

# Introduction

## I Fondad's Three-Year Project on Regional Integration and Multilateral Cooperation

When the Forum on Debt and Development (Fondad) started its three-year project on regional economic integration and multilateral cooperation in October 1994, its main objective was to explore how the ideals of regional integration and multilateral cooperation could be promoted, in a mutually reinforcing manner. Specific questions included: What contribution can regional integration of developing and transition countries make to their development? What degree of integration (ranging from free trade to political union) should these countries pursue? What would be the optimal sequencing and speed of integration of the already established (sub-) regions in Latin America, Africa and Asia? What roles could regional markets and institutions play? Is regional integration a stumbling block or a stepping stone to an improvement in the functioning of the global, multilateral finance and trading system? What roles can multilateral and bilateral donors play in fostering both regional integration and multilateral cooperation?

Over the past three years regional seminars were held in Latin America, Africa and Eastern Europe, at which experienced researchers and high-level policymakers jointly addressed these and other questions. In addition, workshops were organised to discuss the issue of how the system of multilateral economic cooperation could be improved from a more global perspective. One such workshop, for example, discussed ways in which future Mexico-style currency crises could be prevented or better managed. The research was further complemented by two studies on the financial policies and practices of the multilateral development banks, and on the issue of how the multilateral debt problem of low-income countries could be resolved. Both studies were authored by Indian economist and investment banker Percy S. Mistry who also wrote the background study of the project. For the publications resulting from the project see the list of Fondad publications at the end of this book.

Fondad's project was concluded by a two-day conference held in November 1997 in The Hague at which papers were presented to highlight the prospects and priorities for integration in Latin America, Africa and Eastern Europe. Similar papers were also prepared on the regions that

had not yet been included in the research, i.e. Asia and the Middle East. In addition, papers were prepared on the topic of economic globalisation and on the issue of regionalism versus multilateralism. These papers were presented and discussed at the conference in The Hague in four subsequent panels, whose order corresponds with Parts II to V of this book.

After the conference, we realised that the papers and the ensuing discussions were so rich and encompassing that it would be better to publish them in two separate volumes. This one focuses on the main question raised in the project – how can regional integration contribute optimally to national development as well as to multilateral cooperation? – whereas the other focuses on the policy challenges of the globalising economy (for the contents of the second volume, see the list of Fondad publications at the end of this book).

The latter volume is a kind of ‘transition’ book serving as a bridge between the Fondad project which has come to a close and the new three-year research project on which it has now embarked. Fondad’s new project examines the implications of rapid global financial integration for national and international policymaking. It focuses in particular on the dynamics of private capital flows to non-OECD countries and its consequences for bilateral and multilateral development cooperation.

## **II The Political and Historical Context of Regional Integration and Multilateral Cooperation**

Fondad’s project on regionalism and multilateralism – including the conference from which this book results – has focused mainly on the *economic* aspects of regional integration and multilateral cooperation, because we believe that the facilitating economic structures and institutions of regional integration and multilateral cooperation are so crucially important that they deserve special attention. Even more so since the general public is often ill-informed about these matters which are shaping the lives of peoples all over the world. However, I also believe that both regional integration and multilateral cooperation are basically *political* projects. And while supportive economic conditions are needed, the success of both endeavours seems to depend largely on the political support they are able to raise.

Let me illustrate this point by referring to the region which, since the Second World War, has become the success story of regional integration *par excellence*: Europe. If one defines integration rather broadly, one could argue that Europe has had a much longer history of integration dating back to the Greek city-states, the Roman Empire, the Arabic

Mediterranean and Charlemagne's Empire ... and up to the attempts by Napoleon, Bismarck and even Hitler to dominate important parts of Europe. But while these numerous attempts at 'integration' resulted in, at best, the formation of nation-states, it mostly resulted in European disintegration and war. Why? Because of at least one basic flaw: the peoples and countries being 'integrated' were not asked whether they really desired it.

While the 18th, 19th and early 20th centuries were characterised by internal rivalries and attempts at integration, Europe also became the fore-runner of what one might call 'global integration', as exemplified by the 'Empire where the sun never set', stretching from Canada to South Africa, India and Australia – to mention just four of the twenty-four countries constituting the British empire at the time.

After WW II, most of these early 'global' integration arrangements pursued by European nations were dissolved, leaving Europe with the sole, but highly desirable, objective of establishing enduring peace and prosperity in its own region. (It is interesting to note that during this time, one of the countries which had already freed itself from Europe's influence, the United States, emerged as the new superpower trying to integrate large parts of the world, economically as well as politically and militarily.)

The further story of European integration is well-known – European statesmen and businessmen feverishly began to construct an ever more united Europe. Having started in the early 1950s as a European Coal and Steel Community with only six member states, they have now reached the stage of an European (Monetary) Union with fifteen member states and ten more candidate countries in Central and Eastern Europe anxiously waiting to join the club.

It goes without saying that this tremendous success in the deepening and widening of the European integration process was substantially facilitated by the regional *economic* structures and institutions that were put in place to foster intra-regional trade and finance. But we must not forget that all of this was only possible thanks to the *political* push for a united Europe. Without such a push, European unity would not have become reality.

This brief account of European integration points to another issue which I see as one of the major problems of an unbridled process of ever-deepening regional integration: How far should it go? Isn't Europe's energetic embracing of a single currency, the *Euro*, now showing the pitfalls of integration that has gone too fast or too far? Should European nations not put more energy in keeping alive their rich variety of differences – in cultural, social, political and even economic life – rather than almost blindly following the new dogma of 'conversion' of economic policies?

Let me explain. As with other ideals, regional integration should never become a dogma. It is a useful and attractive project as long as those who

are intended to benefit from it indeed reap the fruits (without jeopardising those who remain outside). But on the day that citizens begin to raise serious and well-founded doubts about the supposed beneficial effects, policymakers and entrepreneurs should begin to rethink the wisdom of ever-increasing regional integration. In my view, regional integration should never become an end in itself, but it should be subdued to the broader and 'higher' goals of justice, social equality, cultural identity and respect for nature. In other words, social, political and cultural (and economic!) considerations can be good reasons for a revision of integration plans.

Returning to the example of European integration, citizens, policymakers and entrepreneurs in Africa, Latin America and Asia should view Europe's interesting experience with regional integration with a critical eye. Only then will they be able to assess the 'real' successes, failures and problems of the European example. And even though the economic aspects of regional integration tend to be the most 'visible' and most widely reported, economic arguments should never blind the public view.

Still one thought about multilateralism. While regionalism may be going too far and too fast, multilateralism is often too restricted and too slow. Again, let me explain. Multilateralism has remained largely an ideal which has achieved only limited success. The United Nations has never become the serious, enthusiastically supported forum for discussion that its founding fathers envisioned. On the contrary, many member states have continuously expressed their reservation about giving too much power (or even any power at all) to the UN. Over the last few years some major members have even refused to pay their full contribution. Only those multilateral organisations which are seen as useful by the major members of the UN – in particular the IMF, World Bank and GATT/WTO – have fared better. But even these organisations have applied the principle of multilateralism with only limited success, as is illustrated by the fact that they are only able to enforce policy prescriptions on the less powerful member states. And though in some cases they have been able to reach agreement by all member states on important new multilateral rules of the game (e.g. GATT's success in completing the Uruguay Round on free trade), many observers – particularly in the developing countries – view their actions as inspired and ruled by the major industrial nations. Officials of the IMF and World Bank keep on repeating, therefore, that poorer countries should get the feeling that they 'own' these institutions. As Mark Malloch Brown, Vice-President of the World Bank, put it at Fondad's concluding conference, "one of our challenges is the question of ownership; we still need to move the World Bank from being a shareholder institution to becoming a stakeholder institution".

With regard to multilateralism, however, there is one area where I

remain wary about zealous adherence to the ideal: the current advocacy of a multilateral agreement on investment (MAI). Here, possibly because of the far-reaching success of its predecessor, i.e. the multilateral agreement on free trade, MAI adherents seem too eager on putting their ideal of a world reigned by 'free trade' and 'free investment' into practice. Those who are trying to establish an MAI today should first listen seriously to the criticism that is being voiced in various parts and sectors of the world. A discussion of the pros and cons of the proposed MAI is included in the second volume of the proceedings of Fondad's November 1997 conference.

Let me now introduce some of the extremely interesting economic and political issues that are discussed in this book.

### III The Prospects for Integration in the Regions

#### *Europe*

The three experts whose papers are included in this volume, each deal with a different aspect of the process of European integration. In a broad and daring view, Hungarian economist András Inotai argues that Europe is facing four major challenges: (i) the *deepening* challenge which results from the internal logic of integration and global competition; (ii) the *enlargement* challenge of incorporating Central and Eastern European countries as full members of the EU; (iii) the *global* challenge of, inter alia, international competition, the problem of unemployment, migration, and illegal and criminal activities; and (iv) the *institutional* challenge of the need for reform of the existing EU integration mechanisms and institutions. Hans Peter Lankes, a German economist working for the European Bank (EBRD), explains why, in his view, the key challenge for Central and Eastern European countries is to enhance government and enterprise capacities. This will not only further transform these countries into well-functioning market economies but also promote their growth and prepare them for EU accession. Piritta Sorsa, a Finnish economist with the IMF, assesses the main challenges of Baltic accession to the EU which include economic stabilisation and structural reform in the Baltics, and the elimination of trade restrictions by the EU.

Both in these papers and the subsequent Floor Discussion a large number of interesting observations are made. On the issue of the *deepening* of EU integration these include for instance: The deeper the integration is, the less countries are able to fully participate in the process; With deeper integration, the mechanisms that have made a major contribution to increased cohesion among EU member countries (e.g. CAP and structural

funds) will no longer be sustainable; Deepening may divide Europe, and the costs of division and instability will be substantially higher than the costs of a slower pace of deepening.

Also on the issue of EU *enlargement* many interesting observations were made such as: More sub-regional cooperation in Central and Eastern Europe (CEE) is not a precondition but a consequence of successful integration into the EU; EU enlargement will not result in a crowding out of African countries because the trade pattern of CEE is completely different; Trade between the EU and CEE has developed more dynamically in the last five years than any other bilateral trade relationship in Europe; Given the income gap between EU and CEE, enlargement must be based on market integration as well as developmental integration (similar to the development support given previously to Ireland, Greece, Portugal, Spain and the former GDR); The costs for the EU of opening up to CEE and letting in new members from this region tend to be exaggerated; The populations of the candidate countries in CEE should be made aware of the very painful economic reform they will have to go through in order to become a member of the EU.

As regards the *global* and *institutional* challenges, observations included: The success of European integration crucially depends on its competitiveness in global markets, which can be enhanced by making use of the highly educated and flexible labour of Central and Eastern Europe; The EU has to deal with institutional reform before enlargement takes place, and the closer the EU gets to the accession of the first CEE candidate, the greater incentives will be for the present EU members to agree on institutional reform.

### *Asia and Latin America*

The experts who have written the papers on integration in Asia and Latin America present diverging views. Arvind Panagariya from India, who previously worked with the World Bank and co-authored a pioneering study on *New Dimensions in Regional Integration*, argues in his paper that “it is a folly” to push for preferential trade arrangements (PTAs) in general and in Asia in particular. On the other hand, Miria Pigato from Italy, who works with the World Bank, argues that South Asian countries would benefit from promoting a regional trade agreement, particularly in the political and social sphere. Robert Devlin (IDB) from the US and Ricardo Ffrench-Davis (ECLAC) from Chile give a balanced view of the strategic dimensions and rationale of Latin America’s regional integration process.

Some of the observations presented in the papers and ensuing Floor Discussion are: Interaction in South Asia has been remarkably low, primar-

ily as a result of non-economic factors; Today's integration in Latin America is driven by powerful political objectives; Most of the regional integration agreements in Latin America, particularly Mercosur, go well beyond preferential trade agreements and receive support of the general public who sees them as a way of bringing countries together; It is often overlooked that in the new context of policy change in Latin America, regional integration is an additional instrument to open the economies to global competition; Latin America has a vested interest in ensuring that regionalism is consistent with a progressively more liberalised and rule-based world trading system, if for no other reason that 80 percent of its trade is extra-regional.

### *Africa and the Middle East*

As Ernest Aryeetey from Ghana observes in his overview paper on the prospects for regional integration in Sub-Saharan Africa (SSA), for many years integration has been regarded by policymakers in Africa as "a highly desirable objective", despite the lack of concrete results. Today, however, says Aryeetey, there is a new perception of how integration should be conceived and pursued. He carefully analyses the main policy recommendations currently circulating in SSA, highlighting those that are likely to influence future courses of action. In a similar way, Mohamed El-Erian, from Egypt, provides insights into the reasons for the limited regional interaction in the Middle East and North Africa (MENA), and identifies the main factors that will influence future interaction. Rosalind Thomas from South Africa critically reviews the recently agreed Trade Protocol of the Southern African Development Community (SADC) and suggests how it should be framed in order to design an agreement that takes the needs of the different member countries into account.

Interesting observations from these papers and the Floor Discussion include: It is becoming increasingly evident that small countries in SSA find it difficult to deal with the many problems they are facing (such as the loss of credibility of national institutions and a lack of resources) and therefore turn to supranational structures and institutions; The growing scope of regional integration is derived partly from the new role of the private sector in various SSA countries; The African Economic Community should develop appropriate macroeconomic frameworks to facilitate greater interaction among the resources of countries, and establish mechanisms for attracting both private and public capital flows from the rest of the world; The harmonisation of macroeconomic policies (particularly monetary and fiscal policies) in SSA is probably more crucial than trade reforms in the creation of trade; The integration of financial markets across coun-

try borders in SSA is a major way to attract private capital flows; In MENA, favourable developments in the enabling economic environment and the catalyst of the EU Association Agreements will encourage regional interaction; Greater economic interactions are likely to emerge in the form of further integration of the six members of the Gulf Cooperation Council and greater interaction among other sub-groups of Arab economies.

#### **IV The Regionalism vs. Multilateralism Debate Revisited**

The fundamental question of whether regionalism can contribute to peace and prosperity in member states of regional groupings as well as to the functioning of a multilateral system which serves the needs of *all* nations, is addressed in Parts I and V of this book.

In his contribution to Part I, Jan Pronk, Minister for Development Cooperation of the Netherlands, who sees himself as “an outspoken proponent of multilateralism”, makes a plea for the strengthening of international institutions such as the WTO, the IMF and the World Bank in order to guide the process of economic globalisation. At the same time, however, Pronk argues that “a workable system of international governance does not and cannot exist solely on the basis of global institutions”. In his view, regional arrangements are a necessary complement to – and building blocks for – a system of global governance.

Mats Karlsson, Under-Secretary of State for the Swedish Ministry of Foreign Affairs, emphasises the need to strengthen institutions at all levels – local, national, regional and international – in order to cope with the challenges of globalisation. In his view too, regionalism is not opposed to multilateralism, “rather it is a means to secure the benefits for the region of the globalisation process.” Like Pronk, he advocates a strengthening of global economic governance. In particular, Karlsson supports the idea of the creation of a World Economic Council “anchored in the United Nations and modelled on an Expanded Security Council of about 23 elected countries”.

In Part V of the book, Professor Björn Hettne from Sweden, gives a broad view of the various issues involved in the processes of regionalisation and globalisation, incorporating economic, political, social and cultural aspects in his analysis. Hettne sees the ‘new’ regionalism largely as a political response to “the market-driven process of globalisation and the social eruptions associated with it”. In his view, it is almost self-evident that the *core* regions in the world – East Asia, North America and Europe – are the great supporters of global free trade policies “because the basic point of strong economies is to gain access to weaker economies”, whereas the



*peripheral* regions are more naturally interested in regionalism as a means to promote development, peace and protection of the environment.

In the last paper of the book, Charles P. Oman (OECD Development Centre), from the US, presents an illuminating view on both the history and the policy challenges of regionalisation and globalisation. Oman stresses that globalisation is not a new phenomenon. "The last 100 years alone have been witness to three distinct periods, or waves, of strong globalisation," he says. In his view, in order to understand the specificity of the globalisation wave of today, "one must grasp the nature of change in the microeconomic forces that drive globalisation". Analysing these microeconomic forces – i.e. the way in which economic activity is organised, both within firms and between firms – he observes that even though globalisation is occurring with respect to markets and management systems, "it really is a misnomer to talk about the globalisation of physical production. ... It is more accurate to talk about the *regionalisation* of production." He concludes that regionalisation – in both its policy-driven and market-driven forms – usually stimulates competition within a region and thus enhances the flexibility of the member countries' economies. In doing so, "globalisation and regionalisation tend naturally to be mutually reinforcing," Oman observes.

Although in the ensuing Floor Discussion of the papers by Hettne and Oman (and in the preceding chapters), different opinions are also voiced, most of the experts included in this book seem to agree that regionalism is, or can be, an important stepping stone to multilateralism. If this conviction is so widespread, how can one explain that the debate about regionalism versus multilateralism is still lingering on. Partly, there are good reasons for it, because regionalism can indeed harm multilateralism. But at the same time, it seems to me that there is a less substantial aspect of the debate which reflects a common phenomenon in social intercourse. When people (and social scientists and politician are by no means an exception) dispute each others' convictions, they tend to reiterate what they believe in, rather than search for facts and insights that contradict their wisdom.

As Richard E. Baldwin from the Graduate Institute of International Studies in Geneva argues in one of his recent writings on regionalism ("The Causes of Regionalism", *The World Economy*, Vol. 20, November 1997): One school-of-thought wishes to view regionalism as having benign effects on multilateralism, and sees the benign effects; another school-of-thought wishes to view it as a threat to multilateralism, and sees the negative effects.

However, this observation does not imply that neither school-of-thought could be put to a test. History provides the facts which – if we agree on their interpretation – indicate whose belief comes closest to real-

ity. In reviewing the experience with regional integration over the last four decades, Baldwin concludes: "... many fears concerning regionalism are misplaced. ... most regional deals will weaken the key opponents of free trade (import competitors) while simultaneously strengthening its key proponents (exporters). Regional integration will, therefore, foster multilateral liberalisation and vice versa, just as it has done for the past 40 years".

It is in this fact-searching spirit that Fondad started its research project on regionalism and multilateralism in October 1994, and now concludes it with this book and its accompanying volume I referred to above. I hope that these two publications will contribute to better insights in today's globalisation and regionalisation processes as well as to a well-based and broadly endorsed vision of the future.

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