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**Article — Digitized Version**

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Intereconomics

*Suggested Citation:* Lorenz, Detlef (1991) : Regionalisation versus regionalism— Problems of change in the world economy, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 26, Iss. 1, pp. 3-10,  
<https://doi.org/10.1007/BF02928889>

This Version is available at:

<https://hdl.handle.net/10419/140276>

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Detlef Lorenz\*

# Regionalisation versus Regionalism – Problems of Change in the World Economy

*The distinct trends towards regionalisation in the world economy that could be observed in recent years should not be interpreted merely as the formation of economic blocs or "fortresses". This would amount to adopting a biased, backward-looking approach that sees only the sombre experiences of the thirties and forties and does not take sufficient account of the different challenges of the post-war period.*

Since the mid-eighties we have seen a remarkable renaissance of regionalisation in the world economy, as evident in Europe, North America and East Asia. Initially, this development was discussed primarily in trade terms in parallel with the Uruguay Round of the GATT, which represents the established multilateral (and universal) world trade order. It gained wider coverage as a result of a conference held in 1988 by the Institute for International Economics in Washington under the title "More Free Trade Areas?" and the publication of the conference papers.<sup>1</sup> A number of other, more fundamental studies followed that dealt with far wider questions.<sup>2</sup> Finally, the Development Centre of the OECD recently began a wide-ranging programme of research on "Globalisation and Regionalisation".<sup>3</sup> It is therefore unlikely that the debate will degenerate into a superficial and dogmatic controversy about the formation of blocs and "fortresses". There is a good prospect that regionalisation will not be interpreted merely as bloc-forming regionalism and the antithesis of multilateralism but as open regionalisation supplementing and modifying economic globalism because of development needs.<sup>4</sup> To equate regionalisation with the formation of economic blocs is to adopt a biased, backward-looking approach that sees only the sombre experiences of the thirties and forties and does not take sufficient account of the different challenges of the post-war period, and especially those of the eighties and nineties.

Political economy, and especially foreign trade theory, can unfortunately contribute little in this regard, for in both theory and policy it is concerned primarily with politically and historically determined states or with the world economy as a whole. In practice the two together become a global, universal system consisting of the *small* countries beloved of textbooks on international trade. The GATT, as guardian of the world trade order, also clings to this perception of the world trading system as a collection of a

great many small countries. The coalescence of countries into regional trading communities, customs unions or free trade areas is sanctioned by Article 24 of the GATT, but it is often very quickly viewed askance by academics. For example, in the view of K.W. Dam this article is "one of the most troublesome provisions of GATT ..., a failure if not a fiasco".<sup>5</sup> When, finally, under a rule meant to define exceptions, the unforeseen emergence of the EC took place, this gave rise to the "spectre" of regionalism or, more recently, of "fortress Europe".

Although the available material is sparse—the analysis of *economic space* (regions) has generally taken second place to the examination of economic relations between national *states*—a few illuminating studies have been made on the regionalisation of international economic relations, such as the tripolarity and multipolarity approaches to economic development and the discrimination and integration approaches as an expression of economic policy objectives.

## Tripolarity

The first two approaches have many points in common with the foreign trade theory of Andreas Predöhl,<sup>6</sup> who in the past probably had the greatest success in both perceiving and empirically interpreting the world economy

<sup>1</sup> J. J. Schott (ed.): *Free Trade Areas and U.S. Trade Policy*, Washington 1989.

<sup>2</sup> Cf. D. Lorenz: *Trends Towards Regionalism in the World Economy. A Contribution to a New International Order?* in: *INTERECONOMICS*, Vol. 24, No. 2, 1989, pp. 64-70; L. Emmerij (ed.): *One World or Several? Development Centre/OECD*, Paris 1989; D. Lorenz: *Regionale Entwicklungslinien in der Weltwirtschaft – Tendenzen zur Bildung von Wachstumszentren?*, in: E. Kantzenbach and O. G.Mayer (eds.): *Perspektiven der weltwirtschaftlichen Entwicklung und ihre Konsequenzen für die Bundesrepublik Deutschland*, Hamburg 1990, pp. 11-31.

<sup>3</sup> Cf. C. Oman: *Summary Note*, Paris, September 1990.

<sup>4</sup> On open regionalisation, see D. Lorenz: *Regionale Entwicklungslinien in der Weltwirtschaft*, op. cit., pp. 27-28.

<sup>5</sup> K.W. Dam: *The GATT, Law and International Organisation*, Chicago 1970.

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in terms of locational analysis. The premise of an increase in trilateralism has been discussed in greatest detail by Preeg and Minx and subjected to empirical criticism primarily by Sautter.<sup>7</sup> Broadly paralleling Predöhl's core regions or centres of gravity, trilateralism refers to the economic spaces of Western Europe, North America and Japan *as well as* taking account of certain groups of developing countries (the newly industrialising countries) in "proximity" to the industrial country regions. In his illuminating study, Sautter reaches three conclusions with regard to the long, but not unproblematic period from 1928 to 1976:<sup>8</sup>

□ A clear trend towards increasing regionalisation during the period cannot be confirmed, but a number of developments in this direction can be discerned, such as a strengthening of trade ties within core regions and a decrease in the intensity of trade between cores.

□ "The regionalisation of world trade is ... primarily the result of comparatively *durable* geographic, cultural and economic determinants and only to a lesser extent the result of more recent, regionally confined measures of integration policy" (the EC, for example).

□ "The regionalisation of international trade will ... neither herald nor terminate the growth in world trade, but will be its enduring feature." He therefore regards the fear that "an increasing tendency towards worldwide regionalisation will lead to an erosion of multilateral world trade" as groundless.

### Multipolarity

Neither does a new approach to the analysis of regionalisation run counter to multilateralism, as the two go hand in hand. The most important substantiation of the multipolarity theory is the recognition that the extensive globalisation of many world markets has been accompanied by the formation of new regions that are remoulding the old North-North and North-South configuration into a multipolar world economy.<sup>9</sup> Remarkably, this manifestation of regionalisation in the form of multipolarity again takes account of groups of newly industrialising economies, the well-known generation of NIEs, and, furthermore, even adding to these

the potential "quasi-NIEs" by including the former Comecon countries and the continental states of India and China.

Extended in this way, the concept is bound to induce a significant inter-regional realignment on the basis of a global strategy of expansion: "One of the major questions facing the world community is how the trade and economic growth possibilities of the multipolar world structure can be utilised for the benefit of the world economy as a whole rather than primarily feed the dynamism of regional blocs".<sup>10</sup> This approach could, moreover, provide empirical support for the new concept of "open regionalism" via its world trade matrix. Nevertheless, besides the fact that the concept disregards "peripheral" regions, such as Latin America and Africa, the following point should be considered; although the important addition of the new economic areas of the NIEs to the trilateralists' three (the USA, the EC and Japan) should meet with approval, it is taken too far in this model, probably for operational reasons (world trade matrix). While the Comecon area will become more relevant in the world economic context in future, the inclusion of the former GDR, Czechoslovakia and the USSR as NIEs seems highly problematical. Moreover, the expansion of the group of NIEs by the inclusion of as many as three gigantic continental states – the USSR, India and China – seems equally questionable. Until recently only the People's Republic of China played any role as an NIE, and then only as regards the export zones in its coastal provinces and in increasing trade with Hong Kong and Taiwan. The more limited North-South regions used in another paper appear to be more realistic.<sup>11</sup>

### Discrimination and Integration

Trends towards regionalism have taken on particular relevance at the institutional and economic policy level as a result of the recent debate about a variety of views and US initiatives on free trade agreements.<sup>12</sup> In accordance with Pomfret,<sup>13</sup> this development can be classified under the broad heading of geographically discriminatory arrangements (GDAs). These include not only the new proposals for free trade areas but also the old and new arrangements in Western Europe (EEC, EC, EFTA, EES), various integration agreements between developing

<sup>6</sup> A. Predöhl: Außenwirtschaft, 2nd edition, Göttingen 1971.

<sup>7</sup> E. H. Preeg: Economic Blocs and U.S. Foreign Policy, Washington 1974; E. H. Preeg: The American Challenge in World Trade, Washington 1989; E. P. Minx: Von der Liberalisierung zur Wettbewerbspolitik, Berlin 1980; H. Sautter: Regionalisierung und komparative Vorteile im internationalen Handel, Tübingen 1983.

<sup>8</sup> Ibid., pp. 280 ff.

<sup>9</sup> See the contribution by C. I. Bradford Jr. in: L. Emmerij, op. cit., pp. 26 and 31-40, and C. I. Bradford Jr.: The World Economy in the Mid-1990s: Alternative Patterns of Trade and Growth, Strategic Planning and Review, Discussion Paper No. 2, The World Bank, November 1989.

<sup>10</sup> Ibid., p. 33.

<sup>11</sup> D. Lorenz: Trade in Manufactures, Newly Industrializing Economies (NIEs), and Regional Development in the World Economy – a European View, in: The Developing economies, Vol. 27, 1989, pp. 221-235.

<sup>12</sup> Cf. J. J. Schott, op. cit.

<sup>13</sup> R. Pomfret: Unequal Trade. The Economics of Discriminatory International Trade Policies, London 1988.

countries, systems of preferences for developing countries and even bilateral voluntary restraint agreements. Pomfret's analysis concentrates on the violation of the central tenet of the GATT, namely the principle of non-discrimination, and on demonstrating how advanced the erosion of most-favoured-nation treatment in international trade has been for some time. If the GATT finds ever fewer convinced supporters and defenders (or rather innovators) and to some extent withers away, regionalism may take hold more easily by contagion. Pomfret is nevertheless not inclined to predict a proliferation of regional trading blocs. In his opinion, this danger was greater in the forties than in the eighties, for inter-regional trade is flourishing despite the spread of GDAs of various kinds.<sup>14</sup>

To regard the current trend towards regionalisation of the world economy in terms of discrimination, and especially in terms of trade discrimination only, is to adopt far too narrow a view. Regional developments and preferences should be seen as an economic policy phenomenon in a wider sense. That is quite clear in the case of the highest form of regional development, namely integration, which involves a combination of economic and political integration. There is apparently only one example of this in the world economy: the EC, and in some ways also the so-called European Economic Space (EES).

### Provision of Public Goods

If regional development is not linked with this non-universal final objective, it can only be interpreted as a better transitional method for achieving universal world economic objectives, a commendable means of resolving complex and difficult problems that must be tackled one step at a time. That this strategy was successful in the past is demonstrated by Western Europe's contribution to the liberalisation successfully carried out under the GATT during the long reintegration process of the world economy after 1945. However, the current debate shows that it no longer inspires confidence in different world economic conditions. Moreover, the regional approach now has to compete with the non-regionally based approach of so-called open clubs ("GATT Plus").

Matters can also be seen from a different standpoint, as expressed by Cooper.<sup>15</sup> Regionalisation need not be the final objective (integration/EC), nor need it merely be a means to an end (multilateralism/GATT); it may stem from responsibility for the "provision" of public goods. Returns to scale, external effects and stabilisation policies may call

for what Cooper terms optimal areas of jurisdiction, regions that are smaller than the world but larger than many states. The preferences of the population or politicians for collective goods and autonomy in the search for the "optimal" size of regions are also determinants. If two public goods that have recently been discussed intensively in the context of the management of the world economy are brought into the picture, namely deregulation and economic co-operation both within and between regions, there is much to be said for heeding regional, sub-global determinants, not least in the light of the experiences of the last two decades.<sup>16</sup> "Natural" regions are more realistic than the "abstract" regions represented by trade clubs, because the economic growth and efficiency of geographic regions can be greatly enhanced both by neighbourly co-operation of the "learning by doing" variety and by other social affinities.

### Parallel Tendencies

In addition to the approaches outlined above for explaining the phenomenon of regionalisation, another pragmatic approach also deserves to be considered, namely an examination of the three well-known regions that have drawn attention to themselves on account of their dynamism as regards regionalisation. As mentioned in the introduction to this article, these three regions, although different in many respects, began to display parallel tendencies towards regionalisation at approximately the same time in the mid-eighties. There seems to be little connection between these developments.

The programme for the creation of an internal market in the EC by 1992 partly represents "only" the belated completion of the Common Market or the continuation of this regional liberalisation policy using more appropriate and up-to-date means, and partly reflects the efforts to revitalise the Community in response to the diagnosis of "Euro-sclerosis". These two factors together give rise to justified hopes of an *open* integration policy, in which intra-regional and extra-regional growth support one another.

The international "market" integration in East Asia was activated and intensified by the appreciation of the yen in 1985 and other economic measures in response to the macro-economic imbalances within the region and in relation to the USA, in particular. The restructuring of intra-regional economic relations (trade plus direct investment) instigated by Japan also explicitly reflects the necessary switch from a strategy of exporting to countries outside the region to one of intra-regional development. Undoubtedly this change from an extra-regional to an intra-regional

<sup>14</sup> Ibid., pp. 182 ff.

<sup>15</sup> R. N. Cooper: Worldwide versus Regional Integration: Is there an Optimum Size of the Integration Area? in: F. Machlup (ed.): Economic Integration, London 1976, pp. 41-53.

<sup>16</sup> See D. Lorenz: Trends towards Regionalism in the World Economy, op. cit.

orientation is due not only to protectionism and the limits on the absorption of imports by the USA and Europe but also to a strengthening of regional growth stimulated by development.<sup>17</sup>

Both developments, in Western Europe on the one hand and in East Asia on the other, can be interpreted as a specific manifestation of intra-regional integration, whether more on an institutional basis, as in the EC, or as *de facto* integration based on consensus. They are also influenced, but not dominated, by the state of the world trading system.

Things are different in the case of the USA. Here we are not dealing with an economic region that is still in the process of growing together and forming a single internal market. Even the inclusion of areas in the North (Canada) and South (the Caribbean and Mexico) can be compared only up to a point with the integration of industrial countries and NIEs in Europe and Asia. Accordingly, the above-mentioned trend towards trade regionalisation in the USA through the creation of free trade areas is much more superficial, being orientated more or less towards trade and not towards integration.

Of course, trends in the USA are connected most closely with the development of the GATT system and are a response to it. In the eighties the USA was hardest hit by the deficiencies of the multilateral order it had brought into being. The methods being used to restore the competitiveness of the US economy are by no means entirely consistent with the GATT, however. Strategies based on reciprocity, the creation of a "level playing field" and the emulation of EC regionalism are expressions of a two-tier trade policy. Interestingly, the USA resembles East Asia in that there are both intra-regional and extra-regional accents. However, whereas in East Asia there is a tendency to sell the extra-regional component short in favour of the intra-regional aspect, the USA appears to be pursuing a strategy facing in both directions at once (Canada/Mexico *plus* East Asia/Pacific).

However much the present tendencies towards regionalisation in each of the trilateralists clearly differ in intensity according to their known regional characteristics, the coincidence of these regional developments appears to be anything but pure chance. This is due not least to the fact that the era of "simple" multilateral GATT tariff rounds is over, although Hufbauer's assessment that "a multilateral approach almost certainly works best for tariff

reduction" is undoubtedly correct for the tasks that remain to be done in this field. However, for the real problems of international economic relations, and not only trade, it can be argued that "different (trade) issues should be addressed in different contexts and country groupings",<sup>18</sup> and this not only in relation to the problematic OECD club.

### Internationalisation of Production

As I have shown, there are many trends towards regionalisation, and undoubtedly more than those I have mentioned. Before examining other regional transformation problems, however, it is worth touching briefly on a factor that has provided some counterweight and which has increasingly characterised the globalisation of the world *market* economy of late.<sup>19</sup> This relates primarily to the consequences of the internationalisation of production through the mobility of production factors and the multinationals' various strategies of transferring and diversifying production as part of their worldwide cross-regional activities (strategic alliances, etc.). Indeed, one might ask whether regionalisation has not already been paralysed by a levelling process between the various regions. However, the existence and topicality of locational competition not only between national states but also between regions that are growing or integrating demonstrate that the opposite is true. Locational competition between such economic areas has become more important in the age of endogenous (man-made) and "arbitrary" (Cline) competitive advantages as well as of trilateral competition through innovation in the fields of high technology and services. It will become increasingly significant when the "growth competition between states" (Stegemann) – for example in the shape of the revitalisation policies of the USA and the EC and the concepts for strategic trade policies that depend on having larger economic spaces because of the dynamic scale and synergy effects – gain greater influence.<sup>20</sup> Since at the same time these neo-mercantilistic "players" are heavily dependent on one another at enterprise and regional level, specific problems of inter-regional specialisation will arise here in the context of *open* and *aggressive* regionalisation.

Apart from that, there is some merit in arguments for a continuation of trilateralism broadened out into a multicentric or multipolar world economy à la Predöhl and Bradford. The old core areas of industrial countries have clearly gained the upper hand, precisely in the context of intensified North-South competition. Not only have they

<sup>17</sup> Cf. D. Lorenz: Intra-Regional Trade and Pacific Cooperation: Problems and Prospects, in: W. Klenner (ed.): Trends of Economic Development in East Asia, Berlin 1989, pp. 65-74.

<sup>18</sup> G. Hufbauer: U.S. Trade Policy: Guideposts for the Bush Administration, Washington 1989.

<sup>19</sup> See the OECD project described in C. Oman, *op. cit.*

<sup>20</sup> Cf. K. Stegemann: Policy rivalry among industrial states: what can we learn from models of strategic trade policy? in: International Organisation, Vol. 43, 1989, pp. 73-100.

asserted their supremacy, they have also proved to be centres of gravity for peripheral areas (NIEs). They may even be in the process of absorbing these regions. To that extent, there is therefore some evidence of an increase in regionalisation in the world economy, such as the increase in trade with near rather than distant trading partners, especially on the basis of intra-sectoral specialisation, as demonstrated empirically by the HWWA.<sup>21</sup>

One factor that continues to militate in favour of regional economic analysis is its relative independence from the indicators of empirical analysis. For example, we are no longer dependent on the iron and steel industry for the geographic concentration of world production. Its place has been taken by industrial technology complexes and so-called networks offering agglomeration advantages that are not confined to a single country and which create gravitational fields that draw in the NIEs. Admittedly, the dimension of *inter-core* trade as opposed to *intra-core* trade must be viewed somewhat differently today. Given the keener competition between approximately equal centres of gravity and the competition in terms of growth between innovating and imitating regions, *inter-regional* trade also increases on the basis of *intra-industry* two-way trade between the extended cores.

## Locomotives of Regional Growth

The linking of the regionalisation tendencies in the world economy with the concept of the *growth region* has recently led to a very superficial and sterile debate about the formation of blocs or "fortresses". This is entirely understandable against the background of the Uruguay Round of GATT negotiations, although there has been much international lobbying, too. I shall add nothing to these disputes here; it seems more appropriate to turn to other aspects that have received less attention.

For example, it would be worth examining what have been the locomotives of regional growth that have given the world economy significant demand stimulus since the Second World War, insofar as the financing of regional deficits has permitted.<sup>22</sup> In highly simplified terms, three regional stimuli can be identified: first in the fifties and sixties the reconstruction and reintegration of Western Europe (or of the Atlantic region), then in the seventies the ambivalent effects of OPEC policy and recycling, and finally in the eighties the United States' appetite for imports. Recently it has not seemed impossible, in view of

the revolutionary changes occurring in the USSR and Eastern Europe, that the Western European, import-led "reconstruction spurt" of the past may now be repeated in Eastern Europe, if there is adequate scope for financial or other support. Leaving that aside, it is not inappropriate to point out the remarkable fact that the growth regions of East Asia played no active locomotive role in any of the three phases described above. Certainly, the first phase was limited mainly to the Atlantic economic space, but during the second and third phases the phenomenal export-led growth in Japan and the Asian NIEs depended on the fact that other "import poles" – first and foremost the USA – made this export offensive from the Far East possible. It is interesting that in more or less the same way as the terms of trade deficits created by OPEC's pricing policy were financed by recycling, the trade deficits caused by the East Asian export offensives have been financed to a large extent by Japanese capital exports to the USA and development aid to ASEAN.

## USA: Shift of Preferences?

A quite different, important aspect arises with regard to the growth region centred on the USA and encompassing North and South America. For some time now, the USA has been regarded increasingly as part of the Pacific economic region, which would obviously be far less attractive without the USA. However, if the USA shifts its preferences in favour of the Pacific, either voluntarily because of the area's dynamic growth or involuntarily because of the US deficits in relation to East Asia, this constitutes an *intercontinental* "arrangement", against which Wijkman has warned in the debate on free trade agreements: "...major trading nations such as the United States should not enter into intercontinental free trade agreements. An FTA to which the United States is one party is not just any FTA ... if it goes bilateral the effect on the international trading system will be profound".<sup>23</sup> An intercontinental arrangement in the Pacific transcends even regionalism and at the same time reduces multipolarity to a barren bipolarity: the Pacific versus Europe. Moreover, a US preference for the Pacific would almost automatically mean a weakening of the United States' commitment to South America and hence would reinforce the marginalisation of this sub-continent. However, the interregional initiatives by both the USA and Latin American countries appear to have intensified recently and to have gone beyond Mexico.<sup>24</sup> Up to now, North and Latin America together have been the most "unaligned"

<sup>21</sup> HWWA-Institut für Wirtschaftsforschung: Entwicklungslinien des internationalen Strukturwandels, Hamburg 1989.

<sup>22</sup> See also D. Lorenz: Regionale Entwicklungslinien in der Weltwirtschaft, op. cit., pp. 25-27, and H. P. Gray: The Mechanics of International Economic Locomotion, in: K. Fatemi (ed.): International Trade and Finance, 1989, pp. 24-34.

<sup>23</sup> P. M. Wijkman: The Effect of New Free Trade Areas on EFTA, in: J. J. Schott, op. cit., pp. 181-192.

<sup>24</sup> See the recent Bush initiatives and, for example, S. W. Sanderson and R. H. Hayes: Mexico – Opening Ahead of Eastern Europe, in: Harvard Business Review, September-October 1990, pp. 32-41.

region for a variety of reasons. On the other hand, regional cohesion is far greater in Europe and East Asia, despite all the "politico-economic" differences the two regions display.<sup>25</sup> Let us turn first to Europe.<sup>26</sup>

### European Economic Space

The European economic space suffered disintegration and reactive regionalism between the wars ("Großraumwirtschaft" of Nazi-Germany); after 1945 the political division of the continent forced it to develop in an economically irrational way. From the outset, this politically induced development was therefore under increasing geo-economic strain. The Eastern European Comecon countries (the little six) had been within the gravitational field of the Western European industrial countries. After 1945 they were "brought by political means into the Soviet orbit".<sup>27</sup> This went hand in hand with the export of the socialist (Soviet) model of industrial development via the establishment of heavy industry and led to double dependence and an atypical core-periphery relationship as a result of the rigorous dogma of specialisation within the Comecon: the little six were reliant on imported raw materials (petroleum) and depended on the Soviet Union to take their exports of industrial goods, which were urgently needed in the USSR whereas they could be sold in Western world markets only with difficulty and at a loss owing to the Eastern Europeans' increasingly poor competitiveness.

The Soviet Union could provide Eastern Europe with the blueprints of the development model, as well as with some additional knowhow, and thus become a centre of politico-economic gravity, but this "core" was increasingly unable to supply the peripheral countries with an adequate flow of goods. In particular, the conservative "complementary structure" was neither designed nor able to develop a modern system of intra-industry trade, partly for political reasons but mainly because of the many inefficiencies in the system of economic socialism. The replacement of the Soviet gravitational field by that of Western Europe therefore became ever more urgent and attractive. What applied to trade within Comecon also applied increasingly to East-West trade.<sup>28</sup> Once the political climate and the inefficiencies of the Comecon economic system had created the necessary conditions, it is not at all surprising

that Western Europe should revert to performing a core function. The hoped-for creation of a European Economic Space (EES) comprising not only the EC of the Twelve but also EFTA and Eastern Europe accords with this, at most causing a slight adjustment in the centre of the gravitational field. Only against the background of this return to some semblance of normality in Europe is it appropriate to discuss doubts about possible Euro-centric developments.

### Doubts about Euro-centric Developments

The first point relates to the both politically and economically delicate issue of the still relevant historical roots (recurrent "Anschluß") of the Comecon region, including the vast Soviet Union. As well as weighty political arguments against ignoring this historical burden, there are also economic reasons for not doing so. "In principle, revitalising economic relations within Eastern Europe, including the USSR, appears more promising than forcing these countries to orientate themselves towards the West."<sup>29</sup> In view of the dangerous momentum that the uncontrolled breakdown of economic relations within Comecon is now developing, such a revitalisation appears unavoidable, although it is far from clear how it should be achieved.

Secondly, the appropriate course of action will hardly be to stand Comecon's historical burden (orientation towards the Soviet Union) on its head, as a kind of shock therapy, particularly as the Eastern European countries will continue to have special relationships regarding raw materials supplies, despite the waning of the Soviet Union's gravitational pull.<sup>30</sup> However, the return to normality also demands a thorough modernisation of intra-regional economic relations; among the most important of these will undoubtedly be the transformation of the old geopolitical complementarity in the energy sector. Almost equally important will be efforts to make up the considerable lost ground as regards the *pan-European* division of labour in intra-industry and intra-firm trade within a largely deregulated EES. The question of whether and to what extent the Eastern European countries will soon be able to follow in the footsteps of the newly industrialising economies has been examined in detail elsewhere.<sup>31</sup>

Thirdly, proposals to reconfirm the European economic space at the institutional level are more problematic,

<sup>25</sup> P.M. Wijkman and E.S. Lindström: Pacific Basin Integration: A Step Towards free Trade, in: J. Nieuwehuysen (ed.): Towards Free Trade Between Nations, Melbourne 1989, pp. 144-162.

<sup>26</sup> For a more detailed discussion, see D. Lorenz: West- und Osteuropa – Probleme des Zusammenwachsens in einer offenen Weltwirtschaft, in: Wirtschaftsdienst, Vol. 70, No. 12, 1990.

<sup>27</sup> Predöhl in the foreword to the illuminating study by E. Weber: Stadien der Außenhandelsverflechtung Ostmittel- und Südosteuropas, published by K. Schiller, Stuttgart 1971.

<sup>28</sup> See E. Weber, op. cit.

<sup>29</sup> H.W. Maull and A. von Heynitz: Osteuropa: Durchbruch in die Postmoderne? Umriss einer Strategie des Westens, in: Europa-Archiv, Vol. 45, 1990, p. 446.

<sup>30</sup> See especially the Annual Report of the Centre for Economic Policy Research: Monitoring European Integration: The Impact of Eastern Europe, October 1990, chapter 1.

especially as regards substitutes for the collapsed Comecon integration, such as creating a Comecon European Payments Union or providing for other, possibly partial forms of East-East integration, for example between Poland, Czechoslovakia and Hungary. Here, using former associations would probably do more harm than good, quite apart from the possibility of damaging friction due to old and new animosity (nationalism) between former socialist brother countries.

These three Eastern European aspects should be complemented by *world economic* arguments. For example, the more efficiently the regional economic problems in Europe are solved against the background of an *imperfect* world economic order,<sup>32</sup> the greater the danger of a European diversion. If in addition Eastern Europe showed promising economic growth, the attraction of this centre of gravity in worldwide locational competition would increase. With the ever more effective globalisation of the world market economy, and especially of the capital and financial markets, worldwide allocative interdependence also steadily increases, so that regions compete more directly with one another for resources. The Pacific economic area, but also the USA during the Reagan era, have clearly profited from this situation. If profitability is raised in both the private and public sectors in Europe, the *deregulated* world markets will react in the proper way, without it being possible to criticise such a development as Euro-centric. This would only be justifiable if European multinationals acquired a "fascination" with the sales potential of the European market and treated the Pacific (East Asian) economic space with a kind of "benign neglect", something that should not be assumed of multinationals operating worldwide.

### Division of Labour in the Pacific

Finally, let us turn to the formidable growth region of the Pacific, which has already been touched upon in connection with the American region. The superficial and

long-winded debate about the shape of Pacific co-operation need not concern us here. The *functional* regionalisation of the East Asian region, in particular, appears to be a more decisive factor, quite apart from the region's great heterogeneity and the politico-economic Japanese "co-prosperity sphere" problem. As indicated above, the repercussions of the appreciation of the yen in 1985 gave considerable momentum to the changes that were already taking place in Japan's strategy of exporting to countries outside the region and in its increasing links with the East Asian NIEs. In recent years domestic factors have provided stronger stimulus to Japanese growth and there has been a stronger intra-regional element in intra-industry and intra-firm trade and in Japanese direct investment in East Asia.<sup>33</sup>

There is another aspect, however, that throws an important light on this process. The "flying geese" pattern of development that originated in Japan and East Asia seems to be a model for the emergence of new growth regions in the Pacific. This coalition of former and current NIEs, with Japan at their head followed by the "gang of four" and the ASEAN countries, is theoretically far more than just an Asian version of aggregated product cycles. The real essence of the model lies in the special nature of the coupling-together of economies at different stages of development but with the same foreign trade strategy and rapidly rising *parallel* competition. This dynamic intra-regional growth alliance was characterised in trade policy terms by Yamazawa and Watanabe as early as 1983 as a strategic combination of complementary and competing foreign trade flows. This has been demonstrated again on the basis of figures for 1986, with intra-industry trade also being rightly considered as complementary trade.<sup>34</sup>

Such dovetailing of foreign trade is significant on two counts. First, it is the regional manifestation of a general and extremely important process of structural change in the world economy, namely the switch from the old form of complementary *specialisation* typical of the colonial era to the new substitutive *division of labour* of the second half of

<sup>31</sup> D. Lorenz: Will the Industrialized Countries Also Face Export-Led Growth from Eastern Europe?, in: Journal of Asian Economics, Vol. 2, No. 1, to be published in the spring of 1991.

<sup>32</sup> See especially M. Schrenk: The CMEA System of Trade and Payments: Today and Tomorrow. Strategic Planning and Review, Discussion Paper No. 5, The World Bank, Washington, January 1990, p. 25, and D. Lorenz: Trends Towards Regionalism in the World Economy, op. cit.

<sup>33</sup> For a detailed discussion, see A.-R. Milton: Der asiatisch-pazifische Raum – ein neues Gravitationszentrum des Welthandels?, in: RWI-Mitteilungen, Vol. 41, 1990, pp. 231-264; P. M. Wijkman and E. S. Lindström, op. cit.; I. Yamazawa, A. Hirata and K. Yokota: Evolving Patterns of Comparative Advantage in the Pacific Countries, mimeo, Tokyo 1990. On the situation in the NIEs, see the illuminating study by D. Ernst and D. O'Connor: Technology and Global Competition. The Challenge for Newly Industrialising Economies, Development Centre Studies, OECD, Paris 1989.

<sup>34</sup> Op. cit., p. 17. The papers of Yamazawa and Watanabe are part of the special issue: Trends and Structural Changes in Pacific Asian Economies. Volume 21 (1983), No. 4, The Developing Economies.

<sup>35</sup> D. Lorenz: Explanatory Hypothesis on Trade Flows Between Industrial and Developing Countries, in: H. Giersch (ed.): The International Division of Labour. Problems and Prospects, Tübingen 1974, pp. 83-102.

<sup>36</sup> D. Lorenz: Deficiencies of Orthodox Foreign Trade Theory With Regard to Employment, in: INTERECONOMICS, Vol. 20, No. 3, 1985, pp. 122-129.

<sup>37</sup> S. Awanohara: Japan und Ostasien: Auf dem Weg zu einer pazifischen Arbeitsteilung, in: Europa-Archiv, No. 22, 1988, pp. 639-648, I. Yamazawa et al., op. cit., pp. 23-24, and D. Ernst and D. O'Connor, op. cit., pp. 41-43.

<sup>38</sup> See P. M. Wijkman and E. S. Lindström, op. cit., p. 160.



the twentieth century via the intensive integration of newly industrialising countries via displacement competition.<sup>35</sup> Secondly, in view of the unavoidable problems of employment in the course of the re-allocation process (neo-protectionism), a satisfactory mix of substitutive and complementary industrial trade flows that can cushion the international structural changes and permit consensus in place of conflict is of great importance.<sup>36</sup> That this may be easier to achieve regionally rather than worldwide is a plausible hypothesis that is being discussed seriously in East Asia. Reservations about an undesired hierarchical division of labour, with Japan as the leading power and growth pole can be allayed partly by the argument that vertical relationships within this dynamic flying geese formation are not considered as rigid or permanent.<sup>37</sup> In broad terms, this means that the process of graduation must allow upward mobility so that all member states can

climb the ladder in the international (regional) division of labour.

There is, however, one more weighty objection based on the limitations to regional policy and processes. This is whether the flying geese model can achieve equilibrium only if there is *extra-regional* interchange, in other words whether the regional engine must also have an external "vent for surplus".<sup>38</sup> What happens if, to maintain the goose metaphor, it is no longer sufficient for the head of the bird (Japan) to stretch forwards (to the USA) but must *also* be tucked into the bird's own plumage (East Asia)? Can worldwide imbalances resulting, for example, from East Asia's export-surplus-led growth strategy be *relieved* by an intensification and differentiation of intra-regional trade? This aspect is the only one that counts; there can be no question of choosing in principle between regionalism and multilateralism.

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## GERMANY

Paul J. J. Welfens\*

# International Effects of German Unification

*The merger of the two German states brings together countries with divergent economic systems, different trade orientations and a rift in terms of wealth. Transforming the East German system into a social market economy raises enormous internal and external adjustment problems in a period in which West Germany already faces the challenges of the EC 1992 project and European Monetary Union. German unification reinforces concentration tendencies and protectionist tendencies that will contribute to imperfect competition processes in Europe and the global economy.*

**T**he merger of the two Germanies is changing the European landscape and has considerable international effects. Integrating the East German socialist economy into the West German social market economy requires major internal adjustments, and Germany's existing trade orientations and policy patterns are likely to change as well in the 1990s. Moreover, in the enlarged Germany direct and indirect concentration effects in industry reinforce the tendencies for cross-border mergers and company alliances in oligopolistic markets of the EC.

Will a united Germany contribute to further EC integration in the real and monetary sphere? Will it continue the important role as a protagonist of free trade, the role West Germany has played in the postwar international order? Can Germany be an economic bridge between the EC and Eastern Europe? These are some of the questions posed following German unification, the impact of which has many economic aspects as it entails the merging of two different economic systems and regions: West Germany, a social market economy built upon private property, Schumpeterian competition in markets, and free enterprise – all incorporated in a sophisticated welfare state system; and East Germany, which represents the failure of the socialist command

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