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Frans Buelens\*

## The Creation of Regional Blocs in the World Economy

*International economic relations today show a rather pessimistic picture, with high non-tariff barriers, international trade frictions and a serious crisis in the GATT. The following article analyses present tendencies towards the creation of regional economic blocs and the threats to the world economy which these involve.*

A general tendency towards the building of regional economic blocs can currently be observed in the world economy. In Europe some very important steps have been taken towards the creation of one economic and political unit. In America an important trade agreement was reached between the USA and Canada and there are plans for an American free trade area. In Asia opinion is still divided as to whether one common East Asian economic community should be the goal or the establishment of a coalition structure, which would include the USA.

This tendency towards the formation of regional economic blocs has been observed by many economists and politicians. For example a recent IMF study<sup>1</sup> stated, "According to the study, fears about the creation of economic and trading blocs have been aroused by the increase in bilateral trading arrangements, retaliatory measures of a bilateral nature, and trade measures implemented within regional groups (...) geography appears to be playing an increasing role in determining common positions in trade negotiations, and this may have heightened the impact of regionalism." This tendency however is not interpreted in the same way by every economist. In the first place, some simply deny there is such a tendency: "Dramatic scenarios of the breakdown of the GATT-based international trading system are not supported by the facts. There is no trend towards the disintegration of the multilateral system into three or four regional blocs."<sup>2</sup> Some see the danger very well, but think GATT has the capacity to survive it.<sup>3</sup>

In this article we shall analyse various elements in this tendency which in our opinion contribute to the increase in protectionism and the structural crisis in international trade relations. Increasing regionalism can be considered as an attempt to organize the world trade system, which has been fairly stable since the Second World War, on a different basis. Some of these elements are: the introduction of the "principle" of bilateral reciprocity (even at the sectoral level), a result-oriented approach and a tighter regional economic and institutional integration. These "new principles" are defined in contradiction to the principles of the multilateral system with its "most favoured nation" clause, its broad definition of the reciprocity issue and its rule-oriented approach. The new relations between nations can be described as "regional bilateral trading blocs", i. e. blocs composed of nations in one region, which establish contacts with other blocs on a bilateral basis. Although a kind of regionalism developed in the years the GATT was flourishing, today's regionalism is of a different nature: it is presented as an alternative to the GATT, not as complementary to it.

The historical experience of the thirties shows that the world market can be divided into different economic blocs. This was certainly not by accident and the process can be repeated. Most economists accept that this disintegration of the world market has been detrimental not only to world

<sup>1</sup> IMF: Fund report highlights trade growth, but expresses concern about protectionism, in: IMF Survey, 30 Oct. 1989, pp. 331-334.

<sup>2</sup> R. Pomfret: Unequal trade. The Economics of Discriminatory International Trade Policies, Oxford/New York 1988.

<sup>3</sup> Cf. J. Bhagwati: Multilateralism at Risk. The GATT is dead. Long live the GATT, in: The world economy, Vol. 13, No. 2, June 1990, pp. 149-169.

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welfare but also to international relations between nations. Historical experience should not just be swept aside as some economists and politicians tend to do today.

### The Universal Society of Nations?

At the end of the 18th century, Adam Smith held a very optimistic view of the evolution of international relations. In his work "An Enquiry into the Nature and the Causes of the Wealth of Nations" he attacked mercantilism. This doctrine, which saw international relations as a zero sum game, hence was held responsible for the conflicting relations between nations. Smith modelled international relations as a non-zero sum game: because of the international division of labour the future would bring harmonious relations between nations (the universal society of nations). This may be said to reflect the general optimism at the end of the 18th century, the same as that of the French revolution. However, such a universal society of nations was in England's best interests, because of its dominant economic position in the world economy at that time.<sup>4</sup> Later on, David Ricardo took the same stance: in his classic work "The principles of political economy and taxation" he wrote, "a system of perfectly free commerce ... binds together, by one common tie of interest and intercourse, the universal society of nations ..."<sup>5</sup>

Two centuries later, historical experience contradicts Smith's view. The experience of the thirties indeed shows that commercial relations are not necessarily harmonious and this is confirmed by economic theory. Some major rethinking with regard to the premisses which underpinned the Smithian system has taken place.

First, the static principle of comparative advantage has been criticized. Competitive advantages certainly exist, but they are not as static as the theory of Ricardo and Heckscher-Ohlin would have us believe. Many of them are historically acquired and so they can change. When all this is a dynamic process, why should nations and firms not try to acquire advantages?

Furthermore, the efficiency principle did not prove to be the sole criterion upon which nations built their economic policy. Other criteria may have been more important, such as national security, industrialisation, employment ...

Lastly, the theory of "the political economy of protectionism" and the public choice theory stressed how important it is to define the real actors in the decision-

making process. If not the state as such but oligopolies are the real decision-makers, then the entire framework changes.

The free trade option was in the best interest of the British Empire, as Keynes indicated that it was a duty, "... to respect free trade not only as an economic doctrine which a rational and instructed person could not doubt almost as a part of the moral law."<sup>6</sup> Once Great Britain started to lose its dominant economic position, its adherence to the free trade principle diminished as was demonstrated in the imposition of the imperial system in the thirties.

After the Second World War, the USA, although it had been one of the most protectionist nations in the world, became the great defender of the free trade principle. This fitted in very well with the economic position of the USA after 1945. Subscribing to the free trade principle was at that moment in the best interest of the USA, as it had been before in the best interest of Great Britain. The principles were institutionalized in the GATT (1948). At the time it looked as if this might be the very beginning of the so-called "universal society of nations".

Today international economic relations show a rather pessimistic picture, with high non-tariff barriers to international trade, international trade frictions and a real crisis in the GATT. Before analysing present tendencies towards regionalism as an alternative to GATT, let us first take a look at the foundations of this agreement and the principles on which it was built.

### GATT Inconsistency

The General Agreement came into force in 1948. Its objective was very ambitious: to free world trade from the protectionist disturbances inherited from the thirties. From the very beginning the GATT ran into difficulties: the institutional framework, the ITO (International Trade Organization), was not installed because the UK brought in too many restrictions upon the free trade principle; consequently the American president refused to put the matter to Congress, fearing he would be defeated.<sup>7</sup> Nevertheless, participants in the international negotiations continued their collaboration, based upon the previously signed General Agreement. A fundamental question with regard to the success of international negotiations was, from a game theory point of view, however, not solved, namely the possibility of making

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<sup>4</sup> F. List: *Das Nationale System der Politischen Ökonomie*, originally published in 1840, quoted here in the version published by Gustav Fischer Verlag, Jena 1904.

<sup>5</sup> D. Ricardo: *The principles of political economy and taxation* (originally published in 1817), London 1969.

<sup>6</sup> J. M. Keynes: *National Self-sufficiency*, originally published 1933, republished in: D. Moggridge (ed.): *Collected writings of J. M. Keynes*, Vol. XXI, Cambridge 1978, pp. 233-246, here p. 233.

<sup>7</sup> R. N. Gardner: *Sterling-Dollar Diplomacy*, New York/London 1969.

binding agreements. However, the working of the GATT became based upon the retaliation principle, which after all proved to have a certain success in the following years.

Being a compromise between protectionist survivals and the free trade principle, the GATT was not only handicapped by its institutional weakness but also by the very content of some articles which did not really break with fundamental protectionist concepts and which are often very vague and open to protectionist interpretation.<sup>8</sup>

Considering here the articles only with regard to the possible creation of regional blocs, it is obvious that there is a basic discrepancy between the principles of non-discrimination and the principle of article XXIV. The latter allows for the formation of free trade zones and customs unions within the framework of the GATT. But there are some inconsistencies. In his now classic study "The Customs Union Issue", J. Viner<sup>9</sup> introduces some new tools to analyse the GATT issue. First he criticizes the Haberler position<sup>10</sup> that custom unions are always a step ahead in the free trade direction. This theoretical position is reflected in the GATT doctrine, but it is erroneous, Viner states, because one has to distinguish between the trade creation and the trade diversion effect. Any economic union between a number of GATT member states will have some trade diversion aspects. The Viner position then is that, when the trade creation effect seems to be greater than the trade diversion effect, the world as a whole will gain from the economic union.

The Viner position itself can be criticized because, when considering the question from the point of view of third countries not participating in the economic union, they will always lose. Furthermore, he indicates there will be some "trade suppression" effect due to the realization of positive scale economies among the members of the union. But Viner minimizes this effect, although it seems to be one of the major consequences of the creation of the European Economic Community.<sup>11</sup> After all, Viner does not take a political economy approach but a neo-classical one. This explains why he almost exclusively concentrates on the welfare effects of the world economy as a whole, and not on the interests of the various countries and pressure groups concerned. The formation of a discriminating economic union is always against the interests of the other countries.

There is another important question which needs to be

asked. If customs unions really are a "second best" solution, why are they formed? Why not a multilateral solution? The reason is that the countries engaging in a separate economic union stand to gain more from this union than from a general multilateral approach. This certainly can happen for example when countries A and B, which have entered into an economic union, are small in comparison with country C, which happens to be a large country. Country C can exploit the international trade system (using the optimal tariff for example) and A and B can improve their competitive situation vis-à-vis country C by forming an economic union. Some authors see no problems at all in the formation of such unions and consider them to be entirely in line with the multilateral solution, e.g. Meade<sup>12</sup>: "These regional arrangements need not be scrapped simply because a more universal attempt is made. They will, however, become less important if the universal solution succeeds."

Obviously the Meade vision is conditional: these regional arrangements will only become less important if the universal solution succeeds. But what if the reverse is true? If a universal solution does not succeed, the participants will increasingly move towards the regional solution as far as trade relations are concerned.

### Institutional Discrimination

The General Agreement was not the embodiment of the free trade doctrine. It was issued in a concrete historical situation and reflects the power relations of the time. The initiator of the GATT was the USA. After the Second World War the USA had acquired an overwhelming economic, political and military position in the world economy. It is impossible to understand the articles of the GATT if this historical situation is not taken into account.

When the USA took the initiative to set up a multilateral free trade organization this was a historical move away from its traditional trade policy. From the American civil war onwards (which set the protectionists of the industrialized North against the freetraders of the agricultural South) America's trade policy had been protectionist, as this reflected the historical interests of the American industries, which could better be built behind real tariff walls. In the thirties, the passing of the famous Smoot-Hawley law was followed by a disastrous beggar-

<sup>8</sup> K. J. Dam: *The GATT, Law and International Economic Organization*, Chicago/London 1970.

<sup>9</sup> J. Viner: *The Customs Union Issue*, New York 1950.

<sup>10</sup> G. Haberler: *Der internationale Handel*, Berlin 1970 (originally published 1933).

<sup>11</sup> M. Corden: *Economies of scale and Customs Union Theory*, in: *Journal of Political Economy*, Vol. 80, 1972, pp. 465-475; T. Scitovsky: *Economic Theory and Western European Integration*, London 1967, originally published 1958.

<sup>12</sup> J. Meade: *Bretton Woods, GATT, and the Balance of Payments: a second round?*, (1952), in: S. Howson: *The collected papers of James Meade*, Vol. III, London 1988, pp. 148-160, here p. 158.

thy-neighbour retaliation game. The first sign of a new US trade policy was seen in 1934 with the Cordell Hull approach, which was, however, still based on bilateral and reciprocity principles. After 1945, economic power relations had changed dramatically, and it was in the best interest of other countries to open their borders for US products. When the USA took over the position of leading economic power from Britain it also became the advocate of free trade which Britain had been.

One of the main objectives of US policy after the Second World War was to create one big economic community of all nations with a market economy. This policy was seen by the US Government as a strategy against the growing influence of the Soviet Union. By uniting the market economies the USA hoped to prevent frictions among the

member states from becoming more important than their common aversion to the Soviet Union. One of the main instruments in attaining this objective was the creation of one economic bloc within the institutional framework of the GATT, as confirmed by president Kennedy before Congress on 25 January 1962,<sup>13</sup> "Our efforts to promote the strength and unity of the West are thus directly related to the strength and unity of Atlantic Trade policies (...) If we can take this step, Marxist predictions of 'capitalist' empires warring over markets and stifling competition would be shattered for all time (...) and Communist efforts to split the West would be doomed to failure."

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<sup>13</sup> A. Shonfield: *International Economic Relations of the Western World 1959-1971*, Vol. 1, London 1976.

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# History of Political Economy

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A second instrument in the struggle against the Soviet Union was a certain unification of the market economies of Europe. As a result of this the old contradictions between France and Germany were tackled in a more peaceful way and further expansion of the Soviet influence could be avoided. All this explains the support the USA initially gave to the elaboration of the concept of the economic union of Europe and to the inclusion of article XXIV in the General Agreement, as was demonstrated in the debate in Congress in 1948.<sup>14</sup>

A second objective of the USA with regard to the GATT was the elimination of all preferential agreements with respect to the old colonial powers (France, England, ...). At the Berlin Conference (1885) large parts of the world had been divided between the leading colonial powers of the moment. As the USA was not among them, it lent support to the anti-colonial movement and asked the GATT member states to lift all of the previous trade restrictions. The USA did not attain this objective: a special clause was inserted with exceptions for these areas.

### **Crisis in the Multilateral System**

The GATT proved to be very successful, at least for some years. High tariff walls came down and world trade increased considerably. Nevertheless as tariff barriers came down, non-tariff barriers rose to such an extent that much of the progress that had been made was undone again. Trade restrictions in textiles (Multifibre Arrangement), VERs, OMA and so on were introduced with increasing speed in the last decades.

Conflicting views emerged at the 1990 Brussels session of the Uruguay Round, which had followed a dramatic and painful course. As the gap between the USA and the EC seemed unbridgeable the future of the GATT itself was in jeopardy. Although negotiations were continued later on, pessimism which some had been voicing<sup>15</sup> proved to be a realistic vision. The reasons for this crisis in the GATT are manifold and will be summarized below.

First of all, it needs to be stressed that the very nature of the international trade relations between market economies can be defined as a non-zero sum game. In such a game players can do their favour with cooperation, but it is not an imminent feature of the game. The game is characterized as a non-cooperative game because the main condition for a cooperative game is not fulfilled, i. e. the possibility of making binding agreements. Every

agreement made can at every moment be broken by one of the players. Nevertheless cooperation can be possible under certain conditions, as the GATT has demonstrated.

Secondly, the GATT is basically an organization which rests upon a few players only, although there are many participating nations. These players are the USA, the EC and Japan. The very crisis in the GATT is a manifestation of the crisis in the international relations between these powers. What has caused this crisis? The main reason lies in the structural transformations the world economy is undergoing. The crisis can be described as a transformation of the economic power relations between the great market economies. Whereas after 1945 the USA was the only major economic power in the world, times have changed and other nations, mainly the EC and Japan, have challenged the USA's position. This shifting of economic power is reflected in the external balances of the USA. For more than ten years the USA has been faced with the absurd situation of being a rich country which nevertheless imports more than it exports and which is gradually becoming a debtor state. Consequently, pressure groups inside the USA are urging Congress to take trade policy measures against the so-called "unfair" players. The American Government, in resisting the most rabid hardliners of the protectionist stance for the moment, is moving slightly towards a more protectionist policy.

By deciding to impose high non-tariff barriers (e. g. the famous "voluntary" export restraint agreements) the American Government has officially opted for a so-called aggressive trade policy strategy.

Examples of this can be found in the 1989 Structural Impediments Initiative (by means of which the USA aims to change the very structure of the Japanese economy), the 1985 Export Enhancement Program (which heavily subsidizes the export of agricultural products), the Japan-USA conflict in the semiconductor sector (where the USA wanted a 20% guaranteed share of the Japanese market), the recent Dan Quayle request that a share of the Japanese automotive market should be guaranteed to American carmakers, the 1992 American President's visit to Japan to pressurize Japan into buying American cars.

Nowadays, the very participation of the USA in the GATT system is questioned by some US authors; at the same time, it is suggested that protectionism need not be a bad thing<sup>16</sup> and that alternatives are available. Thus, a former US negotiator proposed, "... withdraw from the current Uruguay Round of multilateral trade talks ... press ahead with the bilateral talks that have become the real

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<sup>14</sup> J. Viner, *op. cit.*, p. 131.

<sup>15</sup> M. Wolf: Fiddling while the GATT burns, in: *The world economy*, March 1986, Vol. 9, No. 1, pp. 1-18.

<sup>16</sup> P. Krugman: Protectionism: try it, you'll like it, in: *The International Economy*, Vol. 4, No. 3, pp. 35-39.

mechanism for trade deals as the Gatt has become increasingly irrelevant."<sup>17</sup>

Trying to resist protectionist lobbying in the USA and in the meanwhile reaching some aggressive trade strategy objectives, the American Government has forced other countries to participate in a new international trade round. While not seriously considering the withdrawal of all the barriers erected in the previous years, the USA concentrated its attention on new fields (services, international investment, intellectual property) and the abolition of all agricultural subsidies, not because of a sudden commitment to the free trade ideal but in the hope that the USA would benefit from certain advantages it has in these fields.

Thirdly, in recent years the world economy has seen several periods of hard recession, which always exert a certain protectionist influence upon trade policy decisions.

Fourthly, power relations have changed, not only within the GATT system, but also on a world scale. As a result of the transformation process towards a market economy undertaken in the Soviet Union and the countries of Eastern Europe, the sharp contradiction between the Soviet Union and the USA has disappeared. This had been a unifying factor for the market economies of the GATT. Occasionally the USA made some concession in the trade field in order to preserve this unity, then again it was the EC which made concessions when it needed US support. For the first time since 1945 and probably for a long period to come there is now no external unifying factor. The USA has won the battle with the Soviet Union and sees itself faced with a new challenge: the economic battle with the other developed market economies.

### **Regionalism: an Alternative?**

In this final section we will concentrate on the actual creation of economic blocs in the present situation. Inside the USA, Japan and the EC, a decision process is now taking place and pros and cons are being formulated by the various forces. Ultimately the direction which the international trade system will take is still uncertain. Different possibilities present themselves. An important yet always unknown factor will be the evolution of the global economic situation.

According to our analysis protectionist forces are most powerful in the USA. Nevertheless, nothing can justify the statement that the protectionist lobby has already won the struggle there, as the anti-protectionists are still in the running. If the protectionists were to win the fight, the multilateral system might not survive since the USA is still

at the heart of the international trading system. In that case, regional blocs will become an alternative for the GATT.

During the eighties an important and fundamental shift took place in American foreign trade policy which should not be minimized, but seen as "a part of US strategic thinking. This represents a profound change in US trade policy."<sup>18</sup> Although the USA lent its support to the setting up of the European Community in its early days, at the same time it feared the EC's becoming a threat to its own dominant position in the world economy. The USA always refused, however, to make use of Article XXIV itself. In the eighties the US policy option changed and various measures were taken to establish a so-called North American Free Trade Association.

### **North American Free Trade Association**

This plan was to be realized in different concrete steps, but it has not been fully implemented. Those steps involved the agreements with the Caribbean countries (Caribbean Basin Act of 1983), with Israel (1985), and with Canada (1988). Especially the latter is the most important because it unifies two industrially highly developed countries and can be seen as the cornerstone of an expanding Free Trade Association. After the US-Canada agreement, negotiations are now under way with Mexico to subscribe to the agreement. During the 1990 Brussels meeting of the Uruguay Round the American President visited some Latin American countries, proposing the formation of a unified economic free trade association (the so-called "Enterprise for the Americas" initiative). Many of these countries are, however, not very keen on the perspective of negotiating on an individual basis with the USA, fearing they would be dominated. They therefore chose to organize themselves in the Mercosur organisation in 1991 in order to resist North American pressure.

The important question which remains now is: What are the underlying reasons for the USA's getting involved in this development? Although there are some non-economic and particular reasons for some of the trade agreements (e. g. the protection of Israel, the anti-Cuban character of the CBI), the main reason as officially formulated by the USA is that this development is seen as a kind of pressure put upon the wavering participants in the multilateral negotiations. Consequently, the initiative, as defined by the USA, should be compatible with the GATT.

<sup>17</sup> C. Prestowitz: A less powerful economy will make America less powerful, in: Harvard Business Review, Vol. 66, No. 6, Nov./Dec. 1988, pp. 92-97, here p. 93.

<sup>18</sup> S. Weintraub: Regionalism and the GATT: The North American Initiative, in: Sais Review, winter/spring 1991, pp. 45-57.

This is a highly questionable interpretation, which should be considered in some detail.

The USA knows that, for many countries, it is the most important export market, i. e. many are highly dependent on the USA (such as South Korea, Taiwan, Mexico, Canada, Japan etc.) The USA exploits this position, which is not new. Indeed, for many years the USA has taken some protectionist measures to restrict trade from these countries, whose dependence on the US market nevertheless remains considerable. If these countries were faced with the choice between the GATT or an alternative agreement, i. e. the NAFTA, it would be difficult for them to choose the GATT because they would benefit more from the NAFTA.

The USA, needless to say, presents itself as the noble defender of the free trade option, while many of the other countries are described (by the USA of course) as "unfair trade partners". The actual situation is quite different: the USA has imposed restrictions on trade (textiles, steel, ...) and often uses methods incompatible with the GATT system. Instead of bringing into question these tactics, the USA expects the other countries to accept the agenda they present. And if this agenda is not accepted, the USA is prepared to transform its regional bloc into an alternative to the multilateral system. The USA has already explicitly formulated a dangerous threat towards the GATT<sup>19</sup> which might be implemented if the negotiations do not result in an agreement: "... we might be willing to explore a 'market liberalisation club' approach, through minilateral arrangements or a series of bilateral pacts ... This accord could turn out to be an attractive, bipartisan counterweight to protectionism (...) If all nations are not ready, we will begin by those that are and build on that success."

This threat is a very good illustration of the American way of negotiating: if the others do not comply with our wishes – accept our points of view – we will leave the negotiating table and organize all those who are willing to go along with us. This kind of reasoning threatens to divide the world economy into rival economic blocs very soon. Some American economists argue that this course of action will not harm the American economy. Popular articles<sup>20</sup> follow suit and are preparing public opinion for protectionist adventures once again. Indeed, it is not very easy for the American public to change its attitude towards

<sup>19</sup> J. Baker: The geopolitical implications of the US-Canada Trade Pact, in: *The International Economy*, Vol. 2, 1988, No. 1, pp. 34-41, here p. 41.

<sup>20</sup> B. Stokes: Après GATT, le Déluge?, in: *National Journal*, 12 Jan. 1991, pp. 75-78.

<sup>21</sup> C. Prestowitz et al.: The last Gasp of GATTism, in: *Harvard Business Review*, Vol. 69, No. 2, March/April 1991, pp. 130-138, here p. 137.

Table 1

### US Public Opinion on Arguments for Protectionism

	Good Argument	Not a Good Argument	Don't Know
<b>Restricting Imports Would:</b>			
Give Americans More Jobs	73%	24%	3%
Help American Companies Make Bigger Profits	51%	41%	7%
Improve Our Trade Balance	68%	25%	7%

Source: Survey by Roper Organization Inc., poll of 2000 adults, reported in: *USA Today*, Feb. 8th, 1985, quoted in: B. V. Yarbrough, R. M. Yarbrough: *The world economy: trade and finance*, New York 1988.

the free trade question after 40 years of free trade rhetoric. Nevertheless, protectionist feelings are on the rise again in the USA (Table 1), which has been amply demonstrated in all the US election campaigns of the eighties. Although protectionist candidates never won elections until now, the danger is there that one day they may; the other danger being that the other candidates are forced also to take the protectionist path.

Not only public opinion is shifting towards protectionism – the legal apparatus itself is also adapting to become a protectionist tool. The recent "Omnibus Trade and Competitiveness Act" of 1988 included some important protectionist measures (e. g. enforcement of section 301), although the Gephardt Amendment has not been accepted.

The easy success of the US-Canadian negotiations (when compared with the very difficult Uruguay talks) can provide an interesting alternative for US negotiators. Although they do not need to leave the GATT as such, they can also take the following stance, as prescribed by one of the most protectionist protagonists<sup>21</sup> in the USA, "The United States should not formally abandon the GATT process (...) But Washington needs to spend (...) much more time developing, in cooperation with major trading partners, a new framework for world trade."

This so-called "new framework" conceived by the protectionist wing in the USA has so far provided two major proposals: one of a "Super GATT" and one of a regional bloc structure. The "Super GATT" would imply the exclusion of third world countries from the GATT, because they cannot fulfil (and are not obliged to do so under present GATT regulations) the reciprocal conditions upon which the USA insists. Realizing this objective would mean that the differences with the Third World would not be given an acceptable solution for the USA in the still



continuing Uruguay Round. Realising the other alternative would mean that the sharp differences with the EC would not be given an acceptable solution for the USA.

### Fortress Europe?

After the Second World War there seemed to be only one great economic power with a market economy structure left. Stimulated by the USA towards more unity, the idea of economic integration was taken over by the western European countries, and stimulated by European oligopolies who saw in European unity a wonderful means of improving their competitive position with regard to the USA and Japan. European Unity was viewed by the European countries in a perspective of international competition, as it had been considered a century before,<sup>22</sup> viz. as a force against the economic power of the United States of America. Constructing this unity not only discriminated against the USA (as was shown above when we criticized Viner's considerations), it was also explicitly conceded as such by the participants in the unifying process. Consequently, the USA began to fear this unification of Europe, as is demonstrated in the following statement of the American president, R. Nixon, on the EC, "... a giant concentration of economic power – with a common external tariff and an expanding network of preferential trading arrangements."<sup>23</sup>

P. D. Wolfowitz, US Undersecretary of State for East Asian and Pacific Affairs, declared before the American Congress in 1984, "I think we are a long way from the time when something highly organized like the EC is feasible or desirable. That approach may have lowered trade barriers among the 10 member countries in Europe but it has not been without its problems for trade relationships between Europe and the rest of the world. I don't think we want to see that spread."<sup>24</sup>

Efforts to speed up the EC integration process were redoubled in the eighties. These are some of the objectives: unification of the internal market; concentration of its R&D efforts upon the acquisition of all the important high-tech sectors; creation of one single currency, a Federal Reserve Bank and monetary stability in Europe; political unification. When this difficult

integration process – which might take some time – is completed, Europe will be a leading economic power in the world economy. It is difficult to believe that this giant will continue to accept the attitude of its US trading partner in the future. With its economic and political position becoming stronger, the EC is developing its own foreign trade policy (resisting American pressure in the Uruguay Round negotiations; VER-agreement with Japan in the automotive sector).

### The Japanese Choice Problem

The threat of regional blocs in the world economy puts Japanese decision-makers in a dilemma. The majority of them are in favour of an open world economy, in which the three big economic powers would cooperate, and they do not want to break ties with the USA, given their export dependence upon the USA. This seems a logical choice, as they have little to fear from an open world economy thanks to their own competitive position.

Japan was never quite welcome in the world economic community: after the Second World War there was strong opposition to Japan's entry into the GATT. It was only the influence of the USA that forced the other countries to accept Japan in 1955, although Art. XXXV was immediately invoked against them. The USA itself also took a protectionist attitude vis-à-vis the Japanese a few years later, when it forced them to conclude a "voluntary" export restraint agreement in textiles (which later on became the Multifibre Arrangement).

The structure of the Japanese economy shows a certain export dependence upon the United States economy. As the best choice for Japan (i. e. an open world economy) would not be feasible with the USA shifting away towards regionalism, it would be very attractive to the Japanese to propose an American-Japanese economic bloc. This version of the trend to regionalism has already been proposed by the influential Japanese author Kojima.<sup>25</sup> Some kind of institutional implementation of this idea can be found in the APEC (Asian Pacific Economic Cooperation) founded in 1989, a coalition structure of Pacific countries. This is seen by some of its members as an alternative to the GATT – should the Uruguay Round collapse. The creation of such a coalition of two major economic blocs would be a real nightmare for the third as J. Groothaert declared: "A double Nippon-American hegemony could arise."<sup>26</sup>

The main impediment to setting up this kind of coalition structure is not, perhaps surprisingly, Japan but the USA. There is simply not a majority in the United States to build such a coalition structure. Most protectionist protagonists are in the anti-Japanese movement, although some minor voices propagate the US-Japanese coalition, such as M.

<sup>22</sup> J. Viner, *op. cit.*, p. 57.

<sup>23</sup> A. Shonfield, *op. cit.*, p. 8.

<sup>24</sup> J. D. Biermeier: America's Shifting Emphasis to the Pacific, in: *INTERECONOMICS*, Vol. 20, No. 5, Sept./Oct. 1985, pp. 245-250, here p. 250.

<sup>25</sup> Cf. W. Lütkenhorst: Pacific Basin Interdependencies – A Case for Large-scale Economic Cooperation, in: *INTERECONOMICS*, Vol. 18, No. 1, Jan./Feb. 1983, pp. 28-33, here p. 29.

<sup>26</sup> J. Groothaert: Le nouveau monde du Pacifique, in: *Studia Diplomatica*, Vol. XLIII, 1990, No. 2, pp. 35-44, here p. 43.

Baucus, chairman of the US Senate Finance Committee, who has stated, "If the US and Japan move toward a closer bilateral economic relationship, both would have more leverage to prevent the EC from shutting them out of 1992 (...) Other nations would be left with the choice of joining the process or largely letting the US and Japan dictate the shape of the world economic environment."<sup>27</sup>

It is not an easy choice for the Japanese. The world economy is confronted with the risk of breaking down into regional blocs; yet they are not accepted as coalition partner by their most important trading partner. The Japanese are becoming more and more divided between those who still want such a coalition and those who want to restore Japan's status as the major economic, political and military power it once was. The latter, although still in a minority position, advocate the formation of an independent Asiatic economic bloc. A significant indication of this is a debate in the Japanese Government during the difficult Uruguay Round, reported as follows:<sup>28</sup> "The topic: a strategy for the Pacific Rim. On the one hand Kiichi Miyazawa and others believe Japan should move quickly to consolidate a friendly but aggressive NIC leadership strategy (...) On the other hand Prime Minister Noboru Takeshita feels that 'taking advantage' of the US would amount to a kind of disloyalty (to the USA)."

This option seems to be the only possibility for a Japan that is threatened by the USA and the EC. In the long run it is also the inevitable historical outcome which seems to correspond with the economic position of Japan, which will not eternally be satisfied with playing a subordinate role. Reflecting this tendency, a real storm in American public opinion was observed, the day the existence of the book "The Japan that can say no: the new US-Japan Relations Card" (written by Akio Morita, chairman of Sony, and Shintaro Ishihara, member of the Japanese Diet) became known in the USA.<sup>29</sup> The book, which had considerable influence in Japan, claimed there was no need for Japan to give in to the USA, an idea which is growing in Japan and could lead to an EAEG (East Asian Economic Grouping) of the kind already proposed by Malaysia and other countries

in the region. They fear they will be squeezed out of the American market and hope the Japanese market and investments will be an alternative.<sup>30</sup>

Resistance against this proposal is very considerable in Japan, which vividly remembers the historical experience of the thirties, when efforts to construct such an East Asian "co-prosperity sphere" resulted in war with the USA. This historical-political component strengthens the pro-American wing in Japan. Nevertheless, should the Americans close their market to the Japanese, the advocates of a strong and autonomous Japan would undoubtedly gain considerable support.

### Conclusion

The entire GATT system is at present facing its most serious crisis since 1948, the main reason being the changing power structure of the world economy. The USA is losing its dominant economic position and wants to force other countries to comply with American demands. They threaten to wind up the GATT while they themselves are setting up a regional bloc (NAFTA). Meanwhile, the EC is creating a rival bloc, which challenges the dominant position of the USA. It is only in Japan that the idea of an autonomous bloc has received a cool welcome, although the possibility is being considered.

In a final attempt to save the multilateral system, the American Government has brought the other nations to the negotiating table in the Uruguay Round. If this round of talks fails, the USA threatens to give full support to the formation of separate economic blocs. The evolution of the world economy and the American position in it will, of course, play an important role here, as will the internal political decision-making process in the USA, where the protectionist forces are really very strong. But the real risk remains that, "if effective multilateral agreement is not reached, trading blocs – which have become more prominent in recent years – may be tempted to take matters into their own hands, exposing world trade to serious protectionist dangers."<sup>31</sup>

All of this is hidden behind general declarations in support of the GATT system. The world economy has become international indeed, but the "universal society of nations" is threatened more than ever. If this trend is not reversed, we could be in for a grim future as the well-known economist J. Meade has warned,<sup>32</sup> "Such a system could not work harmoniously for long. When every country is making bilateral arrangements with every other country (each bargain being at least potentially at the expense of other third countries), economic relationships will become a perpetual source of diplomatic friction."

<sup>27</sup> M. Baucus: Pacific Overture, in: The International Economy, Vol. 2, No. 6, Nov./Dec. 1988, pp. 70-71.

<sup>28</sup> Cf. "Takeshita-Miyazawa NIC squabble", in: The International Economy, Vol. 2, No. 5, Sept./Oct. 1988, p. 16.

<sup>29</sup> A. Goble: Japan's America-Bashers, in: Orbis, A Journal of World Affairs, Winter 1990, pp. 83-102.

<sup>30</sup> J. J. Schott: Free Trade Areas and US Trade Policy, Institute for International Economics, Washington 1989.

<sup>31</sup> Bank for International Settlements: 61st Annual Report, Basle 1991.

<sup>32</sup> J. Meade: The post-war international settlement and the United Kingdom balance of payments, (1943), in: S. Howson, op. cit., pp. 36-66.