase the actual degree of integration it is necessary to weaken core elements of national sovereignty which are protected by national constitutional law. Of similar importance is the fact that the ongoing integration process will inevitably limit national financial autonomy. In both cases enforcement of a still deeper political integration is likely to impose high opportunity costs on the participating nations. It is not surprising that, presently, there is no clear indi-

¹⁶ Still another problem is the common agricultural policy (CAP). Until today, agricultural output is heavily subsidised. The potential new members, however, will be net receivers of subsidies under this regime and might overburden the Community's financial power. It is indispensable, therefore, to reform the CAP substantially before any enlargement can be discussed seriously.

cation whether the member states are really willing to accept a new political framework that would further cut national autonomy in favour of the supra-national power. To make things worse, the commitment to promote the process of political integration is met by growing scepticism of the general public. Many people fear that a centralised and powerful decision making process concentrated in Brussels might be detrimental to their own interests. This more general unease about the dynamics of deep political integration adds to the problems mentioned above.

To sum up, an ambivalent picture of the state of affairs of European integration after the Treaties of Maastricht and Amsterdam emerges. The Treaties have been celebrated as decisive steps towards a politically and economically unified Europe. They left it to further discussion, however, how to resolve the most difficult political obstacles on the way to this ultimate goal. There are at least three fields of such unresolved issues:

- 1) There is no clear concept how to combine the process of the enlargement of membership and that of deeper political and economic integration.
- 2) There are still fundamental differences about the concrete outline of economic policy within the concept of the market economy system that was commonly agreed upon. These differences are a permanent source of political tension¹⁷, and they will be perceived the more strongly the more centralised economic policy making will be.
- 3) There is uneasiness of (not only a few) politicians and a large part of the general public about the consequences of diminishing national autonomy due to political integration.

¹⁷ Wolter and Hasse, e. g., argue that there is a fundamental disagreement between France and Germany on the design of a common economic framework for Europe. These differences can be traced to the negotiations of the Treaty of Rome in 1957 (see Wolter/Hasse, 1997).

The Treaty of Maastricht (and the follow-up Treaty of Amsterdam) left room for the sceptics to gain ground and even to stop the process eventually. Thus, the Treaties have correctly been interpreted as defining an arbitrary situation: "It can be thought of as the penultimate step towards a Federal Europe but also as a means of checking this drive..." (El-Agraa, 1997, 118). Following this interpretation of the present state of affairs it is open to speculation how the European puzzle of enlargement plus deepening will ultimately be solved.

3.2.2 External Openness

The question of external openness of the EU (EC) has attracted considerable attention since its foundation. Until recently, most analysts concluded that the EC is an open integration area. Balassa, for example, found for 1970 that trade creation outweighed trade diversion even if the effect of the highly protected common agricultural policy is taken into consideration. However, the net gain of about 300 Million US\$ has been fairly low (Balassa, 1975). Later on, the scope of investigation has been broadened to include the hypothesis of "natural partners". These kinds of studies do not analyse protectionism directly but argue that the significant increase of regional trade flows is a consequence of the return to normalisation of economic relations among economically, geographically and culturally similar neighbouring states rather than trade diversion (Lloyd, 1992; Anderson/Norheim, 1993). The authors also point out that external trade flows still have expanded in spite of regional integration.

These studies have been criticised for a number of reasons. Bhalla and Bhalla, e. g., show that external trade flows with developing countries did not expand and conclude that

"some of this (EC, the author) trade creation has been at the expense of trade with the rest of the world". They point out that this trade diversion is, in particular, due to the impact of the CAP and the phenomenon of the so-called "new protectionism", both of them prospering during the 1980s (Bhalla/Bhalla 1997). Even EC total external protection is suspected to have risen since the 1960s because of these developments (Laird/Yeats, 1990; Hine, 1991). If this is true, during the 1980s, the balance between trade creation and trade diversion may have switched against the former (Preusse, 1994).

In order to derive a more reliable picture of the effects of EC external trade policy it is necessary to develop a measure of protection that goes beyond the concept of nominal tariffs or arbitrary comparisons of trade flows. Such a measure of openness should be based on a simultaneous calculation of effective tariff rates and tariff equivalents of NTBs (costs and subsidies). Furthermore, the region's commitment to multilateral trading rules such as the principle of non-discrimination should also be considered. Such an indicator is not available at present. However, in order to gain more insight into EU protectionism three single important features can be highlighted:

1. the development of nominal and effective tariff protection in the EU
2. the development of non-tariff barriers
3. the commitment to the principles of most favoured nation treatment.

For the matter of presentation I will first concentrate on the period up to 1990 and then consider the 1990s.

- (1) Average nominal tariffs of the EC have diminished in accordance to overall trade liberalisation after World War II. The weighted average rate of protection of industrial

products in 1988 (after the Uruguay Round of trade liberalisation had been started) amounted to only 5.6%. While nominal tariffs were low *on average* in 1988 they still amounted to considerable trade barriers in *particular sectors*, such as agriculture and food stuffs, textile and clothing, electrical machinery, motor vehicles and footwear (GATT, 1991). It is of particular concern for developing countries that relatively high tariffs on final export products combined with low tariffs on primary products (0 - 2%) generate high rates of effective protection. Hine (1991) estimated that effective tariff rates have about twice the value of nominal rates because of this tariff structure.

- (2) The use of NTBs in the EC rose substantially between 1966 to 1986. Laird/Yeats (1990) show that total trade coverage of NTBs grew more than 2.5 fold during those twenty years. They have been most distinctive in 1986 in agricultural and food production (nearly 100%), but also rose substantially in industry (from 10 to 56%). Within industry, the coverage rate was highest again in textile and clothing, automobiles, footwear, steel and electronics.

These data show that nominal and effective rates of protection and NTBs are concentrated in roughly the same sectors. In these sectors (agriculture, textiles and clothing, steel, automobiles, footwear and electronics) protective measures accumulate into substantial barriers to trade. Taking into consideration crude estimates of the tariff equivalent of NTBs¹⁸ and its strong increase in recent years leads to the conclusion that the favourable balance between trade creation and trade diversion, that has been analysed in the 1960s, has vanished during the 1980s.

¹⁸ Messerlin has estimated a tariff equivalent of the EU antidumping measures of 21%. This is about 3 - 4 times the effect of tariffs (5 - 7%) (see Messerlin, 1989).

(3) Discrimination is not only an attribute of EC trade policy among sectors. It can also be detected in the differentiated treatment of particular (groups of) countries. This kind of discrimination is implicit to the EC, of course, because of the inherent discrimination of any regional agreement (sanctioned by GATT, article 24). However, the EC has also established a sophisticated system of differentiated treatment of groups of trading partners outside the Community. This policy was originally motivated by the commitment of the former colonial powers to their old colonies (and manifested in the treaties of Yaundé and Lomé), then continued with the establishment of the "general system of preferences" and the concession of yet another preferential status to the Mediterranean states and EFTA.

The policy of differential protection against selected countries and regions has been called a "pyramid of preferences" (Gundlach, 1993, et al.), a term which emphasises the good intentions of EC policy makers. However, as well as preferences within the regional zone are discriminatory against outsiders, so are special preferences for different outsiders. The outcome of this policy of preferences is, therefore, better interpreted as a "pyramid of discriminations". This recognition is the more worrisome the more it turns out that the apparently honourous treatment of the receivers of special preferences might be a questionable advantage if exceptions and escape clauses are considered. In fact, critics point out that, by and large, the commission's treatment of its beneficiaries of specialised preferences is the more generous, the less import penetration is to be expected. But product lines are rapidly defined as "sensitive" and excluded from the preferential scheme as soon as the trading partners' ability to export rises.

Evaluating the discriminating effects of EU trade policies traced under points 1 - 3 it is to conclude that multilateral trade flows in the early 1990s accounted for less than 50% of total EU trade (German Council of Economic Advisers, 1994/95). Even if one admits that, in the absence of a reliable measure of protection, it is difficult to interpret these findings as a clear indication of an inward oriented trade regime, there is enough evidence to conclude that the degree of openness of the Community has most certainly diminished during the period under consideration.

A new line of external trade policies in the 1990s?

During the 1990s, a number of important developments have taken place in the field of international trade policy. Above all, the completion of the Uruguay Round and the foundation of the WTO have raised hopes of a revival of a liberal trading system world-wide. The Uruguay Round has indeed provided a substantial drive towards a renewed multilateral approach with an increasing number of member countries agreeing upon these rules. Notwithstanding the fact that these new institutional rules are not immune against abuse and may be put into practise only hesitantly they have undoubtedly changed the tide in global foreign trade policy.

For the EU, the signing of the WTO Treaty implies that external trade policies have to be reconsidered in all relevant areas. First, there will be another cut in tariffs which is about 37% in industrial products (weighted average). More important, tariff cuts will be most effective in the highly protected sectors (Grossmann et al., 1994, 108). The same holds true for NTBs which are defined more precisely under the new rules and now include the most dangerous source of the new protectionism, that is, voluntary export restraints. Textiles will become re-integrated into the GATT system as the Multi Fibre Arrangement (MFA) will

fade out during the next 10 to 15 years. More precisely, this means that a large number of quotas will be transformed into tariffs (tariffication) and then be cut down considerably. With the end of the MFA, EC protection will decrease considerably. Last but not least, agricultural policy has been brought under the rules of GATT¹⁹ and the new institutional bodies of GATS and TRIPS have been established, which apply the idea of a global system based on non-discrimination and openness to a wider range of economic activities.

Preliminary evidence on community data seems to indicate that there are indeed some first signs of decreasing protectionism. Most notably, a decline in the use of non-tariff barriers by the commission has been observed (Grilli, 1997). The commission has also liberalised trade with central eastern European countries. Most of these countries have acquired a preferential status which is comparable to that of the Mediterranean countries. Only the former states of the Soviet Union, the so-called "new independent states", do not participate. Last but not least, the CAP has undergone a first major reform in 1992 and there are plans to proceed in restructuring the system substantially before the next round of enlargement takes place.

These are signs of a relaxation of EU external trade policy which have also been recognised by the WTO (see WTO, 1997). They should not be overestimated, however. For one thing, the decline in the use of NTBs measured by the number of antidumping and VER cases (Grilli, 1997) may be a misleading indicator of a new liberal thinking. In the case of automobiles, for example, the number of cases has diminished simply because country-specific regulations (Italy, France, Spain)²⁰ have been substituted by a new com-

¹⁹ The GATT rules in agriculture may, from a global point of view, be insufficient to change the EU protectionism. However, they should be seen as a first important step to open this sector.

²⁰ These country-specific regulations did not make sense any more because the Common Market increased the scope for intra-regional substitution tremendously.

munity-wide programme (Preusse, 1992). This procedure may also be interpreted as a sign of increasing protectionism. Liberalisation against Central and Eastern European Countries (CEECs), too, is a weak indicator for decreasing external protection, because these countries are candidates for European membership. Trade liberalisation, in that case, is rather a precondition for integration into the region than a sign of lasting trade liberalisation against outsiders. It has, indeed, been argued that the engagement of the EU in the Eastern European transformation economies would be at the expense of the rest of the (developing) world. Thus, today, it is not evident at all if the anti-protectionist impulse which most certainly was initiated by the formation of the WTO will have a lasting effect on the Community's external trade relations.

Altogether this crude analysis of the development and present character of the openness of the EU vis-à-vis non-members does not reveal a clear picture. After an initial period of progressive internal and external reduction of tariffs and NTBs (ending in the early 1970s) the EC turned inward by counteracting the (still vital) GATT process of tariff reductions through its new and aggressive neo-protectionism. This situation became critical at the end of the 1980s and provoked the often cited accusation of a "Fortress Europe". This fear has most probably been an exaggeration even at that time but it correctly pointed out what would have become reality if the trend towards the new protectionism were not stopped. Since then, with the successful ending of the Uruguay Round of global trade talks and the foundation of the WTO the international situation has changed. Under the new system, a mandating catalogue of international actions to improve openness has been agreed upon. As far as the European Community plays by the rules, the "Fortress Europe" scenario, too, will cease to be a case of concern for the rest of the world. There are some indications at the end of the millennium that the trend of increasing international discrimination may, indeed, have been stopped. But there is still a long way back to the

open trade regime that had been established before the rise of neo-protectionism. In any case, the 1990s give rise to hope that the EC might realise the challenge of globalisation and will pay attention to the conditions of success in the new international environment.

4. What lessons can be drawn from the European experience?

The present state of integration reached by the EU is exceptionally high due to the promotion of the Common Market and the implementation of supra-national political institutions. However, the European experience is not directly comparable to other regional blocs, because economic integration in Europe is only part of a process aiming towards the formation of a political union. Ever since its foundation the liberalisation of economic transactions was used as a vehicle for this ultimate goal. One could even claim that it was the very will to promote this political goal that pushed economic integration forward. NAFTA and APEC, in particular, do not show any commitment to political unification and are unable to use it as an instrument to push the process of economic integration beyond a Free Trade Agreement (FTA) or a Customs Union (CU). These lower forms of regionalisation cannot provide the background against which extra benefits from deep integration may arise. This also renders them less attractive compared to multilateral free trade.

If the merits of political integration are also considered, any evaluation becomes highly suspect. On the one hand, it is a fact that in the centre of Europe a peaceful block has been created and historically hostile relations have been turned into friendship. On the other hand, even after the summit of Amsterdam, there is no clear evidence whether the members really will accept a further dismantling of national autonomy in favour of a centralised European solution. If there is a message from this observation to be learnt outside Europe, it is a negative one: there appears to be no chance for any of the other existing regional groups with a much lower commitment to political integration to form an area of

deeper economic *and* political integration. Bearing this in mind, a few selected aspects of European integration are to be considered.

1. The EC relatively quickly established a Customs Union (CU). This development occurred at a the time when an impressive process of multilateral trade liberalisation took place. Thus, both intra- and interregional protection decreased and trade diversion remained relatively low compared to trade creation. As the world economy was struck by severe perturbances in the 1970s, the Community could no longer defend its low level of external protection. It rather played a leading role in pushing neo-protectionism ahead (along with the USA), and tightened its Common Agricultural Policy. In the early 1980s, the enthusiasm for European integration seemed to fade out and the process of integration slowed down. This critical stage of stagnation came to an end in 1985 when the idea of European integration was revived by the announcement of the Single European Act and the proclamation of deeper political integration. Most observers admit that this second round of integration has profoundly changed the EU. So far, the promotion of deeper integration has in parts been successful (with the ultimate outcome of this process yet being open).

As far as economic regionalisation is concerned, it is of particular interest that the approach of the European Customs Union ran into severe problems during the 1970s and 1980s. It is not possible to exactly decide whether this experience is the outcome of the particular European case or rather a general weakness of regionalisation (if not backed by political integration).

2. The main reason for the concept of deep integration having become so popular in recent years are its dynamic effects on growth. Among the preconditions for such

effects to materialise are "external openness" and "institutional reform" on the Community level as well as within national boundaries. In both fields evidence concerning the implementation of reform is scarce. There appears to be a gap between the sound reform concepts agreed upon on various summits and their implementation. For once, the proclamation of external openness on one hand and the implementation of new and severe trade restrictions on the other (e. g. the VER against Japanese automobiles and the regulation of the banana market) are appropriate to demonstrate this gap. In the same way, success concerning institutional reforms appears to be ambiguous. On the national level, some positive institutional changes have taken place in the peripheric countries (like Ireland, Portugal and Spain), which have increased economic convergence (iw-trends, 1997). Those countries in the Community, however, that used to push for integration and growth (the core countries France, Germany and Italy), have to deal with severe problems of structural adjustment and political resistance to institutional reform. Due to their quantitative importance, sustained change is still blocked and the positive effects of deep integration on growth are delayed.

3. In accordance with Article 24 of the GATT, the EU did remain open to newcomers. However, it turns out to become more and more difficult to combine enlargement with deep (political) integration. This conflict will certainly not be solved in the near future.

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ANNEX

Table 1
Degree of Openness on Goods Markets in Selected Countries
(1970 - 1996. in per cent)

Country	1970	1980	1990	1995	1996
EU					
Belgium	67.90	100.84	111.33	111.19	
Germany	34.10	46.26	50.07	40.61	41.11
France	24.80	35.13	36.06	34.50	34.67
Italy	24.60	38.02	31.03	38.93	36.31
Netherlands	67.50	92.78	87.45	83.11	84.53
Portugal	38.54 ⁷²	52.93	58.89	58.28	
Sweden	39.70	50.86	47.99	61.75	60.12
Spain	6.62	24.97	28.55	35.68	37.66
UK	31.10	40.04	40.28	45.37	46.72
NAFTA					
Canada	36.20	47.91	43.32	55.74	64.10
Mexico	10.04	12.92	33.31	52.99	
USA	8.10	17.02	15.45	18.30	18.66
MERCO SUR					
Argentina	9.43	8.33	11.38	14.17	
Brazil	12.39	18.24	11.76	13.41	
Chile	15.59	37.01	50.68	45.76	44.30
Honduras	54.30	70.70	59.11	71.93	
Peru	27.86	33.69	18.44	22.63	22.64
Selected Asia					
China		13.88 ⁸²	24.21	34.14	
Japan	16.70	23.73	16.74	14.13	15.59
Malaysia	76.00	95.99	128.64	169.04	
Philippines	30.40	41.65	46.02	59.13	
Korea	30.50	61.97	51.17	55.39	
Thailand	25.80	45.75	61.15	72.25	

(Exponents refer to different years)

Source: IMF, International Financial Statistics, Yearbooks, 1994, 1997.

Calculation:

$$\begin{aligned}
 \text{Degree of Openness} &= \frac{\text{Goods (Exports + Imports)}}{\text{GDP}} \\
 &= \frac{(77\text{aa d} + 77\text{ab d})}{99\text{b}} \quad (\text{for 1970}) \\
 &= \frac{(78\text{aa d} + 78\text{ab d})}{99\text{b}} \quad (\text{for 1980 - 1996})
 \end{aligned}$$

Table 2
Degree of Openness on Service Markets in Selected Countries
(1970 -1996, in per cent)

Country	1970	1980	1990	1995	1996
EU					
Belgium	23.80	53.00	106.88	77.53	
Germany	10.50	12.66	17.42	17.24	17.47
France	9.90	17.28	21.15	28.98	27.50
Italy	9.70	10.94	13.95	19.76	19.16
Netherlands	22.20	37.50	40.30	38.84	39.08
Portugal	19.73 ⁷²	17.88	17.72	23.12	
Sweden	10.30	14.70	23.78	29.54	29.22
Spain	9.42	10.46	12.84	16.70	17.69
UK	16.70	32.44	39.28	37.17	37.44
NAFTA					
Canada	10.90	11.64	14.22	17.54	17.54
Mexico	8.75	8.02	13.43	13.83	
USA	4.20	7.34	9.10	9.98	10.22
MERCO SUR					
Argentina	3.45	4.68	9.67	7.07	
Brazil	4.36	6.96	5.69	5.27	
Chile	5.24	16.19	21.74	14.29	14.39
Honduras	12.30	17.90	20.84	22.21	
Peru	10.05	13.98	12.07	10.50	10.19
Selected Asia					
China		2.29 ⁸²	3.92	9.53	
Japan	4.80	7.02	11.92	10.29	12.92
Malaysia	17.20	26.16	34.83	41.21	
Philippines	9.30	14.89	20.48	33.38	
Korea	9.90	19.17	10.98	13.49	
Thailand	11.40	14.33	20.67	26.36	

(Exponents refer to different years)

Source: IMF, International Financial Statistics, Yearbooks 1994, 1997

Calculation:

$$\begin{aligned}
 \text{Degree of Openness} &= \frac{\text{Services (Debit + Credit)} + \text{Income (Credit + Debit)}}{\text{GDP}} \\
 &= \frac{77ahd + 77aid + 77ajd + 77akd}{99b} \quad (\text{for 1970}) \\
 &= \frac{78add + 78aed + 78agd + 78ahd}{99b} \quad (\text{for 1980 -1996})
 \end{aligned}$$

Table 3

Foreign Direct Investment outward stock, by home region and economy 1960-1996

(Millions of Dollars)

	1960	1973	1980	1990	1995	1996
World	-	-	518869	1690082	2811007	3178169
European Union	25000	71000	236579	854862	1395195	1585772
Austria	-	-	747	4656	12887	13542
Belgium and Luxembourg		2000	6037	28965	64317	73300
Denmark	-	-	2065	7342	19934	22444
Finland	-	-	743	11227	15177	18300
France	4000	9000	23604	110126	181255	206441
Germany	1000	12000	43127	151581	259746	288398
Greece	-	-	-	1	20	26
Ireland	-	-	-	2150	4038	4531
Italy	1000	3000	7319	56105	97042	118474
Netherlands	7000	16000	42116	109124	164754	184738
Portugal	-	-	116	503	2772	3542
Spain	-	1000	1226	16128	33540	38169
Sweden	-	-	5611	49491	71491	76338
United Kingdom	12000	28000	80434	230825	302847	356346
NAFTA						
USA	32000	101000	220178	435219	709200	794102
Canada	3000	8000	22572	78853	103721	111264
Mexico	-	-	136	575	2681	3234
MERCO SUR						
Argentina	-	-	70	420	586	832
Brazil	-	-	652	2397	6460	7431
Chile	-	-	42	178	2759	3715
Paraguay	-	-	30	30	30	30
Uruguay	-	-	3	9	17	17
East Asian Growth Economies						
Hong Kong	-	-	148	13424	85156	112156
Indonesia	-	-	-1	25	701	1213
Korea (South)	-	-	142	2301	10227	13757
Malaysia	-	-	414	2283	8903	10809
Singapore	-	-	5586	9675	32695	37495
Taiwan	-	-	97	12888	24200	27296
Thailand	-	-	13	398	2324	4064
China	-	-	-	2489	15802	18002
Developing Countries	-	-	11310	74109	231405	282216

Source: United Nations, World Investment Report, 1997

Table 4

Foreign Direct Investment inward stock, by host region and economy 1980 - 1996

in Millions of Dollars

	1980	1985	1990	1995	1996
World	479175	745171	1726199	2865839	3233228
European Union	184960	226613	711481	1114812	1219179
Austria	4459	6122	10765	18636	19886
Belgium and Luxembourg	7306	8840	36635	86847	100767
Denmark	4193	3613	9192	22620	23393
Finland	540	1339	5132	8465	9401
France	22617	33392	86514	147623	168432
Germany	36630	36926	111231	167137	170989
Greece	4524	8309	14016	19306	20310
Ireland	3749	4649	5634	12498	13953
Italy	8892	18976	57985	63455	74991
Netherlands	19167	25071	73337	112336	118626
Portugal	1102	1339	5132	6139	6747
Spain	5141	8939	65234	98580	104976
Sweden	3626	5071	12461	36521	42007
United Kingdom	63014	64028	218213	314650	344703
NAFTA					
USA	83046	184615	394911	560088	644717
Canada	54163	64657	113054	122469	129150
Mexico	8105	18802	32523	64002	71537
MERCO SUR					
Argentina	5344	6563	8778	24630	28915
Brazil	17480	25665	37143	98839	108339
Chile	886	2321	10067	15547	18687
Paraguay	218	298	401	1095	1321
Uruguay	700	766	980	1450	1618
East Asian Growth Economies					
Hong Kong	1729	3520	13413	21769	24269
Indonesia	10274	24971	38883	50603	58563
Korea (South)	1140	1806	5727	10478	12491
Malaysia	6078	8510	14117	36778	42078
Singapore	6203	13016	28565	57324	66764
Taiwan	2405	2930	9735	15736	17138
Thailand	981	1999	7980	17163	19589
China	57	3444	14135	126808	169108
Developing Countries	106241	207283	352751	189743	917553
Total					

Source: United Nations, World Investment Report, 1997

Table 5

Annual Rates of GDP Growth in the EU (1960 - 1997)

in per cent	1960	1970	1975	1980	1985	1990	1995	1997
EURO 9	7.6	5.0	-1.6					
EURO 12			-1.1	1.3	2.5	3.1		
EURO 15						2.9	2.4	2.3
France	5.5	5.7	-0.3	1.6	1.9	2.5	2.2	2.1
Germany	4.6	5.0	-1.3	1.0	2.0	5.7	1.9	2.2
Italy	8.2	5.3	-2.1	3.5	2.8	2.2	3.0	1.4
Belgium	5.0	6.4	-1.5	4.3	0.7	3.7	1.9	2.2
Netherlands	3.1	5.8	0.2	1.2	3.1	4.1	2.1	2.8
Luxembourg	3.8	1.7	-6.6	0.8	2.9	3.2	3.4	2.8
Denmark	6.4	2.0	-0.7	-0.4	4.3	1.4	2.8	3.1
UK	3.3	2.3	2.2	-1.6	3.5	0.4	2.4	3.0
Ireland	5.0	2.7	5.7	3.1	3.1	7.8	10.7	5.8
Greece	11.1	8.0	6.1	1.8	3.1	0.0	2.0	2.5
Spain	11.8	4.2	0.5	1.3	2.6	3.7	2.8	2.7
Portugal	5.2	7.6	-4.3	4.6	2.8	4.6	2.3	2.8
Austria	5.3	7.1	-0.4	2.9	2.5	4.2	1.8	1.6
Sweden	5.7	6.5	2.6	1.7	1.9	1.4	3.0	2.1
Finland	7.6	7.5	1.2	5.3	3.4	0.0	4.2	3.7

Source: Eurostat, Review, 1970-79, 1976-85

Eurostat Jahrbuch, 1996

Europäische Wirtschaft, 1980,7; 1989,42; 1997,63

EURO 9: France, Germany, Italy, Belgium, Netherlands, Luxembourg, Denmark,
Great Britain, Ireland

EURO12: EURO 9 and Greece, Spain and Portugal

EURO 15: EURO 12 and Austria, Finland, Sweden

Table 6

Annual Unemployment Rates in the EU (1960 - 1997)

in per cent	1960	1970	1975	1980	1985	1990	1995	1997
EURO 9	2.5	2.0	4.3					
EURO 10			4.2	5.7	10.8			
EURO 12				6.1	11.6			
EURO 15						8.3	10.7	11.2
France	1.4	1.3	3.9	1.1	10.3	9.4	12.7	12.5
Germany	1.0	0.6	4.2	3.4	6.9	4.9	8.2	9.7
Italy	5.7	4.4	5.3	7.2	9.5	9.8	11.8	12.0
Belgium	2.8	2.2	5.3	9.1	11.3	7.2	9.3	9.5
Netherlands	0.7	1.0	4.0	6.2	10.5	7.7	7.5	6.0
Luxembourg	0.0	0.0	0.2	0.7	3.0	1.6	2.9	3.3
Denmark	1.5	1.0	4.6	6.7	7.8	8.3	7.0	5.1
UK	1.4	2.5	3.8	6.0	11.5	7.0	8.7	6.8
Ireland	5.8	5.3	8.5	8.2	18.0	14.1	12.9	11.7
Greece	6.1	2.6	1.1	1.1	7.8	7.0	9.1	8.9
Spain	2.4	1.2	4.7	9.9	21.9	16.3	22.7	21.3
Portugal	1.7	2.8	4.6	6.7	8.6	4.7	7.1	7.0
Austria	2.6	1.6	1.7	1.9	3.6	3.2	3.8	4.2
Sweden	1.7	1.5	1.6	2.2	2.8	1.7	7.6	9.9
Finland	1.5	1.9	2.4	5.3	5.1	3.4	17.2	14.0

Source: Eurostat, Review, 1970-79, 1976-85
Eurostat Jahrbuch, 1997
Europäische Wirtschaft, 1978,1 and 68/1997

EURO 9: France, Germany, Italy, Belgium, Netherlands, Luxembourg, Denmark,
Great Britain, Ireland

EURO12: EURO 9 and Greece, Spain and Portugal

EURO 15: EURO 12 and Austria, Finland, Sweden