REGIONALISATION PROCESSES AS CONVERSION OUTCOMES OF ECONOMIC INTEGRATION

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In the context of globalisation, regionalisation could be seen as integration at regional level. Trade liberalization, being the first stage in the linear model of economic integration and the main measure of openness of an economy, is an important and complex issue, and regional trade liberalization is even more so. In this context integration is a process toward inter-state security.

This paper examines the main aspects of integration phenomena, peculiarities and trends of regionalisation processes with regard to the regional integration and multilateral co-operation discussion, and finally applies the theoretical insights to the case of European integration facing challenges of the recently approximated neighbourhood.

Key words: regionalisation, economic integration, multilateral cooperation, neighbourhood, openness, association, regional trade.

JEL Classification: F40, P16, R10.

Introduction

During the last decades and the few years of the recent one, there has been a considerable resurgence of interest in regionalism among developed and developing countries. New arrangements are somewhat different from earlier efforts, extending not only to trade in goods but also encompassing trade in services and mutual investment opportunities and guarantees. In various parts of the developing world, existing regional arrangements have been revitalised or expanded and new groupings formed. Examples include the Association of South East Asian Nations (ASEAN) which has an agreed trade liberalisation agenda, Mercosur in Latin America, the West African Economic and Monetary Union (WAEMU) and the Southern African Development Community (SADC) which has formulated its strategy for market integration.

These initiatives have coincided in time with new and deeper regional integration involving industrialised nations, as exemplified by the Treaty on European Union (EU), two enlargements of the EU and the creation of the North American Free Trade Area (NAFTA). On top of all this, the successful conclusion of the Uruguay Round has led to the creation of the World Trade Organisation (WTO), thereby strengthening the multilateral trading system.

The start and the development of European integration, as well as the initiation of the regional integration processes in other parts of the world, present more than a few issues for theoretical discussion. This paper analyses cases of regional integration schemes that involve the voluntary linking in the economic and political domains of two or more formerly independent states to the extent that the authority over key areas of national policy is shifted towards supranational level. It refers to integration as the end of state and the process taking place at the macro-level, with no distinction between the positive or negative approaches to it, kind of co-operation across territorial boundaries that would confer mutual benefits in socio-economic, political, cultural, scientific and technological aspects of social life, with regard to the assumption that the ultimate intent of regional integration is cooperation across territorial boundaries in a way that maximizes mutual benefits for development along a spectrum of social life.

The scientific problem analysed in the paper rises from wide theoretical discussion on effects caused by economic integration, seen differently in classical and recent approaches, and gains its actuality with the intensifying regionalisation processes throughout the World and Europe in particular. The EU, being the most progressive regional integration arrangement, is now facing enlargement challenges along with approximation of the new neighbourhood. Policies for dealing with the latter (involving participation of the new member states), among

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other issues, encompass relations with Southern Mediterranean region, which is comparatively less developed and therefore needs specific treatment.

The analysis is based on the conviction that market integration cannot be explained without reference to institutions, and that institutional analysis that fails to refer to market transactions risks being meaningless.

The aim of this conceptual paper is to explore the background to regional economic initiatives among European states and to propose insights for the EU cooperation with Southern Mediterranean region. It also aims to provide a better understanding of the motivations, processes and constraints to regional integration and cooperation.

Research methods used: analysis of conceptual scientific literature, comparative analysis of empirical study reports.

**Economic integration as precondition for regionalisation**

The classic linear scheme of economic integration sees countries moving along a continuum from preferential trade area to free trade area, customs union, common market, economic and monetary union. In preferential trade areas countries lower tariffs on trade with each other while retaining autonomy in setting tariffs on trade with third countries. In free trade areas, countries eliminate tariffs on trade with each other while retaining autonomy in trade policy with third countries. A problem with preferential and free trade areas is the danger of trade deflection, where goods are imported through the country with the lowest external tariff for free circulation throughout the region. Trade deflection can be controlled by the use of rules of origin or through forming a customs union. Customs unions remove tariffs on trade with other members and apply a common trade policy towards third countries. A common market aims at removing restrictions on factor mobility (capital, labour) between members as well as freeing trade in goods and services. Economic and monetary union implies, in addition, a common currency and central bank and co-ordinated economic policies.

All these forms are cases of the so called "negative integration" because they involve removal of rules discriminating other partner countries in the union: state subsidies, anti-competitive business practices, domestic fiscal arrangements, discriminatory public purchasing, standards which effectively exclude imports, border controls and administrative processes, etc. On the other hand "positive integration" implies that a common effort is made to reach a specific objective. Such common or co-ordinated monetary, fiscal and sectorial policies are increasingly needed at later stages of economic integration. Therefore the linear scheme of economic integration could be seen as a move from negative integration – the removal of barriers to trade and factor movements – to positive integration involving policy harmonisation and coordination (for example, in monetary integration) (Vitali, 2000). However, experience shows that this is a false dichotomy. Policy harmonisation may well be needed to make trade integration work, particularly if extended to services trade (the lesson of the single market programme in the EU) and may indeed precede trade integration. Similarly, policy co-ordination can take place on a functional basis or in the framework of a regional integration arrangement.

Supporters of the integration schemes are mainly concerned with the effectiveness of integration in economic terms. But integration is often pursued explicitly by political motives. Even if political motives are not uppermost, political will is a crucial ingredient in the integration process and, in its absence, little progress will be made. At the same time, economic integration can have political consequences, as when it contributes to stabilising a political regime or enhancing regional peace and security. Political commitment is not necessarily the same as political aspiration to a greater degree of political unity. Political commitment has been a factor in the success to date of the EU so far (Matthews, 2002). The chances of success for regional integration increase when the political and economic benefits complement each other.

Given the importance of a strong long-term political commitment, implying the willingness to forgo national goals for regional ones, political scientists have debated whether regions with a single dominant member (referred to as the regional hegemony) are likely to be more or less successful. Some claim that examples of successful regional integration point to the central role of economically powerful states as the core and motor of integration. Their argument is that there are regional benefits, which take the form of so called "regional public goods". Regional peace, stability and order are also the public goods which the hegemony would be expected to supply. Because, as the largest state, it has the most to gain from these public goods, the argument is that it will be willing to shoulder a disproportionate amount of their costs, thus facilitating agreement on distributional issues. The counter argument is that the presence of a regional hegemony undermines the stability of the grouping because of fears among the remaining members about the distribution of benefits and their concerns that the grouping is simply a mechanism for the hegemony to extend its economic and political influence.

3 Formally, (regional) public goods have two characteristics. They are non-divisible in the sense that enjoyment of the benefits by one state does not reduce their value to another state. Second, they are non-excludable in the sense that once these goods are provided to any state, it is impossible or very costly to prevent other states from benefiting.
Worldwide experience examples show that integration process is promoted and supported by a growing number of interdependent relationships, as well as by the increasing size and structural power of non-state actors, which do not always speak in favour of the hegemony influence-led integration. What is found more often is the so called “market-led” process of integration. The scope of market integration is dependent on the type of economic sector. There is no single pattern of integration followed in each and every sector of economic activity (Tsoukalis, 1991). Sector-specific integration did not necessarily yield a formal inter-governmental process of integration. However, integration on a sector-by-sector basis required a continual adjustment of the balance of payments between countries. Supporters of a sectorial approach to integration contended that national governments were more inclined to make limited commitments with reasonably clear implications than to integrate all sectors at the same time (Balassa, 1961).

In some cases, integrative processes develop out of what was sector-specific interdependence. The integrative effect of economic transactions locates integrative processes both above and below the regional level. Integration of some economic sectors proceeds more intensively at the local or regional level as in transport cost-sensitive manufacturing and assembly processes, or at the global level in financial markets and telecommunication links. Economic sectors such as telecommunications, automobiles, pharmaceuticals, and financial and insurance services are also central to the state’s national interest (Weiss, 1999). The size of these sectors, however, is determined by specific economies of scale. For example, the integration of the financial services and telecommunications sectors takes place at the global level; the integration of the manufacturing sector at the regional level; and the small-scale services sector (e.g., restaurants, housing, shopping, health care, etc.) and other service industries (e.g., local suppliers, parts and component subcontractors, etc.) are integrated in domestic markets.

Indeed, many forms of regional cooperation take place on an ad hoc basis around specific projects or thematic issues. Such sectoral cooperation can have advantages such as: decreasing duplication of functions in different countries; enhancing efforts to deal with issues such as human, animal and plant diseases which know no borders; facilitating the sharing of regional resources and experience in activities such as research and training; or building a regional infrastructure (Matthews, 2002). Economic integration refers specifically to trade integration in the first place, though it may also be accompanied by various degrees of policy coordination and integration. Trade integration yields benefits by promoting a more efficient allocation of resources, by intensifying competition and by underpinning political credibility. It is now almost taken for granted that trade integration is one of the main benefits sought by countries either forming or joining a region. Page (2000) points out, however, that it is hard to explain the growth of interest in regionalism based on trade motives alone given that tariff levels in most regions have been falling and are now at relatively low levels. She concludes that all successful regions have objectives other than free trade, and this may be essential for their will to evolve: “Trade may well be secondary to political or security objectives or a tool rather than an objective: it is difficult to find any groups which have only a strictly trade agenda”.

Regionalisation processes: regularities and trends

Theoretical insights on regionalism

Regionalization denotes the (empirical) process that leads to patterns of co-operation, integration, complementarity and convergence within a particular cross-national geographical space. Or, as it is stated in Columbia Encyclopedia (2005), regionalization is the process in which neighbouring nation states form new regional supranational structures for governance. Regionalization can be seen as a compromise between the growing need for large-scale, border-crossing government due to globalization and the difficulties of establishing this because of the existing differences in economic development, political priorities and cultural background between the countries of the world. As globalization causes governments to lose the capacity to realize societal values, one of the reactions towards globalization therefore is the pooling of authority at a higher administrative level than the nation-state. By making decisions or regulations on a supranational level, national governments are able to in a way retain some of the capacity to govern what they lost because of globalization.

Mussa (2000) defines three fundamental factors that in his opinion have affected the process of global economic integration and are likely to continue driving it in the future. First, improvements in the technology of transportation and communication have reduced the costs of transporting goods, services, and factors of production and of communicating economically useful knowledge and technology. Second, the tastes of individuals and societies have generally, but not universally, favoured taking advantage of the opportunities provided by declining costs of transportation and communication through increasing economic integration. Third, public policies have significantly influenced the character and pace of economic integration, although not always in the direction of increasing economic integration.

Although technology, tastes, and public policy each have important independent influences on the pattern and pace of economic integration in its various dimensions, they clearly interact in important ways. Improvements in
the technology of transportation and communication do not occur spontaneously in an economic vacuum. The desire of people to take advantage of what they see as the benefits of closer economic integration – that is, the taste for the benefits of integration – is a key reason why it is profitable to make the innovations and investments that bring improvements in the technology of transportation and communication. And, public policy has often played a significant role in fostering innovation and investment in transportation and communication both to pursue the benefits of closer economic integration (within as well as across political boundaries) and for other reasons, such as national defence.

Page (2000) defines a region as “a group of countries which have created a legal framework of cooperation covering an extensive economic relationship, with the intention that it will be of indefinite duration, and with the possibility foreseen that the region will evolve or change.” This definition is suitable for discussing regionalisation, as it highlights a number of its important characteristics. First, it represents a formal and conscious political strategy and de jure process, to be distinguished from the growth of closer economic ties between geographically proximate countries arising from a more informal, de facto, process, also referred to as regionalisation. Formal regionalism may or may not involve countries which are geographically contiguous to each other. Second, the criterion of extensive economic relationships is intended to exclude regional groupings which form around a single issue. This is reinforced by the criteria of permanence and evolution, implying that the countries involved have made a commitment to deepening their relationships over time although there is no guarantee, of course, that the region will be successful in this aim.

The academic literature on regionalism – a policy whereby the interests of a nation in world affairs are defined in terms of particular countries or regions – covers the contributions of economics, international relations and international political economy. Economists’ analysis of regions begins with the classic theory of customs unions formulated by Jacob Viner, James Meade and others and has been developed more recently in the context of imperfection competition. This traditional theory is then contrasted with the developmental regionalism espoused by theorists concerned with developing countries and finally the latter is opposed by the “open regionalism” popularised more recently in Asia and in Africa by, among others, the World Bank (Matthews, 2002).

The traditional efficiency advantages of removing barriers to economic activities are likely to appeal to industrialised countries with large, diversified industrial structures where significant scope to re-allocate resources among alternative activities exist. Page (2000) points out that this type of gain is unlikely to have a strong effect on a developing country integration, and it has not normally been the objective of developing country groups: “their existing industrial structures are small relative to their economies or to their planned development, and the static gains from rationalising these among member countries by easing flows of trade are correspondingly small”.

For developing countries, the rationale for economic integration has been structural in nature. They have been concerned with the development of new industries through cross-border coordination to exploit the advantages of economies of scale, which a larger home market permits. Thus, much thinking in developing countries on the advantages of regional integration sees it as a development tool (Asante, 1997). The advocates of import-substitution industrialisation strategies could see the problems of pursuing these strategies in the context of small home markets, and saw regional integration as the way to establish these industries on a more competitive footing. The implicit assumption was that the choices made within the regional context would be efficient, and that member countries would accept specialisation (Page, 2000). To avoid uneven levels of industrialisation between the member countries as a result of trade liberalisation an explicit framework of measures was often designed to ensure an equitable allocation of new complementary investment. Positive discrimination in favour of the less advanced countries was implemented through complementarily agreements.

This traditional approach to regionalism among developing countries has been heavily criticised within the trade creation/ trade diversion framework (Bhagwati and Panagariya, 1996). In this framework, the larger the share of the third country imports in total imports, the bigger the tariff revenue loss when a region is formed. Similarly, trade partners with initially higher tariffs lose more when a region is formed because more tariff revenue is redistributed away from them. Since developing countries often have high extra-regional trade dependencies and initially high tariffs, they will tend to lose from forming regions. The costs in terms of trade diversion will be high. From this perspective, the failure of so many developing country regional groupings is not surprising. Poorer or less industrialised members found themselves in the position of subsidising the inefficient industry of their neighbours and doing so without adequate compensation since the relative wealth of their partners did not permit extensive income transfers.

The new regionalism is occurring in a very different policy context. It typically involves countries that have already committed themselves to lower tariff barriers and are pursuing outward looking strategies. These policies reduce the scope for trade diversion costs. Static trade creation benefits are no longer the primary motivation. The new economics of regionalism stresses the potential gains from reduced administrative and transaction costs and other barriers to trade. These show up for an econ-
omy in increased inter-firm competition and a reduction of production costs and monopoly rents. To achieve these gains, however, much more than a simple free trade arrangement is called for if transactions and administrative costs are to be significantly reduced and market segmentation is to be overcome. But why could countries not seek these lower costs in the world market directly? The usual answer is to be found in the lower transactions costs involved in producing for the regional market compared to the world market. Information on prices and consumer preferences are more readily available, and transport costs are lower. The new regionalism also stresses that schemes of North South integration are likely to be more beneficial to developing countries (Venables, 1999).

Open regionalism is often seen as the logical conclusion of the new regionalism. A number of Asian and Latin American countries claim to be pursuing open regionalism. This is defined as regionalism that contains no element of exclusion or discrimination against outsiders. It implies that negotiated tariff reductions between members are agreed on a most favoured nation (MFN) basis and thus passed on to third party members of the WTO. The regional dimension consists of undertaking these cuts on a jointly agreed phased basis. In this process, open regionalism is a co-operative arrangement rather than a rules-based community set up under GATT article XXIV. By definition, it avoids the trade diversion costs which have troubled developing country regional groups in the past.

In summary, the recent more favourable assessment of regional integration arrangements involving developing countries particularly among donors is based on the following considerations. Regionalism will lead to net trade creation as long as it is coupled with a significant degree of trade liberalisation and where emphasis is put on reducing cost-creating trade barriers which simply waste resources. Regional economic integration may be a precondition for, rather than an obstacle to, integrating developing countries into the world economy by minimising the costs of market fragmentation. Integration with industrialised countries may be desirable where it provides the policy credibility which is necessary to attract investment inflows (Matthews, 2002).

Welfare gains from regional trade arrangements

The traditional approach to trade integration among regions assumes perfect competition in markets and is concerned with the implications of forming a region for the allocation of resources in a static sense. This static analysis distinguishes between the trade creation and trade diversion effects of regional trade integration.

The fact that the welfare outcome of preferential trade liberalisation is ambiguous, the net result of the trade creation and trade diversion effects, has spawned a huge literature on the conditions needed to ensure a net overall gain. As trade diversion is most likely when countries do little trade with each other prior to integration, one rule of thumb, although not an infallible one is that regional integration between countries which trade little with each other should not be encouraged. Other conditions favouring net trade creation, according to Matthews (2002), include:

- tariffs and non-tariff barriers of member countries should be high prior to integration, since this maximises the likelihood of trade creation.
- members should be geographically close, since this reduces transactions costs such as transport and communications.
- tariffs and non-tariff barriers to extra-regional trade should be low after the region is formed since this minimises the likelihood of trade diversion.
- members should have complementary economic structures (dissimilar patterns of production) since there will be scope for intra-industry specialisation.

These criteria led to the traditional view that the ideal grouping for economic integration includes countries at comparable levels of development but with disparate, complementary resource bases. Such countries would have the maximum to gain from integration but little to worry about in terms of the distribution of benefits in favour of rich countries at the expense of poor countries.

However, if the barriers restricting trade are cost-increasing rather than rent-creating barriers, the welfare analysis is quite different. Here, there is no tariff revenue accruing to the home country government before integration, and thus any reduction in domestic prices arising from sourcing supplies in a partner country can only have positive, trade-creating effects.

The trade creation gains identified in the previous section arise even under perfect competition because resources are re-allocated within the home country in line with its comparative advantage. In more recent analysis of welfare gains, the perfect competition approach has been supplemented by models that allow for imperfect competition, economies of scale and product differentiation. These new analytical perspectives on market integration emphasise the pro-competitive effects of larger markets rather than comparative advantage. These additional sources of welfare gain under imperfect competition include:

- In many small countries the domestic market may not support a large number of firms and thus there is a tendency for firms to collude and raise prices at the expense of consumers. Reducing trade barriers may encourage firms to eliminate excess ‘fat’ (so-called X-inefficiency) as well as force them to price more in line with marginal cost (more competitors increases the elasticity of demand for a firm’s products and makes it more difficult for them to charge margins in excess of marginal costs).
- Larger markets as a result of regional integration
may allow firms to exploit economies of scale, thus driving down costs and prices to local consumers.

- Larger markets may increase the range and variety of products which are available to consumers. In well-integrated customs unions such as the EU, much of the increase in intra-regional trade takes the form of intra-industry trade (the exchange of similar products such as Renault cars for Mercedes cars between France and Germany) rather than the classical inter-industry trade (such as the exchange of cars for wine between Germany and Portugal) which would be predicted on the basis of comparative advantage.

Modern theory also highlights a number of other consequences of regional trade arrangements: accumulation or growth effects, investment effects, transactions costs, credibility, etc.

A crucial issue in the success of integration schemes is the equitable distribution of gains from integration between countries. The new economic geography throws light on the location decisions of firms by focusing on the interaction between scale economies (which favour concentrating production in one or a few locations) and trade costs (of which transport costs are the most important but which include any costs in moving goods to and keeping in touch with consumers). If production costs are equal, firms will want to locate close to consumers where the largest markets are. But there is circularity here. The largest markets will be where firms are located because of the importance of other businesses and employees as customers. Baldwin (1997) explains this as follows: “accordingly there is a mutually amplifying interaction between transport-costs-avoidance and market size determination. Firms’ desire to be near customers tends to concentrate demand for intermediate and final products. And this agglomeration of firms’ and workers’ purchasing power tends to attract more firms. Thus, there is a circular mechanism involving transport-costs-avoidance (firms’ wish to be near large markets) and market size (firms’ location decisions influence market size). We refer to this as “circular causality”.”

If some factors are immobile in the peripheral region, then a growing unevenness in dispersion of the production will be accompanied by increasing wage differentials. Eventually, the attraction of relatively low wages may attract sufficient new investment to begin a process of cumulative growth and catch-up with the more prosperous regions (the experience of the Republic of Ireland in the EU during the 1990s may be an example of this effect). The impact of regional integration on this process is likely to be ambiguous.

Whether there is a tendency for countries within a region to converge is explored in the new growth theories, which in many cases also emphasise the potential for catch-up. The simple theory outlined above, however, suggests that whether convergence is observed or not will depend on the balance of opposing forces at a point in time. Jenkins (2001) provides evidence from the Southern African region that poorer members catch up with (converge on) richer ones through the process of trade. The more general lesson, however, is that relocation is inevitably part of the process of regional integration and, if it is politically unacceptable, integration schemes need to include mechanisms which minimise or offset these effects.

**Regional integration and multilateral cooperation**

An alternative scheme to regional integration is multilateral cooperation, which Teunissen (1998) believes to be also a basically political project: “while supportive economic conditions are needed, the success of both endeavours seems to depend largely on the political support they are able to raise”. 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 has been addressed by many authors (i.e. Teunissen, 1998; Pronk, 1998; Karlsson, 1998).

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 in deed 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 – integration should never become an end in itself, but it should be subdues 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 some reserve. 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.

To compare, 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 (Teunissen, 1998).

However, there exist promising cases of multilateralism as well, i.e. a multilateral agreement on investment (MAI) which foresees full rights for foreign investors to invest and establish themselves in all sectors (excluding perhaps, defence) in any WTO member, get treatment for the Foreign Direct Investment (FDI) at least on the same level as accorded to the domestic investments, and effective implementation of the obligations undertaken in the agreement. 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. The implementation of the obligations of governments is sought to be ensured by locating the MIA in the WTO, so that for any perceived infringement, action can be taken against exports of the country.

**European integration experience and the Wider Europe incentive**

*What is specific about European integration*

The bulk of theoretical literature giving account of regional integration processes has overwhelmingly focused on the European Union case. This is so, partly because the EU is the oldest and most far-reaching of these regional agreements, and partly also because it has experienced a tremendous transformation in the last decade. The literature on European integration could be characterised by largely divergent strands analysing international relations with sophisticated and alternative theoretical versions of the integration process. However, the excessive attention to the European Union has unwaveringly constrained the number of comparative efforts based on single theoretical frameworks. Only recently, had some scholars decidedly started to engage in cross-regional comparative analysis (i.e. Kelstrup, 1998; Rosamond, 2000).

The French Constitution says that the European Union comprises of “states which have freely chosen <...> to exercise certain of their powers in common” (New Article 88-1 A). In Germany European integration is defined as a “union of democratic states (that) performs sovereign tasks through the exercise of sovereign authority” (Judgement of 12 October 1993) (Harrison, 1995). What these declarations have in common is the deliberate decision to share a common exercise of national powers, authorities or “sovereignty”. From that follows a process of transferring and organising actual power. This is the essence of what is meant by European integration. It implies some new body or new institution, which has real delegated authority, legal personality and independence of its creators. Such a form of integration is an innovation in the means of organising relations between nations. There cannot be found a historical pattern (Vitali, 2000).

What are the motives of the European Integration? Weidenfeld (1999) writes in his book that after the World War II the descended European states started the experiment of integration to overcome their armed conflicts and to create some space for the bundling of their powers. Behind this background he sees especially five motives that encouraged the Europeans: the desire for a new self-understanding, for security and freedom, for liberty and mobility, for economic well being as well as the desire for common power. Whereas security, freedom, liberty and prosperity are the declared aims of the community building since the 1950s, some other objects were added later. Economic growth and the desire for a well-balanced approach of the economic and social levels should be mentioned. A further motive (in the treaty of the ECSC) is the will of the organised Europe to contribute with the integration to the civilisation. In the 1980s, as a consequence of the south enlargements, the governments added the terms of “democracy” and “political stability”.

Talking about the issue of intergovernmentalism versus supranationalism, the EU experience, as mentioned before, envisages a more diversified political system in which power is shared at several levels and interacts in complex ways and not necessarily meaning progress towards a federal political structure or confederation, but rather an alternative way. Following the Maastricht Treaty of European Union, the EU operates in supranational mode in most of the issues of the first (economic) pillar and in intergovernmental mode in the other two pillars (justice and home affairs, and foreign and security policy).

Another specific feature about functioning of the EU is the principle of subsidiarity. All regions face the question of which powers and responsibilities should be allocated upwards to be undertaken at the regional level and which powers should be retained at the national (or sub-national) levels. This debate is referred to as the operation of the subsidiarity principle in the EU and has been addressed from an efficiency standpoint by economists using the economics of multi-tier government (Matthews, 2002). Using the classic distinction between the allocation, stabilisation and redistribution functions of government this literature suggests that stabilisation and redistribution functions are best performed at the regional level, while the allocation function is usually best exer-
cised at more local levels where it can respond to differences in preferences for public goods. For example, one community may prefer a more varied and diversified rural environment and may be willing to make environmental payments to its farmers to achieve this objective. Because this more attractive rural environment mainly benefits local citizens, it is argued that the decision to provide these payments should also be made locally rather than at the regional level.

However, exceptions are made when allocation choices in one area have spillovers or implications for those living in other areas, or where there may be economies of scale in the provision of joint infrastructure or facilities. In these situations, there are clear efficiency benefits to transferring the decision-making level upwards to the region to facilitate the internalisation of these externalities or the exploitation of these scale economies. Efficiency, of course, is not the only value at stake, and considerations of accountability or democratic involvement may run counter to those of efficiency. As noted in the previous paragraph, supranational institutions may make even more difficult democratic participation and accountability. An important constitutional issue is where residual powers lie; in other words, can any powers be exercised at the regional level provided members state agree or, as in the case of the EU following the explicit reference to subsidiarity in the Treaty of Maastricht, is there an attempt to constrain these powers to those which can be exercised more effectively at the regional level? The subsidiarity principle is a good starting point to think about the role of regions in promoting common economic issues. The common efforts could also serve as those activities which add value to country efforts through stabilisation or redistribution, or where there are strong efficiency arguments for a regional approach, which should be encouraged at the regional level (Matthews, 2002).

The motor of integration had mostly been the deepening and widening of one European market. That was the process that has drawn the individual economies of the member states ever closer together and had been the prime rationale for building and maintaining common institutions. Of minor importance had been the treaties, declarations of intent or the common expenditure programmes in the opinion of Harrison (1995). Models of Integration explain different strategies the EU could choose for their future development. The emphasis lies on deepening, widening, “watering down” or diminution as well as on the combination of these strategies. By deepening is meant that more topics become matters for co-operation, and that for any topic co-operation becomes closer and more detailed (i.e. development from the Customs Union to the Single Market and the steps towards the Economic and Monetary Union.). Widening refers to the geographic expansion of the EU (Since 1958 six enlargements have been taken place which led to the EU-20 in 2004).

According to Hansen and Nielsen (1997) further integration would raise problems: after a process of deepening enlargement is more difficult because applicants have to accept bigger changes when they acquire membership. Countries with monetary instability may be having problems to participate in the monetary integration. On the other hand after widening it may be more difficult to agree on the process of deepening. As the EU has to handle big challenges in its future which make necessary more integration the institutions have to find a way to manage the dilemma of the choice between widening and deepening.

The EU experience in coping with a larger and more diversified membership has risen out the concepts of “variable speed” and “variable geometry”. Variable speed refers to situations where all members agree to be bound by common aims or objectives, but some members are allowed a longer time to meet these objectives. Rather than holding all members back to the pace of integration of the slowest and most reluctant member state, some member states can move ahead to a common policy and the others can catch up when they are ready. Variable geometry, on the other hand, refers to situations where subgroups of members (and possibly different sub-groups on different issues, hence the term variable) wish to pursue deeper and more intensive forms of integration and cooperation on specific issues, while other members wish to remain outside these initiatives on a permanent basis. Talking about the cases of southern Mediterranean countries, the concept of “variable speed” is of a great concern, and creation of sub-groups could be a helpful solution for better coordinated catch-up processes.

**EU enlargement gains and challenges**

At the turn of the centuries the European Union can look back on several successes. The economic integration has made much progress. The internal market is largely complete and is yielding tangible benefits for consumers and business. The Euro has been successfully been introduced and is delivering the expected benefits for the European economy. According to the Presidency Conclusions of Lisbon, the forthcoming enlargement will create new opportunities for growth and employment. Now it is on the union to preserve their ability to act through continuing institutional reform. Moreover, Europe has to face the conditions of the “New Economy” which are a result of the globalisation and the developments towards a knowledge-driven economy and an information society. The European Council’s role of giving the necessary strategic orientation has gained more and more importance over the last decades. Its co-ordinating function should be strengthened in the future, in order to ensure an effective monitoring of the progress towards the EU main goals and guidelines. The further integration rests with it (Vi-
The progress of European integration was so to speak driven by the deepening objectives – the previous enlargement of the EU in 1995 was not much challenging in economic terms as the accession countries (Sweden, Denmark and Austria) were of comparable level in socio-economic terms.

Since the Treaty on the European Union realisation of an ever closer union of Europe's nations has become one of the major goals. The door of the membership in one of the most powerful regional integration associations is open to all democratic European states that are able to take on the economic challenges of membership and to implement its rules. Article 49 of the Treaty on European Union states that any European state may apply to become a member of the European Union. Prospective candidates must meet the criteria for membership: democracy, the rule of law, human rights, respect for minorities; a functioning market economy, and the capacity to cope with competitive pressures; the ability to take on the obligations of membership (meaning to apply effectively the EU’s rules and policies). It is expected that enlargements should contribute to peace, security and stability in Europe not to speak of the economic side of the matter - enlargement is expected to stimulate economic growth in both new and old EU countries – for the benefit of all.

After the Cold War, political and economic integration continued in the European continent with the establishment of the single market in 1992 and the introduction of a single currency in 1999. The issue-areas facing the European agenda also involved an enlargement to the south east of the European continent of 2004, which brought in eight countries from central and eastern Europe and the Mediterranean islands of Malta and Cyprus. The latter enlargement was the biggest and most ambitious in the EU’s history. The arrival of the newcomers raised the number of members from 15 to 25, with a total population of over 450 million. This is more than the combined population of the United States and Russia.

According to the European Commission (2001), the European Union is the world’s biggest trading partner, accounting for over a fifth of all exports in 1999. Since its earliest days, the EU has been committed to removing trade barriers between its individual members on the grounds that this will stimulate economic prosperity and national and individual well-being. It has championed the same principles on the world stage. The EU supports the idea that multilateral trade liberalisation can yield very substantial benefits for the global economy and that much of this should go to developing regions. It considers that economic growth through trade liberalisation is a major factor in improving social conditions worldwide and contributing to sustainable development. The multilateral trading system has been progressively liberalised through a series of international negotiations over the past half-century. During that time, world trade has grown seventeen-fold, world production has more than quadrupled, world per capita income has doubled and average tariffs applied by industrialised countries have dropped from 40% in 1940 to under 4%.

The new political map of Europe raises a lot of formerly “closed” questions directly linking economic and security issues for the first time in over forty years, as the biggest issues of economic and political organization are once again on the table, subject to debate and redefinition. That debate is ultimately about the very meaning of national security and about the future of Europe as well. Inotai (2000) claims: “Europe has reached a difficult stage of its development. Difficult not in the negative sense but difficult in the sense that Europe in several aspects reached a crossroads in its past-war and post-Berlin development process”. Enlargement challenges can be identified in four main areas: (a) security, (b) competitiveness, (c) redistribution of resources and (d) institutional changes in the EU decision-making process.

EU, seeking to strengthen its positions on the world market and to gain a wider security space, on the other hand, faces some decline of competitiveness (in average terms) on the global market and approaches new neighbourhood proximity. Another concern for differentiation among Central and Eastern European countries asserted before and remaining unsolved after the de facto accession, is the growing structural differentiation within the region, due to the on-going redistribution of the resources in the extended market. This is also due to the different historical heritage, different economic policies, particularly regarding the privatization pattern and the inflow of foreign direct investment but also to geographic and some other factors.

The second challenge refers to the reforms in the EU. There have been three major areas of EU reforms which have been already manifested in the Agenda 2000: the reform of the Common Agricultural Policy, the new financial framework (the EU budget for 2000-2006), and the institutional reforms. Two of these issues – namely the financial framework and the agricultural reform – were part of the Berlin Summit in March 1999. The first one went surprisingly smooth, however the agricultural reform failed. The last issue has been practically relegated to the WTO negotiations and no prior reform without the WTO decisions or agreement is expected at the moment. The third area – the institutional reforms – have started in February 2000, and it really demonstrated that the EU has reached a point at which the decision making at the supranational level is a complicated matter with the increased number of member countries (the formerly candidates have taken active part in solving the institutional questions).

The incentives for reform in the countries of the last accession round, created by the prospect of membership, have proved to be strong – enlargement has unarguably been the Union’s most successful foreign policy instru-
In some cases the issue of prospective membership has already been resolved. Accession has been ruled out, for example, for the non-European Mediterranean partners. But other cases remain open, such as those European countries who have clearly expressed their wish to join the EU. In reality, however, any decision on further EU expansion awaits a debate on the ultimate geographic limits of the Union. This is a debate in which the current candidates must be in a position to play a full role.

**Insights for EU cooperation with Southern Mediterranean region**

The apparent utility of regional integration for coping with external economic dependence was responsible for much of the initial interest of less-developed countries in regional integration. Increased interest in integration in 1990s of the underdeveloped countries may be attributed in part to a desire to imitate the European example and to deliberate efforts to counteract possible trade-diverting effects of the European Common Market (Balassa, 1961). In many developing areas of the world integration was also a paradigm for industrialization (Mytelka, 1972). Integration was expected to foster economic growth in Europe and Latin America through trade and scale economies. Regional integration schemes in less developed areas may have been different processes in causal terms, in terms of important differences in infrastructure, market mechanisms, external dependence, administrative resources, political group structure, interdependence of social sectors, national consciousness, and ideology (Nye, 1988). Integration among less-developed countries, such as those in Southern Mediterranean region, necessitate a high degree of structural intervention at the early stages of integration which subsequently are supposed to give way to an increased role of private enterprise.

The geographical proximity presents opportunities and challenges for both the EU and for its neighbours. More specifically, geographical proximity increases the importance of a set of issues revolving around, but not limited to, the management of the new external border and trans-boundary flows. The EU and the neighbours have a mutual interest in cooperating, both bilaterally and regionally, to ensure that their migration policies, customs procedures and frontier controls do not prevent or delay people or goods from crossing borders for legitimate purposes. Infrastructure, efficient border management and interconnected transport, energy and telecommunications networks will become more vital to expanding mutual trade and investment. Equally, threats to mutual security, whether from the trans-border dimension of environmental and nuclear hazards, communicable diseases, illegal immigration, trafficking, organised crime or terrorist networks, will require joint approaches in order to be addressed comprehensively. In the 1995 Barcelona Declaration, the EU and the Mediterranean partners recognised that geographical proximity increased the value of developing a comprehensive policy of close association, reflected in the negotiation of Association Agreements with each country.

A new EU approach to its neighbouring countries cannot be confined to the border regions alone. If the EU is to work with its neighbourhood to create an area of shared prosperity and stability, proximity policy must go hand-in-hand with action to tackle the root causes of the political instability, economic vulnerability, institutional deficiencies, conflict and poverty and social exclusion.

Southern Mediterranean countries have a comparatively low rate of growth in GDP per capita. Egypt, Israel and Tunisia are the only countries to have exceeded 2% growth since 1975, while Algeria, for example, shows a small negative growth rate. Israel is the richest of the EU’s neighbours (€19578), with Lebanon (€5284) second richest, albeit at a considerably lower level of GDP. Despite the sluggish rate of economic growth, the Mediterranean region has long been characterised by a low level of absolute poverty. Relative poverty is, however, an issue as nearly 30% of the population live on less than $2 a day and illiteracy rates remain high. Only 0.6% of population use the internet and only 1.2% have access to a computer.

Democracy, pluralism, respect for human rights, civil liberties, the rule of law and core labour standards are all essential prerequities for political stability, as well as for peaceful and sustained social and economic development. Nearly all countries of the Mediterranean have a history of autocratic and non-democratic governance and poor records in protecting human rights and freedom of the individual. Political reform in the majority of the countries of the Mediterranean has not progressed as quickly as desired.

Trade and investment are vital to improving economic growth and employment. While the openness of the Mediterranean Partners to foreign trade (exports plus imports/GDP) has improved somewhat since 1992, attaining 58% of GDP in 1999, the region ranks nevertheless in this regard behind South-East Asia and the countries of Central and Eastern Europe (CEECs), with Hungary and Poland at 64%. Above all, intra-regional trade still accounts for no more than 5% of the total, despite the fact that successive Euro-Med Conferences have underlined the importance of intra-regional integration. The North-South pattern has changed little since the Barcelona Declaration, with the EU being the Mediterranean Partners’ main trading partner in roughly the same proportion (52% of their trade -visible imports plus exports).  

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4 As set out in the 10 November 2000 Council/Commission Statement on EU Development Policy.  
5 Individuals earning less than $1 per day, measured in purchasing power parity terms  
6 UNDP Arab Human Development Report
against 54% in 1995). The export base of all but the most highly industrialised of the Mediterranean partners is still too narrow and/or reliant on low level processing. To diversify their exports and generally integrate more fully into the global economic context the Mediterranean partners need to overcome their current unspecialised status as producers.

The volume of foreign direct investments (FDI) will be crucial to the region's future. But the substantial flow of investment to the emerging economies has passed the Mediterranean partners by – foreign investors still shy away from the Middle East and Southern Mediterranean region, preferring to invest in the central European or Mercosur countries. The proportion of EU FDI going to Mediterranean partners has fallen from 2.2% in 1992 to below 1% in 1999. Starting from roughly similar levels in the early 1990’s, annual EU investment flows to the central European countries have increased ninefold while investment into the Mediterranean partners has increased only threefold over the entire decade (European Commission, 2002).

Ensuring secure and sustainable energy supplies will call for additional, vast investments in the Mediterranean. At the same time, economic diversification towards labour-intensive, employment-creating industries and services are urgently needed, not only in relatively resource-poor countries, such as Morocco, but also in energy-rich countries, such as Algeria. Energy dominates imports from Southern Mediterranean, where textiles and agricultural produce represent a considerable share of imports from certain countries (Morocco, Tunisia).

The Euro-Mediterranean partnership offers a strong policy framework for the EU’s relations with Mediterranean countries. Since the Barcelona declaration it has formed the basis for a continuing dialogue and cooperation in spite of the political disturbances in the region. In the context of a new EU neighbourhood policy, further regional and sub-regional cooperation and integration amongst the countries of the Southern Mediterranean region are strongly encouraged as well.

As far as the bilateral dimension of EU relations is concerned, the basic framework is similar for both groups of countries: Association Agreements or Partnership and Cooperation agreements, including political dialogue, are accompanied by national Meda/Tacis programmes and agreements on specific issues (readmission, fisheries etc.). The most important difference is that, in the Mediterranean, an explicit regional dimension encouraging the development of intra-regional initiatives and cooperation in a broad range of sectors is included.

The main objective of the economic component of the “Wider Europe” policy is the gradual participation of the Mediterranean partners in the EU Internal Market. This would result in more regulatory convergence between the EU and its Mediterranean Partners. Participation in the Internal Market is not a goal in itself but a means to achieve economic objectives of long-term growth, employment creation, improved competitiveness and investment climate and strengthening the rights and benefits of citizens and consumers. Participation in the Internal Market requires substantial economic, legal and administrative reform efforts, to establish a functioning market economy that is able to withstand the competitive pressures that go along with being part of the EU economy (European Commission, 2003).

Regional trade and integration is a recognised objective of the EU’s Mediterranean policy, not least because of the positive effects on regional political and economic stability that are supposed to result from the creation of a larger Mediterranean market. The EU has Free Trade Agreements (FTAs) in place with the countries of the Southern Mediterranean and the Barcelona process envisages that these should now be expanded to include the services sector as well as the goods sector more fully. Regional integration is also foreseen through the rapid negotiation and implementation of FTAs between the Mediterranean partners, as well as with the EU’s customs union partner Turkey. While some Association Agreements with the EU still need to be ratified, the Mediterranean partners are already being encouraged to approximate their legislation to that of the Internal Market.

Conclusions

Economic integration refers specifically to trade integration in the first place, though in long term it should also be accompanied by various degrees of sector-specific policy coordination and integration, which in its turn implies the need for regional arrangements in terms of common obligations. The driving force for integration-led regionalization processes is continuously increasing need for so called regional public goods, encompassing economic as well as political needs of separate regions at levels ranging from subnational to supranational.

Though influence-led integration arrangements appear to be more viable and durable, there is substantial empirical evidence that market-led processes do not necessarily depend on the size and the economic or political power of the countries forming a region, but rather on the sector-specific economies of scale: the more economic efficiency can be attained by moving decision-making to the higher regional level – the more credibility of a successful regional scheme can be expected.

Regionalisation should not be unilaterally judged as a process increasing interdependence of formerly separate

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Footnote:

7 Association agreements with Tunisia, Israel, Morocco, Palestinian Authority and Jordan have entered into force. Those concluded with Egypt, Lebanon and Algeria await ratification. An association agreement with Syria is under negotiation.
states and constraining sovereignty of national decision-making, but rather as a way of retaining some capacity to govern that they lose because of globalisation. For developing countries economic integration first of all means advantages of economies of scale and regional specialisation in line with positive discrimination in favour of them preventing unequal allocation of investment. However developing countries having high extra-regional trade dependencies and initially high tariffs, in short and medium term would tend to lose from forming regions.

The tendency in regionalism is increasingly deep integration and involvement of the less developed countries into the regional trade associations. The last ES enlargement (and the close perspective of another one) in this context is a big challenge and opportunity for the Central and Eastern European countries. It is probation of the EU as a regional trade association as well. The incentives for reform in the countries of the last accession round, created by the prospect of membership, have proved to be strong — enlargement has unarguably been the Union’s most successful foreign policy instrument. Coming out of the enlargement experience, approaches of “variable speed” and “variable geometry” are applied to the comparatively less developed members. Talking about the cases of southern Mediterranean countries, the concept of “variable speed” is of a great concern, and creation of sub-groups could be a helpful solution for better coordinated catch-up processes.

The main objective of the economic component of the “Wider Europe” policy is the gradual participation of the Mediterranean partners in the EU Internal Market. This would result in more regulatory convergence between the EU and its Mediterranean Partners. Participation in the Internal Market requires substantial economic, legal and administrative reform efforts, to establish a functioning market economy that is able to withstand the competitive pressures that go along with being part of the EU economy.

The EU’s ability to manage its relations with these regions will have major consequences for regional and global stability in general, and for the transatlantic relations in particular. These efforts also raise important questions of foreign policy and international relations theory, especially concerning the role of institutions and military force in facilitating international cooperation. The aim of the new Neighbourhood Policy is therefore to provide a framework for the development of a new relationship which would not, in the medium-term, include a perspective of membership or a role in the Union’s institutions. A response to the practical issues posed by proximity and neighbourhood should be seen as separate from the question of EU accession.

References


