Shams, Rasul

Working Paper

Why do countries form regions? The political economy of regional integration

HWWA Discussion Paper, No. 169

Provided in Cooperation with:
Hamburgisches Welt-Wirtschafts-Archiv (HWWA)

Suggested Citation: Shams, Rasul (2002) : Why do countries form regions? The political economy of regional integration, HWWA Discussion Paper, No. 169, Hamburg Institute of International Economics (HWWA), Hamburg

This Version is available at:
https://hdl.handle.net/10419/19331

HWWA HAMBURG

DISCUSSION PAPER

Why Do Countries Form Regions? The Political Economy of Regional Integration

Rasul Shams

HWWA DISCUSSION PAPER

169

Hamburgisches Welt-Wirtschafts-Archiv (HWWA)
Hamburg Institute of International Economics
2002
ISSN 1616-4814

The HWWA is a member of:

- Wissenschaftsgemeinschaft Gottfried Wilhelm Leibniz (WGL)
- Arbeitsgemeinschaft deutscher wirtschaftswissenschaftlicher Forschungsinstitute (ARGE)
- Association d'Instituts Européens de Conjoncture Economique (AIECE)

Why Do Countries Form Regions?
The Political Economy of Regional Integration

Rasul Shams

The author is grateful for many helpful suggestions by the participants of the HWWA workshop on Public Choice and Development on 12 November 2001.

This Discussion Paper has been prepared within the HWWA's programme "Trade and Development".

HWWA DISCUSSION PAPER

Edited by the Department
World Economy
Head: PD Dr. Carsten Hefeker

Hamburgisches Welt-Wirtschafts-Archiv (HWWA)
Hamburg Institute of International Economics
Öffentlichkeitsarbeit
Neuer Jungfernstieg 21 - 20347 Hamburg
Telefon: +49/40/428 34 355
Telefax: +49/40/428 34 451
e-mail: hwwa@hwwa.de
Internet: http://www.hwwa.de/

Rasul Shams
Telefon: +49/40/42834-442
e-mail: shams@hwwa.de

Contents

Abstract

To understand the reasons for the formation of regional economic groupings two basic concepts are introduced: association and dissociation. Moreover, the importance of interest groups and strategic groups is discussed, and security and bargaining power as basic political motivations are evaluated. The paper also analyses some political economy arguments regarding the determinants of the size of economic groupings and the dynamics of their development through different stages. Finally it considers regional groupings as strategical coalitions with a deep impact on the future of the world economy.

Zusammenfassung

Um die Ursachen für die Entstehung regionaler ökonomischer Gruppierungen zu verstehen werden zwei grundlegende Konzepte eingeführt: Absonderung und bedingte Gruppenbindung. Darüber hinaus wird die Bedeutung von Interessengruppen und strategischen Gruppen diskutiert und Sicherheit und Verhandlungsmacht werden als grundlegende politische Motivationen bewertet. Das Papier analysiert ebenfalls einige polit-ökonomische Argumente hinsichtlich der Determinanten für die Größe ökonomischer Gruppierungen und der Dynamik ihrer Entwicklung durch verschiedene Stadien. Schließlich werden regionale Gruppierungen als strategische Koalitionen begriffen, die die Zukunft der Weltwirtschaft stark beeinflussen.

JEL classification: F, F15, P16

Keywords: New Regionalism, Regional Groupings, Interest Groups, Security and Bargaining Power, Strategic Coalitions

1. Introduction

The question discussed in this paper is: why do countries form regions? This topic has been extensively discussed in the literature. There have been many answers to the question of the economic and political motivation behind the creation of regional groupings. In the following we assess this wide variety of answers on the basis of a systematic public choice approach. First of all, we outline what is labelled "new regionalism" in the literature. We then introduce the terms "association" and "dissociation" as basic concepts to help explain the process of integration. In the fourth section, interest and strategic groups are discussed, as well as their importance for the formation of regional groupings. Part five analyses security and bargaining power as a basic motivation behind the formation of regional groupings. Other forms of political and economic motivation promoting the formation of regional groupings are discussed in the following two parts. In part eight we study briefly some political economy arguments while considering the determinants for the size of regional groupings. The stages of integration are analysed in part nine. Finally, part ten is devoted to present regional groupings as strategic coalitions. The paper ends with some concluding remarks resulting from the public choice approach used to study the reasons for formation of regional groupings.

2. New Regionalism

The 1950s and 1960s witnessed what is known as "old regionalism". With the exception of Europe, most of these regional arrangements remained shallow. At the beginning of the 1970s a number of new arrangements were notified to the GATT. A real surge in the number of newly established regional integration arrangements, or RIAs, took place in the 1990s, thus justifying the term "new regionalism" (see Appendix, Fig. 1). This included the emergence of new groups as well as a revival of old ones. As a result, the share of intra-regional trade has increased strongly in some regions. This is especially true of APEC and NAFTA. Other examples are MERCOSUR and ASEAN (see Appendix, Table 1). In the EU the share of intra-regional trade decreased slightly in recent years, but in 1998 more than 55 % of total trade was still handled within the region. Geographically, the new arrangements are regional in scope, so that the participants are neighbouring countries.

Trade is usually taken as the most important criterion for integration in a regional arrangement. This is assumed by the conventional economic classification of free trade areas, customs unions, and common markets, a classification which assumes a continuum from less to more integration. However, numerous regional arrangements were established while tariffs were falling, which can be taken as a strong indication that integration is also based on other elements beyond trade (Page 2000, p. 8). Examples are non-trade barriers in areas like investment, services, intellectual property, non-trade subsidies and other differences in market conditions other than trade.

There is no single path towards integration. Groups move in different ways towards more or less and different forms of integration. Regions do not have the same customs or the same division of responsibilities between the centre and the member states. We therefore face a diverse international structure, with different groups at different stages or with different degrees of integration.

3. Association and Dissociation as Basic Political Economic Principles

The public choice approach uses economic methods to explain political processes. Therefore, the above mentioned drive towards new regionalism as a political phenomenon must find its explanation in the utility calculus of economic agents. However, since regional integration includes political decisions such as the abandonment of sovereignty rights, the transfer of power to supranational institutions, etc., the utility calculus must be extended to cover such "political prices" that have to be paid in order to participate in a group. A basic hypothesis used to explain such dynamic politico-economic processes as regional integration is that these processes are driven by two deep-rooted, fundamental, opposite but complementary human agencies: association and dissociation. The agency of association means that human beings survive much better in groups than individually. In order to realise their aspirations in life it is necessary for individual human beings to build alliances, to become group members and to associate themselves with others. In order to benefit from the group services individuals have to pay membership fees and recognize the group's statutes or regulations. This means they have to sacrifice a certain amount of their freedom to take decisions or the totality of their individual autonomy (Lemper 1990, p. 31). For the individual, independence and self responsibility are usually at the centre of his or her sphere of interest. Individuals are ready to surrender their independence to some extent

and to join groups because they believe they can realise their own goals through group activities.

The same is true of firms, which enter into an array of associative activities beginning with loose working groups and cartels up to complete fusion. In much the same way as individuals, firms undertake such associations in order to realise entrepreneurial goals despite their general preference for independence.

At the level of national economies we encounter the same basic principles in the formation of military alliances and other conditional group buildings. Economically, the same principles express themselves at the national level as processes of integration and protectionism. In this case the nation state is ready to surrender its sovereignty to some extent in exchange for economic benefits. Nation states lend tremendous weight to their political sovereignty and are willing to relinquish this sovereignty only if substantial economic benefits can be realised instead. Economic integration is usually the outcome of a negotiation process where different national interests are brought into concurrence. A process of this kind usually culminates in the signing of a treaty. Integration engenders a dynamic process which can end either in disintegration or, more successful, in higher stages all the way up to political union.

4. Interest Groups, Strategic Groups and the Formation of Regional Groupings

The nation state is not a uniform entity. It usually consists of numerous groups and associations with complicated structures and inter-relationships. Therefore the prime force behind integration and protectionism is not the nation as a whole, but usually powerful groups which are in a position to enforce their claims. In political economy models these groups are dealt with as economic agents that seek to maximize their economic welfare. According to the theory of interest groups, agents engaged in productive activities lobby for policies that will raise their real income levels. These lobbyists address government officials as the providers of the public policies they desire and who in turn seek to maximize their own economic welfare. This is achieved through re-election to political office. In return for campaign contributions from groups that benefit from their policies, politicians are willing to supply certain policies e.g. import protection for an industry. However, the policies sought by these groups usually have harmful effects on other groups. Import protection, for example, leads to price increases

which benefit some factors of production, but have the effect of decreasing the real income of other agents and thus of generating political opposition to the import protection (Baldwin 1998, p. 48).

Government officials do not evaluate equally the benefits and disadvantages their decisions cause to different groups. They follow a maximizing rule, according to which the different abilities of particular groups to mobilise political resources are assessed. Government officials thus act as a transmission device for the political pressure brought to bear by active interest groups (Holthus and Shams 1987, p.280).

So far, the discussion has referred to developed countries. A number of special features must be taken into account when applying interest groups theory to developing countries. The label "interest group" in this case should not be confined to formally organized groups. In these countries, groups that are not formally organized can often have an enormous influence on the shaping of economic policies. For example, organizational parameters such as ethnic origin or other socio-economic circumstances can become important factors in the formation of groups (Shams 1988, p.92-93).

The structural diversity of developing countries also makes it virtually impossible to postulate a uniform configuration of groups. In any given country at any point in time a particular pattern of such informal groups may predominate; this pattern can be affected by changes in world economic conditions, a crisis in the country's development strategy or the emergence of new socio-economic groups in the course of the development process. To demonstrate the difference between developing and developed countries in this regard it is reasonable to differentiate between interest groups and strategic groups. In contrast to interest groups, strategic groups are not bound by democratic traditions and therefore compromise and compensation are not institutionally anchored as elements of intergroup exchanges. The implication is that the state is not institutionally confined in its power to define and enforce property rights and there will be outright competition to control state power by different strategic groups (Shams 1991, p. 145).

The formation of regional groupings is therefore driven by interest or strategic groups respectively, which expect to benefit from integration and are able to dominate the political agenda of the participating countries. The distribution of the benefits of integration among groups within the respective countries defines how far a consensus exists on integration policies. Depending on the quality of political institutions a more equal distribution of benefits will ensure a consensus while an unequal distribution will

lead to conflicts on integration policies. Germany and the United Kingdom might be cited as examples for the impact of these different distributional patterns within the EU.

5. Security and Bargaining Power as Basic Motivations for the Formation of Regional Groupings

The formation of regional agreements is usually modelled by economists in strictly economic terms. Utilizing the interest group theory, a variety of political economy models have been developed which analyse the changes in economic welfare of various groups leading up to the formation of regional agreements. Examples are the tariff-formation function approach, the political support function approach, the median voter approach, the campaign contribution approach and the political contributions approach (reviewed by Rodrik 1995). In the political contributions approach (Grossman and Helpman 1995), for example, the formation of free trade areas depends on two factors: it is either due to overwhelming consumer benefits which allow governments to ignore the lobbies against it, or because export lobbyists, who can sell in the partner country at higher prices, support a free trade area and can offset the resistance of import-competing groups in both trade creating and trade diverting sectors. Resistance from the worst-hit sectors is often obviated by exceptions to the free trade area. The sectors exempted are most likely to be those which feature a substantial amount of trade creation and are dominated by import-competing producers.

Lobbying by producer groups may make it easier for countries to liberalize trade on a regional basis than unilaterally or through the multilateral process. There are two reasons for this: first, regional integration improves market access for the home country in partner countries' markets but, assuming the foreign trade is internationally broadly diversified, limits the increase in international competition to manageable proportions, since liberalization is only with the partner countries. Second, since the partner countries' markets are similarly protected from competition from the rest of the world quite large profits may be possible (The World Bank 2000, p.27). Regional integration therefore proves to be a politically feasible way to liberalize trade.

Political motivations are not usually discussed in such approaches, although they play a crucial and often decisive role in the formation of regional groupings. As a matter of fact the primary purpose of integration is often political (The World Bank 2000, p. 11).

The two most influential political motivations, very often discussed in informal writings about such agreements, are security and bargaining power.

The argument that regional integration binds the participating countries together and therefore increases security is based on the proposition that trade, by fostering understanding and raising the level of interaction, increases trust and therefore alleviates conflicts between partners. Regional integration as a policy to promote trade within a region will therefore increase regional security. Regional integration arrangements promote security in many ways. They can for example reduce tensions between previously antagonistic states, stabilize neighbouring countries and respond to outside threats by strengthening relations between integrating partners (Schiff and Winters 1998, p. 185). The idea that increasing trade reduces the risk of conflict had already been formulated by Kant at the end of 18th century. Other personalities who upheld the idea have included the British politician Richard Cobden in the 19th century and U.S. Secretary of State Cordell Hull in the 20th century (The World Bank 2000, p. 13).

The most prominent example of regional integration serving to promote security is the EU. European security was already the main aim of the European Coal and Steel Community (ECSC) founded in April 1951 by France, West Germany, Italy and the three Benelux countries. In this case, sectoral market integration was merely the means to bind Europe together politically. In 1957, the European Economic Community (EEC) and the European Atomic Energy Community (Euratom) treaties were signed in Rome. These treaties embodied the hope that "by creating an economic community the foundations of a deeper and wider community among peoples long divided by bloody conflict" could be laid. Economic means were therefore adopted in order to achieve political ends. The process of economic integration in Europe proves therefore to be a vehicle for ensuring security (Shams 2001, p. 4)

Security considerations also played an important role in the signing of the Treaty of Asunción in 1991 establishing MERCOSUR. Relations between Brazil and Argentina were characterized by military rivalry for a long period before the signing of the treaty. Sectoral agreements signed in the mid-1980s had already served to reduce tensions between the two countries. The creation of MERCOSUR reinforced this process (The World Bank 2000, p. 12).

As in Europe, security interests were also of overriding significance when ASEAN was established in 1967. Due to internal and external conflicts, most of the countries

participating in the establishment of the organization had to spend a tremendous amount of their resources for defence purposes. ASEAN promoted regional peace by ending intraregional conflicts after the signing of the treaty.

Trade can help resolve conflict, but it is not sufficient to do so by itself (Skaperdas and Syropoulos 2001, p. 357). To justify security as a basic motivation for a regional arrangement one has therefore to show that it contributes to a political rapprochement which would not have happened without it (Schiff and Winters 1998, p. 186). Regional integration can worsen intraregional security if it generates too much competition or large intraregional transfers which trigger conflict. The net effect of trade on security is determined as much by the economic characteristics of the member countries as by the style and design of the integration arrangement (The World Bank 2000, p. 16).

Regional trade agreements may be adopted in order to increase the bargaining power of the participating countries in negotiations with third parties. For this to happen three conditions must be satisfied. First, since in a free trade area no common external economic policy exists, the regional arrangement must take the form of a customs union rather than a free trade area. Second, the participating countries should together have more bargaining power than they would individually and third, the regional trade arrangement should reduce the transaction costs involved in reaching an optimal negotiating position (Fernández and Portes 1998, p. 211).

Regional trade agreements increase both economic and political power. The regional grouping is conferred with the power to menace. Such power can be used to secure the objectives of the group within the framework of multilateral trade negotiations. The threat to withdraw from negotiations gains credibility, since the group can signal that it has an alternative if negotiations do not proceed satisfactorily. The power to menace is also useful in bilateral negotiations with large industrial countries. This may be important for small developing countries but also for industrial countries with a view to increasing their competitiveness in relation to larger industrial countries (EU versus US and Japan). Generally, "countries which are vulnerable to pressure from strong countries may find themselves encouraged to form a region" (Page 2000, p. 40).

The most prominent evidence for an increase in bargaining power through regional trade arrangements is provided by the case of EU. The formation of the original European Economic Community (EEC) in 1957 was partly based on the desire to increase the relative bargaining power of member states in relation to the US. During

GATT negotiations the EEC achieved two important objectives. US-European trade liberalization in manufactures was accelerated, thus improving European access to American markets, while that in agriculture was delayed, raising the incomes of Europe's farmers (The World Bank 2000, p. 18).

In contrast to developed countries, developing country groupings have not succeeded in negotiating as groups. One reason may be that shared location does not necessarily mean shared economic interest. But "even if regionalism cannot confer the power to menace, it can sometimes confer the power to be noticed" (The World Bank 2000, p. 19). The clearest example for this has been the Caribbean Community and Common Market (CARICOM). CARICOM has been successful in articulating the position of the African, Caribbean, and Pacific countries' group in negotiating the Lomé conventions, in getting their nationals elected to key international positions, and in negotiating preferential market access arrangements with Canada, the United States, and the EU (The World Bank 2000, p. 20).

In conclusion, security and bargaining power appear to be the most basic motivations for the formation of regional groupings. By preserving security and bargaining power regional groupings can become ideal agents for the development of the world economy.

6. Other Political Motivations Promoting the Formation of Regional Groupings

Beyond the two basic motivations discussed above there are a number of other arguments commonly cited as explanations for the formation of regional groupings. Sometimes regional integration may serve to unite in the face of a common external threat. In this case joint economic efforts make it easier and more credible to act together to preserve extraregional security. A good example is the formation of the Southern African Development Coordination Conference (SADCC) in 1980 against the apartheid regime in South Africa.

Regional integration may also help to lock-in to decisions. In this case the formation of a regional grouping provides a commitment mechanism for the countries involved. This is especially true in the case of trade. Member countries do not reverse their trade liberalization, since they may lose the preferential access to the market of the partner countries. MERCOSUR is often mentioned as an example where, due to pressure from

Argentina, Brazil was forced to give up its attempts to deviate from the agreements. Other policies regional integration may serve to lock in are the commitment to democracy or other economic reforms besides trade. Examples are again MERCOSUR for formally excluding any country that "abandons the full exercise of republican institutions" and NAFTA for locking in a broad range of economic reforms in Mexico (The World Bank 2000, p. 24-25).

By increasing trust between the parties, regional trade agreements can help to achieve project cooperation in areas such as rivers, fishing grounds, hydroelectric power, or rail connections. Without such agreements, joint action may prove impossible due to difficulties in finding equitable ways to share the burdens and benefits of cooperation.

Regional trade agreements can also be used to make access to a larger country's market more secure for smaller countries. In this case, implicit side payments in the form of domestic policy disciplines are usually expected from the smaller partner country (Whally 1996, p. 17-18).

Another explanation for regional trade arrangements is provided by the domino theory. The basic idea is that forming a regional trade area, or deepening an existing one, produces trade diversion (Baldwin 1997, p. 875). This induces "pressure for inclusion" by non-participating countries. If the bloc is closed, outsiders may form a preferential arrangement of their own. MERCOSUR is usually given as an example in the western hemisphere as having been stimulated by NAFTA (Baldwin 1997, p. 881). One deficiency of the domino theory is that it does not explain the existence of the original regional grouping that triggers the pressure for inclusion.

Although probably less significant and surely less general, even these secondary arguments show that regional integration is shaped primarily by the political needs of government officials and pressure groups. The economic impact of regional trade arrangements is therefore incidental to the political debate on the formation of a regional grouping. If the impact is positive it gives a further impetus to the regional agreement. But sometimes the economic impact may be negative and can cause high welfare costs. In these cases the economic impact becomes more important and may interfere with the politically desired formation of regional trade arrangements.

7. Economic Motivations

Traditional economic analysis evaluates the desirability of regional integration arrangements according to their trade diversion and trade creation effects. Trade creation occurs if partner country production displaces higher cost domestic production. Trade diversion implies that partner country production displaces lower cost imports from third countries. Trade diversion increases intrabloc trade at the expense of trade with third countries, while trade creation does not have this negative effect. Therefore a regional trade arrangement is only desirable if trade creation outweighs trade diversion. From a politico-economic point of view these static effects of integration are less important. Trade diversion is often neglected by government officials when considering the formation of regional trade arrangements which are politically desired.

The above mentioned economic analysis of integration is conceived as a problem of economic welfare maximization. Economists applying this maximization rule usually assume the existence of a "benevolent dictator" who is perfectly in charge of the welfare of the world economy and is endowed with an infinite ruling mandate without being responsible to other persons (Lemper 1990, p. 23). Under the rule of such a "dictator", a regional trading arrangement can only pass the test if it is a "natural integration area". Otherwise, multilateral liberalization should be preferred and regionalism should be effectively eliminated.

Politically more important are the dynamic effects of integration. These include increased competition, scale effects, increased efficiency, a fall in import prices (terms of trade improvement), more FDI flows, and convergence and divergence effects due to locational choice, agglomeration and flows of knowledge (The World Bank 2000, pp. 51-61). The net effect will be positive or negative depending on country circumstances and existing policy options. The decision to form a regional grouping or to extend its duration will be encouraged by positive effects and discouraged by negative effects. The continued vitality of the EU as well as the collapse of a grouping like EAC in 1977 demonstrate, amongst other things, the impact of these dynamic effects on integration.

8. Size of an Integration Area

How big should an integrated region be? Considering optimum currency areas, Sheila Page (2000, p. 19) discusses the difficulties of trying to look at regional groups in the same way. According to her, we are then asking for the optimum trading area, the optimum capital or labour mobility area, the optimum regulatory area, the optimum areas for all public goods and the optimum number of levels of responsibility. From this list it is clear that it is a complex issue with no easy answers. But considering the basic motivations for the formation of regional groupings it can be argued that regions are a stage in the development of the world economy from a local, then national and on to a global scale. Preserving security is often a matter concerning neighbouring countries with a long-standing experience of violent conflict, and building a regional group is the means to promote trust and therefore security. Bargaining power likewise includes countries which have the same location and the same interests. In both cases, therefore, a limited number of neighbouring countries qualify for the formation of a regional grouping.

Paradoxically enough, the economic effects of integration do not suggest building trading regions but rather the liberalization of trade on a global scale. In this case trade creation is maximized and trade diversion avoided. Similar conclusions can be drawn with regard to the dynamic economic effects of integration. On a world scale, competition can be increased and scale economies fully realized. Likewise, agglomeration forces will be low in a liberalized world economy. Firms will go where labour costs are lowest. There will be more chances for less developed areas to catch up and thus more possibilities for convergence.

But loose liberalisation arrangements on a global scale (GATT and its successor WTO) have always been less important than more restricted arrangements on a regional level. The reason is that a large number of heterogenous countries makes negotiations too difficult to conduct, implement, and control (high transaction costs), thus undermining their credibility. Smaller groups of countries therefore are better able to consent to far reaching trade agreements on a regional basis (Hefeker and Gros 2000).

Regional groupings are therefore a political phenomenon and their proliferation can be explained only in politico-economic terms.

9. Different Stages of Integration

While a regional grouping has benefits in the form of increased security and bargaining power, the participating countries have to pay "political prices" in order to enjoy these benefits. The details of an integration treaty are the outcome of an evaluation process carried out by the participating countries in assessing the benefits and costs of group building. The stage of the integration reached is therefore the result of the associative and dissociative forces prevailing at the time of negotiations. The lowest stage in the integration process is marked by the establishment of a free trade area. It promises political benefits by preserving security and economic benefits due to trade liberalization. Its political costs are relatively small. National sovereignty is preserved to a great degree and common institutions are usually not required (Lemper 1990, p. 35).

A customs union renders bargaining power to the member countries besides preserving security. By establishing a common external tariff, however, it limits the autonomy of the members to import freely from third countries. In addition, common policies in other areas like agriculture, competition, currency and macroeconomic stabilization very often become necessary in a customs union. Again, in all these areas associative and dissociative forces come into operation and determine the form of the attained agreements.

In passing over to the next stage, that of a common market, politico-economic motivations prevail once again. This stage implies the abolishment of barriers to the free movement of factors of production, the harmonization of national technical norms, security and legal regulations, etc. While the political costs of integration are no longer negligible in this case, the economic benefits could be substantial, depending on the degree to which a single market can be realized. At this stage, the detailed assessment of economic benefits and costs becomes important. Economic considerations may surmount political considerations.

The common market increases the level of intrabloc trade. But after exploiting the potential for trade, stagnation is unavoidable. Another step in the development of the regional grouping becomes necessary in order to overcome the standstill in intrabloc relationships. A further step such as monetary union opens new frontiers, but requires ever more concessions to supranational institutions. Political union, as the final step in the development of a regional group, requires the member countries to relinquish a great deal of their national political identity.

The whole process of integration is driven by the opposite forces of association and dissociation and the related economic phenomena of leaping forwards and stagnation. Every agreement characterizing a phase in development is determined by political considerations and is followed by economic impacts which, in their turn, prepare the next stage in development. Politics and economics are closely intertwined as driving forces behind the development of integration through its various stages.

10. Integrated Regions as Strategic Coalitions

After a regional group is formed, it becomes an economic entity on the world economic scene. It encompasses several member countries which are united in a strategic coalition to realize their common economic goals and enforce them against possible opposition from other world economic agents. The regional group becomes an independent unit transcending its unilateral relationship with interest groups or national government officials. This is true, of course, in case of deep integration schemes. Shallow regional integration often involves little more than tariff and quota liberalization and cannot therefore possess the bargaining power characterizing a strategic coalition.

At the regional level, special interest groups may have less power than at the national level. In a region, however, new interest groups may develop as national sectoral pressure groups merge in different countries or as new pan-regional groupings evolve. A strategic coalition therefore develops its own social cohesion through pan-regional institutional structures.

The European Union is an outstanding example of a strategic coalition. This is verified by its present stage of integration and institutional development. NAFTA, MERCOSUR and ASEAN can also be viewed, although to a lesser degree, as strategic coalitions. These are relatively successful cases, exerting a gravitational pull on neighbouring countries. The economic relations between different strategic groups are characterized by conflict and cooperation. As a bloc grows in power, other blocs become concerned and attempt to dilute the power of the first bloc by "either proposing some form of regional link with the bloc or pressing for multilateral trade-liberalizing negotiations" (Baldwin 1998, p. 60).

Sapir (2000, p. 1146) maintains that as a result of parallel initiatives by the EU and the US, the world trading system is about to change completely. Both regions have implemented regional trade agreements with neighbouring developing countries (southern Mediterranean and Mexico), and both have taken steps towards such agreements with countries outside their own geographical areas (South Africa and Latin America, respectively). The Free Trade Area of the Americas (FTAA), encompassing North and South America and Caribbean countries is to be established by 2005. Likewise the EU is considering the establishment of regional trade agreements with its traditional ACP (=African, Caribbean and Pacific) partners. As a result "by the end of current decade, the emergence of two major 'hegemon centred' trading blocs" could be expected (Sapir 2000, p. 1146). The further development of the world economy will depend crucially on whether the two emerging blocs become closed or open entities. Since there are on-going negotiations between members of the two blocs the probability for the emergence of closed regional blocs is not very great.

Within MERCOSUR, Brazil is by far the most powerful economy. According to Grugel and Medeiros (1999, p. 57), MERCOSUR functions for Brazil both as a means to realize a gradual integration of the country's industry into a liberalized international system and as "a way to preserve traditional claims to leadership with LAC" (=Latin America and the Caribbean). Dominated by Brazil, MERCOSUR has frequently been considered as a challenge to NAFTA and as an alternative to an Enterprise for The Americas-type integration scheme. Brazil was traditionally critical about the establishment of an FTAA and resisted forcing the pace of its implementation. Complying with the decision to introduce FTAA in 2005, Brazil has been ready to give up the idea of constituting MERCOSUR as the basic unit of a South American Free Trade Area.

ASEAN has not yet passed the status of a free trade area. The distinctive characteristic of ASEAN is not the institutional development of the organization but the search for cooperative solutions to bilateral problems. Although, in the "ASEAN+3" scheme, ASEAN has extended cooperation to include China, Korea and Japan, the question of whether a free trade area should apply to this extended area as yet remains unresolved. The dynamic development of the Chinese economy in particular, with its higher productivity and efficiency, is going to become a problem for ASEAN. As China is developing into a powerful rival of ASEAN regarding exports and attracting foreign direct investments, animosities are unavoidable in the region in the long run (NZZ 2001, p. 11).

Regional trading arrangements in the developing countries are often shallow and without visible success. One important reason for this is the prevalence of rent-seeking activities, which produce inefficient outcomes. An interesting example is the failure of the ECOWAS trade liberalization scheme (Kufour 2000). In ECOWAS, intrabloc trade has never risen above 11 per cent in spite of the trade liberalization scheme (TLS) of 1975. The rules of origin in ECOWAS played an important part in this respect. They were designed to deny foreign firms entry into the TLS. In exploiting the TLS the interests of state-promoted firms in Ghana and Nigeria stood against foreign controlled firms in Senegal and Cote d'Ivoire. To reduce the likelihood of foreign controlled firms benefiting most from the TLS to the disadvantage of state-promoted firms, Nigeria, as the most influential founder of ECOWAS, persuaded the community to accept the rules of origin. With the restricted condition of "indigenous ownership and participation" in the rules of origin only a few firms were eligible for participation, so that the TLS remained without any visible impact on intra-region trade flows (Kufour 2000, p. 145). There was no resistance from Senegal and Cote d'Ivoire. Both countries welcomed the rules of origin as a means of protecting their home market from competition on the part of other Community members.

11. Conclusions

In this paper the basic hypothesis for explaining regional integration has been that such processes are driven by the two human agencies of association and dissociation. Economic integration resulting from the mode of operation of these agencies is the outcome of a negotiation process in which different national interests are brought into harmony with each other. A nation consists of numerous groups and associations. The formation of regional groupings is therefore driven by interest or strategic groups respectively, which dominate the political agenda of the participating countries, with political motivations playing a crucial role. The two most influential political motivations are security and bargaining power. Other political motivations exist, but are of less generality and importance. Even less important are economic motivations behind the formation of regional groupings.

Regarding the size of regional groupings, the basic political motivations suggest that only a limited number of neighbouring countries qualify for the formation of a regional grouping. In the process of the development of a regional grouping through different stages, political and economical motivations are very closely intertwined. After a

regional grouping is formed it constitutes a strategic coalition with its own economic goals and survival mechanism. It is very probable that the future of the world economy will be determined to a great deal by conflict and cooperation between a limited number of such regional coalitions.

References

Baldwin, Robert, E. (1998)

The Political Economy of International Trading Arrangements: A survey, in: Cohen, Daniel (ed.), Contemporary Economic Issues, Macmillan, Houndsmills and London, pp. 44-64

Baldwin, Robert, E. (1997)

The Causes of Regionalism, in: The World Economy, Vol. 20, No 1, pp. 865-888

Fernández, Raquel, Portes Jonathan (1998)

Returns to Regionalism: An Analysis of Non-traditional Gains from Regional Trade Agreements, in: The World Bank Economic Review, Vol. 12, No 2, pp. 197-220

Grossman, Gene, M. and Helpman, Elahanan (1995)

The Politics of Free-Trade Agreements, in: The American Economic Review, Vol. 85, No. 4., 1995, pp. 667- 690

Grugel, Jean; Medeiros, Marcelo, de Almeida (1999)

Brazil and Mercosur, in. Grugel, Jean and Hout Will (eds.), Regionalism Across the North-South Divide, ECPR, London and New York, pp. 46- 61

Hefeker, Carsten; Gros, Daniel (2000)

The Dynamics of Trade Integration and the Political Value of Commitment, in: Oxford Economic Papers, Vol. 52, pp. 398-414

Holthus, Manfred; Shams, Rasul (1987)

Anpassungspolitik und Interessengruppen in Entwicklungsländern, in: Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik, 32 Jahr, Mohr, Tübingen, S. 275-289

Kufour, Kofi, Oteng (2000)

Public Choice Theory and the Failure of the ECOWAS Trade Liberalization Scheme, in: World Competition, Vol. 23, No. 4, pp. 137-154

Lemper, Alfons (1990)

Europäische Integration als gruppendynamischer Prozeß, in: LIST FORUM, Band 16, Heft 1

NZZ (2001)

China - ein unbequemer Nachbar der ASEAN, in: Neue Zürcher Zeitung 11./12b August 2001, No 184, PS. 11

Page, Sheila (2000)

Regionalism Among Developing Countries, Macmillan, Houndsmill, London

Rodrik, Dani (1995)

Political Economy of Trade policy, in: Grossmann, Gene, M. and Rogoff, Kenneth (eds.), Handbook of International Economics, Vol. III, Elsevier, Amsterdam a. o., pp. 1457-1495

Schiff, Maurice and Winters Alan, L. (1998)

Dynamics and Politics in Regional Integration Arrangements: An Introduction, in: The World Bank Economic Review, Vol. 12, No. 2, pp. 177-195

Skaperdas, Stergios and Syropoulos, Constantinos (2001)

Guns, Butter, and Openness. On the Relationship Between Security and Trade, in: The American Economic Review, Papers and Proceedings, Vol. 91, No. 2, pp. 353-357

Sapir, André (2000)

EC Regionalism at the Turn of the Millennium: Toward a New Paradigm?, in: The World Economy, Vol. 23, No. 9, pp. 1135-1148

Shams, Rasul (2001)

Vision and Historical Development of the European Integration, Draft, Hamburg

Shams, Rasul (1991)

Hemmnisse der wirtschaftspolitischen Reformpolitik in Entwicklungsländern, in: Sautter, Hermann (Hrsg.), Wirtschaftspolitische Reformen in Entwicklungsländern, Schriften des Vereins für Socialpolitik, BD. 209, Duncker und Humboldt, Berlin, S. 135-159

Shams, Rasul (1988)

Adjustment Policy and Interest Groups in Developing Countries, in: INTERECONOMICS, Vol. 23, March/April, pp. 91-94

The World Bank (2000)

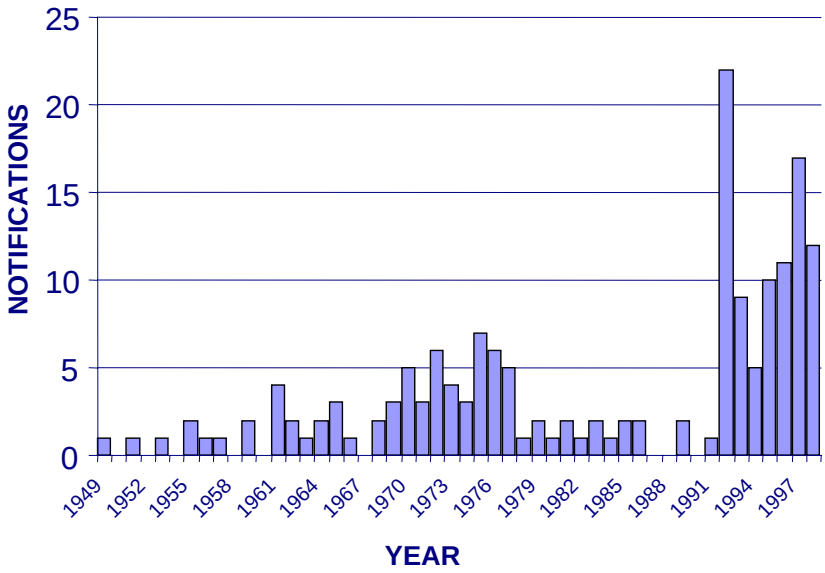
Trade Blocks, Oxford University Press, New York

Whally, John (1996)

Why Do Countries Seek Regional Trade Agreements?, NBER Working Paper Series No. 5552, Cambridge, MA

Appendix

Figure 1: Notifications to GATT and WTO of RIAS, 1949-98



Source: Maurice Schiff, Trade Blocs, A Policy Research Report, World Bank (Power Point Representation)

Table 1: Intra-regional trade of regional trade-blocs, 1970-1998 in per cent of total exports

	Exports within bloc							
% of total exports	**1970**	**1980**	**1985**	**1990**	**1995**	**1996**	**1997**	**1998**
High-income and low- and middle-income economies								
APEC	57,9	57,9	67,7	68,5	72,0	72,1	71,8	69,7
European Union	59,5	60,8	59,2	65,9	62,4	61,4	53,8	55,2
NAFTA	36,0	33,6	43,9	41,4	46,2	47,6	49,1	51,7
Latin America and the Caribbean								
Andean Group	1,8	3,8	3,2	4,1	12,1	10,7	10,3	11,9
CACM	26,0	24,4	14,4	15,4	17,0	18,9	15,5	14,5
CARICOM	4,2	5,3	6,4	8,1	4,7	13,3	13,5	17,1
LAIA	9,9	13,7	8,3	10,9	16,8	16,6	17,2	16,7
MERCOSUR	9,4	11,6	5,5	8,9	20,3	22,7	24,8	25,1
OECS	..	9,2	6,5	8,2	11,7	9,1	9,7	10,6
Africa								
CEMAC	4,8	1,6	1,9	2,3	2,2	2,3	2,1	2,6
CEPGL	0,4	0,1	0,8	0,5	0,5	0,5	0,4	0,6
COMESA	9,1	6,1	4,7	6,6	6,6	7,9	7,6	7,7
ECCAS	2,2	1,4	1,7	1,4	1,5	1,6	1,6	2,0
ECOWAS	2,9	10,1	5,2	7,8	9,3	8,8	9,0	10,8
MRU	0,2	0,8	0,4	0,0	0,1	0,2	0,4	0,4
SADC	1,4	0,3	1,4	2,8	10,1	10,3	10,0	10,2
COMESA	7,5	10,3	5,4	7,6	7,9	8,7	9,3	9,3
UEMOA	6,5	9,6	8,7	12,9	9,8	9,6	11,5	11,1
Middle East and Asia								
ASEAN	22,3	17,2	18,6	18,9	24,3	24,2	23,7	20,4
Bangkok Agreement	2,7	3,7	3,7	3,8	5,1	5,3	5,2	5,1
ECO	2,2	6,3	9,9	3,2	8,0	7,1	7,6	8,3
GCC	4,6	3,0	4,9	8,0	6,6	5,6	4,6	4,5
SAARC	3,2	5,2	4,8	3,2	4,4	4,3	4,0	5,3
UMA	1,4	0,3	1,0	2,9	3,7	3,4	2,6	2,6

Source: Worldbank, WDI 2000