

Fischer, Bernhard

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Globalization and the Competitiveness of Regional Blocs in Comparative Perspective

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1. INTRODUCTION

There are processes of globalization and regionalization in the world economy and it might be challenging to determine the competitiveness of regional blocs in a comparative perspective. The approach to address these issues will be, first, to identify the critical new features of globalization (chapter 2), second, to characterise briefly trends in regionalization (chapter 3), third, to clarify the meaning of competitiveness in a global and regional context, and to elaborate major determinants affecting the competitive position of selected regional blocs (chapter 4), and, finally, to suggest some promising policy stances which might support both, further regional integration and improved competitiveness at a global level (chapter 5).

2. GLOBALIZATION OF THE WORLD ECONOMY

It is a widespread fashion in these days to make globalization either responsible for all types of national challenges (see, for example, Rodrik 1997) or to stress the opportunities arising from globalization for exploiting significant welfare gains around the world (see, for example, World Bank 1997). Taking into account that as long as people have exchanged goods and services in different currencies and factors of production have crossed national borders there was a process of internationalization or globalization. Indeed, on several economic measures - such as the share of foreign capital in domestic investment, cross-border flows of investment in relation to national output, flows of people in relation to population - the world was more closely integrated before 1914 than it is now (The Economist, September 20th, 1997). The critical question is whether there is a new dimension in this process, quantitatively and/or qualitatively. A brief look to the statistics will demonstrate that the speed of globalization has indeed accelerated, already mobile factors of production (capital) have become even more mobile, and formerly rather immobile factors of production (services, labor) have become increasingly mobile. Private actors have become more and more the driving forces of this process, while at the same time it has become less and less controllable by national governments.

Mainly driven by progresses in multilateral trade liberalization efforts, which culminated in the successful completion of the Uruguay-Round in December 1993, world trade growth doubled from 4 per cent per annum between 1980 and 1993 to 8 per cent 1994-96, outpacing world output growth by a widening margin (OECD 1997). Technological innovation, particularly in communication and information processing, has expanded significantly the borders of tradable services. Trade in commercial

services grew at double the rate of merchandise trade between 1980 and 1997 (8,7 per cent versus 4,5 per cent). In 1995 it amounted to 23 per cent of total world trade.

Reductions in transport and communication costs (Table 1), capital account opening, financial market deregulation and privatization of state enterprises have combined to create a favourable environment for increased capital mobility. From 1990 to 1995, borrowing on international capital markets rose by one-fourth, to US\$ 1,3 trillion. Net resource flows from OECD to non-Member countries amounted to US\$ 252 billion in 1995, twice their 1990 level. The trend towards a dominant role for private flows has significantly accelerated in recent years. Their share in the total has risen from one-third in 1990 to two-thirds in 1995. Foreign direct investment represents more than half of private financing from OECD to non-Member economies.

Taking into account that about 50 per cent of trade in goods and services is intra-firm trade and two-third of international capital flows are managed by private actors it becomes evident that the private sector, in particular multinational firms and institutional investors, is the major player in this globalization process.

Table 1
Transport and Communication Costs, 1920-1990
(1990 US dollars)

Year	Sea freight ^a	Air transport ^b	Telecommunication ^c
1920	95	d	d
1930	60	0.68	244,7
1940	63	0.46	180,5
1950	34	0.30	53,2
1960	27	0.24	45,9
1970	27	0.16	31,6
1980	24	0.10	4,8
1990	29	0.11	3,3

a) Average ocean freight and port charges per short ton of import and export cargo;

b) Average air transport per passenger mile

c) Cost of a 3 minute telephone call New York to London;

d) not available.

Source: Hufbauer (1991)

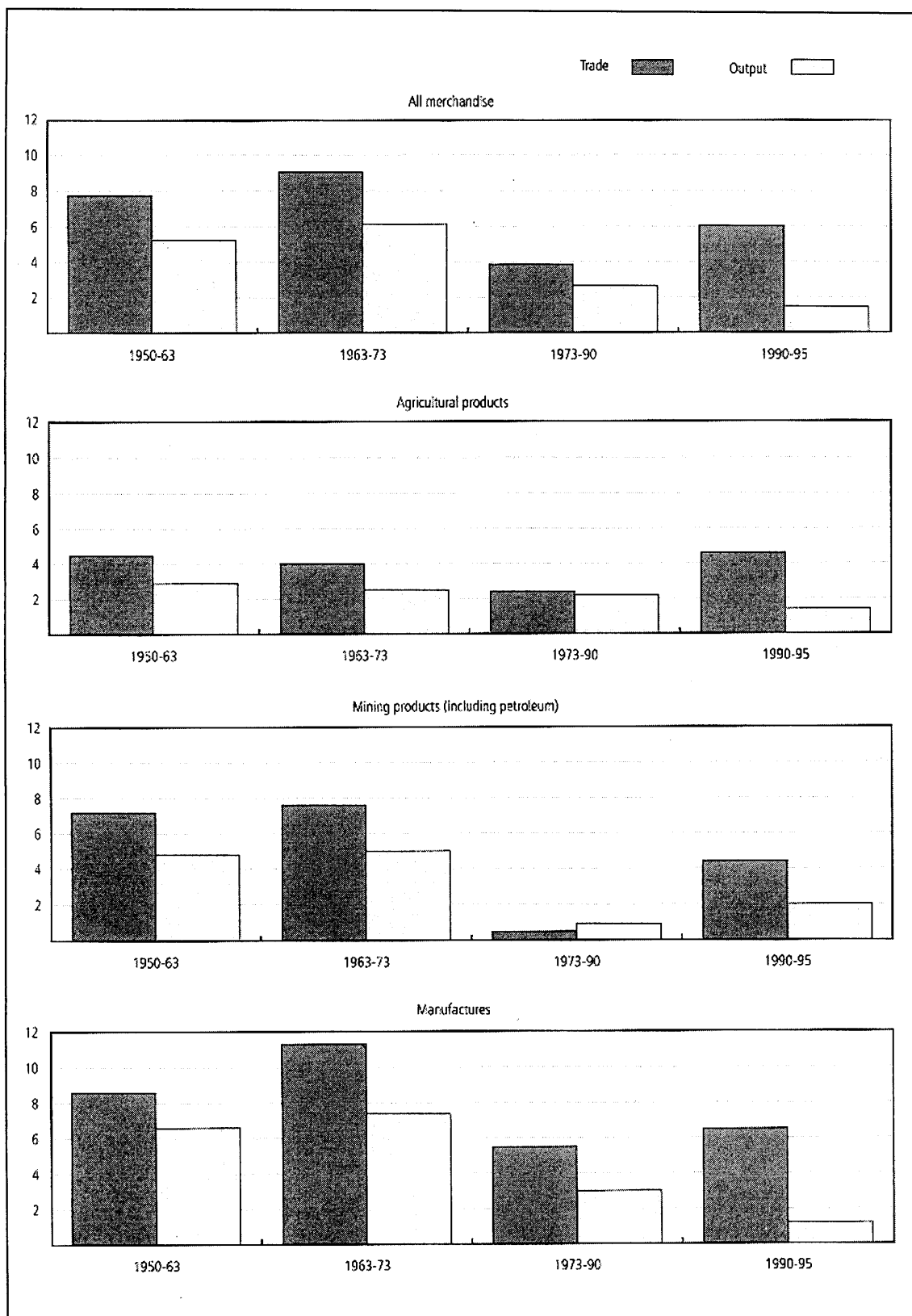
The globalization of markets mainly concerns the integration of product and capital markets. Labor markets remain highly segmented by immigration policies and by language, cultural, and other barriers to the international movement of labor. Although residents born abroad, as a share of total population, have been increasing in many advanced countries, their number is still below 5 per cent in most countries and exceeds 10 per cent in only four (IMF 1997). It does not appear that labor markets have become more integrated in recent decades.

One measure of the extent of product market integration is provided by the ratio of trade to output. By this measure, product market integration has doubled since 1950 and has risen significantly in the past decade (Table 2). This measure obviously understates the degree of integration because an increasing share of output in advanced countries consists of services, a large proportion of which are non-tradable.

Another way of assessing the degree of product market integration is to examine the extent to which prices for internationally traded products converge across countries. Empirical studies have consistently found large and persistent deviations from the law of one price for a wide range of traded goods, except for some highly homogenous commodities, such as gold (Rogoff 1996). This may be attributed to various adjustment costs and trading frictions, including transportation costs, tariff and non-tariff barriers and transaction costs. Thus, even though international goods markets are becoming increasingly integrated they are clearly not yet as integrated as domestic goods markets (Rogers 1996).

Capital markets have also become more integrated especially over the past two decades. However, despite the phenomenal growth of cross-border flows and the rapid progress toward the integration of financial markets, financial globalization seems to be confined to heavily traded, highly liquid financial assets, while countries' overall investment performance continues to be determined predominantly by their domestic saving rules rather than by net capital inflows. But the highly integrated segment of the capital market is significantly large to exercise higher constraints than in the past on the conduct and effectiveness of macroeconomic policies.

Table 2
World Merchandise Trade and Output by Major Product Group 1950-95
(average annual percentage change in volume terms)



Source: WTO, Annual Report 1996, Vol. II, Geneva 1996

In the past 30 years, and particularly since the mid-1980s, the environment for FDI and trade has changed significantly (UN 1996). The most important changes relate to the reduction of technological and policy-related barriers to the movement of goods, services, capital, professional and skilled workers, and firms. More specifically, technological developments have greatly enhanced the ease with which goods, services, intangible assets and people can be transported, and tasks related to the organization and management of firms implemented over distances. As a result, international production has grown substantially, as many firms have become transnational corporations. For example, the number of parent firms headquartered in major developed home countries nearly quadrupled between 1968/69 and 1993, from 7,000 to 27,000. Thus there is a substantial presence of foreign affiliates in the world economy today. The principal effect of the new environment is that firms are freer to choose how to serve foreign markets: by producing at home and exporting, by producing in a foreign country for local sale, or by producing in a foreign country for export. They also have greater freedom to obtain foreign resources and inputs for producing raw, intermediate or financial products for use elsewhere in national, regional or global markets.

One important consequence of the rapid progress in globalization is that margins of competitive advantages have become thinner: a small shift in costs somewhere can seriously affect a nation's competitiveness, which means that comparative advantage has become increasingly volatile (Bhagwati 1997). This is partly reflected in industrial countries by increased pressures on the labor markets. In the USA the problem takes the form of poverty wages and in Europe of unemployment, in particular of unskilled workers. The underlying cause appears the same: The developing countries' comparative advantage in unskilled labor. The serious challenge for industrial countries is that globalization is tending to reduce the capacity of the state when it comes to taxes and spending while at the same time it is enlarging the demands on the state when it comes to the labor market. This implies a big threat for a national social consensus and income disparities within countries, a phenomenon which can be observed in both industrial and developing economies.

3. TRENDS IN REGIONALIZATION

Together with the acceleration of the process of globalization regional trade agreements have gained momentum in the 1980s and 1990s in all parts of the world (see, for example, Borrmann, Fischer et al. 1994), involving economies at all levels of development (Appendix Table). This means that the world has seen at least as much fracturing than merging. With the emergence of APEC, virtually all members of the

World Trade Organization (WTO) now participate in at least one agreement to advance regional trade liberalization in goods and/or services. In the context of the newly established Committee on Regional Trade Agreements, the WTO Secretariat has identified 88 individual regional agreements currently in force (WTO 1996, Table III. 2). These agreements and initiatives vary substantially in coverage, scope and completeness: The European Community, the only entity with a fully fledged single market and a supranational authority; MERCOSUR, the Andean Group and CARICOM designed as "classic" custom unions with a common external tariff; EFTA and NAFTA as free trade areas; APEC as an example for a looser association of trading partners with a long-term aim of free trade; the Free Trade Area of the Americas, a grand design but being still only at a conceptual stage. Whether regional and multilateral trade liberalization are compatible or whether there exists the possibility of fragmentation of the international trading system through the development of different sets of rules is a concern (Sager 1997). As regional trading arrangements (RTAs) have spread, enlarged and deepened over the last decade the discussion has intensified whether RTAs stimulate growth and investment, facilitate technology transfer, shift comparative advantage towards high value - added activities, provide credibility to reform programs, or induce political stability and co-operation. There is also the proposition that RTAs are a useful vehicle for countries to employ for improving their international competitiveness. In this context it is claimed that trading blocs can serve as a testing ground for eventual global integration as they allow firms to gradually develop internationalisation skills. This argument reminds to the infant industry protectionist argument in which barriers are used to protect domestic industries until they develop the skills necessary to compete internationally: As history proves such policies have a fairly poor record.

Although conclusive evidence on the significance of trade diversion induced by regional integration schemes is almost impossible to produce, recent trends in intra-regional and extra-regional trade allow for some tentative conclusions on whether regional, rather than global networking was the dominant feature in the world economy during the 1980s and early 1990s. It is not surprising that intra-regional trade linkages are clearly most developed in Europe, considering the EU's long tradition and advanced stage of economic integration (Nunnenkamp 1996). More than two-thirds of total EU exports go to neighbouring countries (other EU Members, EFTA countries, and Central and Eastern Europe). However, the share of extra-regional exports did not decline further since 1980. The process of completing the Internal Market had little impact on the relative importance of intra-EU trade until 1993. Intra-regional trade has traditionally been less

significant for the United States than for Europe (even if US exports to Latin American countries are considered as part of regional trade relations). But there are nevertheless two important similarities: Intra- and extra-regional trade increased at similar rate in 1980-93 and total US export growth was in line with world export growth. Most surprisingly, NAFTA has been estimated to have only marginal trade diversion effects on non-member countries in Latin America. Regional networking in Asia, which was mainly market driven, in contrast to institutionalized regionalism elsewhere, is also highly unlikely to have retarded the globalization of Asia's trade relations. There are also indications that the regionalism in ASEAN will continue to take the form of 'open regionalism' (Athukorola, Menon 1997).

There are at least two indications that the regional integration schemes in Latin America may be labelled as open regionalism. First, when comparing the periods 1986-90 and 1991-95 changes in the growth rates of imports in Latin America have been less pronounced for intra-regional imports in Latin America than for their imports from the rest of the world (Table 3). For example, while growth of intra-regional imports in the MERCOSUR was 24.6 per cent in the period 1991-95 vis-à-vis 18.5 per cent in 1986-90, the growth rates of imports from the rest of the world were 19.7 per cent or 7.9 per cent respectively. Secondly, as MERCOSUR has demonstrated with its association agreement in the cases of Chile and, recently, Bolivia, the integration schemes offer access for potentially new members. Evidence for the potential adverse effects of RTAs on member and on third countries was recently provided by a World Bank study for MERCOSUR (Yeats 1997), but this analysis only is capturing static, excluding dynamic effects from integration. Although trade regimes may constitute an important element of a competitive strategy I will in the following focus on the meaning of competitiveness in a global context and then discuss to what extent it makes sense to speak of competitiveness among regional blocs.

Table 3
Growth of Intraregional Imports in Latin America, 1986-1995
(growth rates of the import value in US\$, c.i.f., per cent)

Regional Integration Schemes	1986-90		1991-95	
	Intra	RoW	Intra	RoW
MERCOSUR	18.5	7.9	24.6	19.7
Andean Community	9.8	34.6	2.7	16.0
CACM	3.0	5.7	20.8	15.6
CARICOM	6.7	0.4	6.2	6.3

RoW = Rest of the World

Source: IMF, Directorate of Trade Statistics, Washington, D.C.

4. COMPETITIVENESS IN A GLOBAL AND REGIONAL CONTEXT

The rapid process of globalization and regionalization of the world economy has serious consequences on the understanding of competitiveness. While competitiveness at the firm level is characterized by a firm's increased market share at the expense of others, competitiveness at the level of nations (and thus regions) has lost its significance with the increased mobility of factors of production. The competition is more and more among (increasingly less) immobile factors to attract internationally mobile resources from the global pool thus raising the incomes of complementary immobile factors within the borders (Findlay 1995). However, Krugman's (1994, p. 44) notion that "competitiveness is a meaningless word when applied to national economies" is somewhat exaggerated, as competition between nations continues to matter because there are systemic differences in economic performance (Hufbauer, Stephenson 1995).

Factors affecting domestic productivity gains are the rate at which capital is accumulated domestically, the rate at which human skills are acquired, and the efficiency of using physical and human capital in producing goods and services. However, competitiveness cannot be reduced to the mere notion of GDP growth and productivity. The success of firms also depends on other economic, institutional, political, socio-cultural, human and educational dimensions of a country. The International Management Forum Davos (IMD) has identified the following national

factors which are - according to economic theory and empirical evidence - conducive to the demonstrated social competitiveness of enterprises operating in a country:

- macroeconomic stability and predictable policies (domestic economy);
- extent to which a country participates in international trade and investment flows (internationalization);
- extent to which government policies are conducive to competition (government);
- performance of capital markets and quality of financial services (finance);
- extent to which resources and systems are adequate to serve the basic needs of business (infrastructure);
- extent to which enterprises are managed in an innovative, profitable and responsible manner (management);
- scientific and technological capacity, together with the success of basic and applied research (science and technology);
- availability and qualifications of human resources (people).

Based on statistical indicators obtained from international and regional organisations, private institutions and national institutes as well as survey data compiled from an Executive Opinion Survey sent to executives world wide to obtain their view on the present and future competitiveness of the country the IMD has calculated a factor ranking and an overall ranking for 46 countries which assesses each country's competitiveness relative to its competitors (for methodological details see Linard de Guetechin 1996). Table 4 shows the relative ranking positions within factors of competitiveness for countries belonging to major regional integration schemes. The ranking pattern suggests that the countries belonging to a regional co-operation scheme are very heterogeneous with regard to their relative competitive position, which is not just a reflection of their different levels of development. Therefore it makes not much sense to compare the competitive positions of regional blocs as a whole. Comparing the relative competitive position of individual countries belonging, for example, to the EU or MERCOSUR, respectively, the biggest competitive disadvantage of Brazil vis-à-vis Germany, for example, can be identified in internationalization, finance, and management. A comparison between Argentina and Germany reveals that Argentina lags behind in particular in science and technology, finance, and management. Such isolated comparisons of factors of competitiveness can of course only provide a rough indication of relative competitive positions as the quality of interaction of these indicators also matter but are not easy to quantify.

Table 4
Ranking of Countries Belonging to Selected Economic Blocs with
Respect to Factors of Competitiveness, 1995, Part I

	Domestic Economy	Internationalization	Government	Finance
EU				
Germany	19	9	19	8
France	23	7	36	22
Italy	28	21	45	27
United Kingdom	21	8	16	9
Spain	33	25	35	25
MERCOSUR				
Argentina	30	28	24	41
Brazil	35	46	18	34
NAFTA				
USA	1	2	7	1
Canada	26	17	10	13
Mexico	41	40	38	42
ASEAN				
Indonesia	25	37	25	36
Malaysia	7	16	4	19
Philippines	29	31	12	35
Singapore	3	1	1	3
Thailand	12	33	8	26
Memo				
China	2	23	9	37
Japan	5	14	21	2

Source: IMD, The World Competitiveness Report, Lausanne 1996; own compilations

Table 5
Ranking of Countries Belonging to Selected Economic Blocs with
Respect to Factors of Competitiveness, 1995, Part II

	Infrastructure	Management	Science & Technology	Human Capital
EU				
Germany	12	20	3	12
France	17	19	5	20
Italy	28	21	45	27
United Kingdom	14	23	16	27
Spain	23	33	30	26
MERCOSUR				
Argentina	27	44	42	31
Brazil	35	46	18	34
NAFTA				
USA	1	10	1	15
Canada	4	16	10	6
Mexico	31	35	46	39
ASEAN				
Indonesia	36	42	40	45
Malaysia	22	15	29	34
Philippines	44	29	26	38
Singapore	33	4	12	8
Thailand	42	31	44	40
Memo				
China	40	30	28	35
Japan	26	2	2	4

Source: IMD, The World Competitiveness Report, Lausanne 1996; own compilations

The main challenge today for both industrial and developing countries is globalization. The challenge of regionalization, though significant, is subordinate to the challenge of globalization. The importance of FDI and inter-firm tie-ups points to the importance of policies to attract such investment; but it also points to a danger of excessive competition among governments seeking to attract it (Oman 1994). There is therefore the need for greater policy co-ordination among potential competitors for foreign investment which in turn points up a possible role of enhanced regional or sub-regional integration both as a means to achieve such policy co-ordination and as a means to attract FDI - the latter because of the greater steadiness and credibility regionalization can give to member government's policies as well as the larger market it offers to investors. Another challenge is to resolve the problem of frequently weak price

competition among firms in the domestic economy. The persecution of *de jure* regionalization, and/or policies conducive to greater *de facto* regional integration, can be a means to weaken the power of locally entrenched oligopolies, rent seekers, and distributional cartels. Regionalization can, at the same time, work to strengthen the effectiveness and credibility of the State and of economic policies in general, which are required for attaining political stability, macroeconomic stability, and investment growth. In particular, policy makers in developing countries can thus reduce the risk of exclusion from the growth dynamics of globalization.

5. CONCLUSIONS

Given the uncertain outcome for regional trade arrangements and given the need for improved international competitiveness due to ongoing globalization it seems advisable to promote at a national level those policies which might help to enhance both integration into the regional and world markets. Prominent candidates for such policies are the build-up of infrastructure at the national and regional level and human capital formation (Fischer, Gleich, Grabendorff 1994). According to estimates by the World Bank (1994) about 60 billion US\$ would have to be invested in infrastructure up to the year 2000 to enable Latin America the successful continuation of its exports led growth strategy. Presumably the greatest competition between nations, in terms of bidding for a larger share of mobile resources, occurs in the context for the managerial and technological skills of successful multinational enterprises, including the competition for the talent of highly skilled professionals - academic researchers, engineers and other professionals (Hufbauer, Stephenson 1995 and Garelli 1996). Therefore human capital development should be a priority on the policy agenda. Finally, the enforcement of institutional competition could be a deliberate strategy in improving the competitiveness of economies (North 1995). Institutions are the constraints that human beings impose on human interaction including formal rules, informal constraints and enforcement characteristics.

Given the importance of FDI as a driving force of both regional and global integration there is an urgent need to ensure a fair international competitive environment, in particular with regard to foreign direct investment. Investment issues are currently the subject of discussion or negotiation in a number of regional fora. One important initiative was the launching, in May 1995, of negotiations aimed at the conclusion of a Multilateral Agreement on Investment among the Members of the OECD. The main aim of these negotiations is to eliminate discrimination between foreign and domestic investors. The agreement is intended to provide a broad framework for international

investment, with high standards for the liberalization of investment regimes and the protection of investment, and with effective dispute management. Other regional and international fora have already addressed investment issues, or are in the process of doing so, including APEC, ASEAN, SADC, NAFTA and MERCOSUR, as well as initiatives pursued in the context of the Free Trade Area.

Other proposals aim at the negotiations of multilateral rules on FDI in the framework of international organizations with global membership. In particular, the WTO has been mentioned as an appropriate forum for such negotiations as the inter-twining of investment and trade requires a more integrated approach to international rule-working. The WTO already deals with certain aspects of investment issues in the context of the agreements on trade in services, trade-related investment measures and trade-related aspects of intellectual property rights. In perhaps one of its most important decisions, the WTO Singapore Conference in December, 1996, set up a working group to examine competition policies. Yet the big question is whether trade liberalisation and WTO discipline will be best served by adding to the trading system a global codex, harmonizing national competition policies *ex ante*, or by mutually recognizing well-functioning national competition policies. While sound economic arguments support the latter, prevailing country-of-destination principles conjure up concerns that the former will dictate the approach (Spinanger 1997).

The further development of regional and international rules on FDI needs to consider at least the following key issues (UN 1996):

- Investment measures that affect entry and operations of foreign investors. Particularly relevant are issues relating to admission and establishment, ownership and control, operations, incentives and investment-related measures;
- Application of certain standards of treatment. Particularly relevant are issues of national treatment, most-favoured-national treatment, and fair and equitable treatment;
- Measures dealing with broader concerns, including the proper functioning of the market. Particularly relevant are issues related to restrictive business practices, transfer pricing, transfer of technology, employment, the environment, and illicit payments;

- Investment protection and the settlement of disputes. Particularly relevant are issues relating to expropriations and property taking in general, abrogation of state contracts with investors, transfer of funds, and dispute settlements.

Appendix Table
Intra-Trade of Regional Arrangements, 1970 - 1993

Region	Intra-trade of group as percentage of total exports of each group			
Developed and Developing Countries and Territories	1970	1980	1990	1993
APEC	57.1	57.5	60.0	67.2
EFTA	18.1	14.7	13.5	11.4
EU (12)	53.2	55.7	60.6	56.0
EU (15)	59.5	61.0	66.0	61.2
NAFTA	36.0	33.6	41.4	45.4
Developing Countries				
America				
Andean Group	1.8	3.8	4.1	9.2
CACM	26.0	24.4	15.4	14.2
CARICOM	4.6	4.3	7.8	8.5
LAIA	9.9	13.7	10.8	15.9
MERCOSUR	9.4	11.6	8.9	17.5
OECS	-	19.7	8.2	9.4
Asia				
ASEAN	21.1	16.9	18.7	20.0
Bangkok Agreement	1.5	2.2	1.7	2.5
ECO	3.3	18.4	3.0	1.4
GCC	6.0	3.0	7.9	7.6
SAARC	4.6	5.0	3.0	3.5
Africa				
CEPGL	0.4	0.1	0.5	1.1
ECCAS	2.4	1.5	2.2	2.5
ECOWAS	3.0	10.2	7.9	8.6
MRU	0.2	0.8	0.1	0.0
PTA	9.6	12.1	7.6	7.0
SADC	5.2	5.1	5.2	5.1
UDEAC	4.9	1.8	2.3	2.3
UEMOA	6.4	9.9	12.0	10.4
UMA	1.4	0.3	2.8	3.2

Source: UNCTAD; Handbook of International Trade and Development Statistics 1994, New York and Geneva 1995

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Abbreviations

APEC	Asia Pacific Economic Co-operation
ASEAN	Association of South-East Asian Nations
CACM	Central American Common Market
CARICOM	Caribbean Community
CEPGL	Economic Community of the Great Lakes Countries
ECCAS	Economic Community of Central African States
ECO	Economic Co-operation Organization
ECOWAS	Economic Community of West African States
EFTA	European Free Trade Association
EU	European Union
GCC	Gulf Co-operation Council
LAIA	Latin American Integration Association
MERCOSUR	Southern Common Market
MRU	Mano River Union
NAFTA	North American Free Trade Area
OECS	Organization of Eastern Caribbean States
PTA	Preferential Trade Area for Eastern and Southern African States
SAARC	South Asian Association for Regional Co-operation
SADC	Southern African Development Community
UDEAC	Customs and Economic Union of Central Africa
UDEAC	Central African Customs and Economic Union
UEMOA	West African Economic and Monetary Union
UMA	Arab Maghreb Union
UNCTAD	United Nations Conference on Trade and Development