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# **New Institutionalism Meets International Political Economy:**

## **A New Approach to the Study of Regional Integration Dynamics In- and Outside of Europe**

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### **Abstract:**

Regional integration in- and outside Europe is a theoretical and empirical puzzle for Political Scientists. After 50 years of integration studies, there is still a gap in the academic discussion. On the one hand, New Institutionalism mainly discusses the successful example of European integration and argues about the influence of supranational vs. intergovernmental institutions. On the other hand, International Political Economy debates the emergence of more and more preferential trade agreements around the world, but neglects the dynamic of regional integration. In order to overcome these deficits, this paper proposes a new approach to regional economic integration, which simultaneously overcomes the Eurocentrism of Institutionalism and the static nature of Political Economy approaches. According to this view, regional economic integration results from demand and supply factors. Thereby, demand and supply of regional integration needs not be the same as in Europe. Whereas comparative cost advantages and economies of scale are important factors for the demand for regional integration in Europe and North America, the attraction of foreign direct investments and development aid may be more important for regions of the South. And whereas common institutions are a driving force behind integration in Europe and South America, regional integration in North America and Southern Africa may be more supplied by regional hegemony. Integration dynamic may evolve if feedback effects occur and one or more of the demand and supply factors are reinforced due to previous integration steps. But such 'spill-over' may also look different than the European example, as the economic and institutional preconditions differ. After developing such a theoretical approach, the proposed paper will illustrate its hypotheses using the example of the EU, the NAFTA, the MERCOSUR, the SADC and the ASEAN.

**Keywords:** comparative regional integration, institutionalism, integration theory, international political economy, new regionalism

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## 1. Introduction

Regional integration outside Europe is still a puzzle for Political Science. The academic discussion about regional integration still concentrates on the European example and widely neglects other regional integration schemes. The old debate between Neofunctionalists (Haas 1958, Schmitter 2002) and Intergovernmentalists (Hoffmann 1968, Moravcsik 1998) focuses only on the European Union (EU), and the various approaches of the so-called New Institutionalism are also mainly applied to EU policy-making (Fligstein and Mara-Drita 1996, Pierson 1996, Pollack 1997, Stone Sweet and Sandholtz 1997). This obvious gap in the literature is even more striking if one keeps in mind the growing importance of regional integration outside Europe. The phrase 'New Regionalism' captures the phenomenon that a growing number of regional integration schemes have emerged around the world since the early 1990s. Regionalism has become a distinguishing feature of the international system, and most of the regional integration schemes outside Europe seem to have consolidated in recent years – even if they are not as advanced as the EU. The problem for the analysis of regional integration outside Europe is that integration theories which were developed in the European context cannot simply be applied to other regions, because the economic and political preconditions for integration on other continents differ widely (Haas 1967, Mattli 2005, Robson 1993). Thus, the crucial question is, how the different theories of European integration can be fruitfully employed to establish a theoretical approach for regional integration outside of Europe.

Approaches to the systematic comparison of regional integration schemes in- and outside Europe can mainly be found outside of the Political Science 'mainstream' in the field of International Political Economy. Scholars from this discipline analyse why states decide to integrate their economies (Mansfield and Milner 1999, Schirm 2002), under which circumstances this is successful (Mansfield, Milner and Rosendorff 2002, Mattli 1999), and what the consequences for the creation or distortion of international trade are (Dür 2006, Krueger 1999). However, the shortcoming of these approaches to the study of regional integration is that they all regard regional integration more as an end than as a process. They do not analyse the dynamic of regional integration schemes and the reasons behind this

development. This is a surprising shortcoming 15 years after the start of the 'New Wave of Regionalism', especially given the fact that many integration schemes outside Europe were significantly reformed in recent years. Thus, additional research is needed to analyse the dynamics of regional integration outside Europe (Mansfield and Reinhardt 2003).

The aim of this paper is to propose a theoretical approach to the systematic analysis and comparison of regional economic integration dynamics in- and outside of Europe. Therefore, it aims to bridge the gap between the New Institutionalism in EU studies and the International Political Economy in comparative regional integration studies, and to overcome the respective shortcomings of these approaches. In the following, the paper conceives regional integration as a club good (Mattli 1999, Padoan 2001). I.e. non-members of a regional integration scheme can be excluded from its consumption, but the members of the scheme nevertheless face cooperation and coordination problems when supplying the good. As Mattli (1999) points out, the success of providing such a club good can then be traced back to certain demand and supply factors. However, in contrast to Mattli, this paper does not adopt a static view of demand and supply factors, but focuses on dynamic feedback mechanisms and interactions between the two factors. The question is not only whether or not specific demand and supply factors are given in a certain region, but also whether they may change during the process of regional economic integration in order to make further integration steps possible. In this way, regional integration schemes may be able to produce the necessary conditions for their success, and self-contained integration dynamics may emerge.

In its first part, the paper develops a theoretical approach for the analysis of regional integration dynamics in- and outside of Europe. Thereby, it relies on the International Political Economy in order to identify the demand for regional integration and on the New Institutionalism in order to analyse supply factors. Most important for the dynamic of integration is the question of how initial integration may feed back on one of those factors. In the subsequent empirical part, the theoretical approach is illustrated by applying it to the five most important regional integration schemes, which are the EU, the North American Free Trade Agreement (NAFTA), the Mercado Común del Sur (MERCOSUR), the Southern African Development Community

(SADC) and the Association of Southeast Asian Nations (ASEAN). The conclusion summarises the most important arguments of the paper and gives an outlook on further research.

## **2. Towards a New Approach to Regional Integration**

In order to develop the theoretical approach, the paper proceeds in three steps. It starts by identifying different demand factors for regional economic integration. The demand factors for regional integration outside Europe may differ widely from the European example, because many integration schemes consist of less-developed countries. Subsequently, different supply factors of regional economic integration are identified. These are also fundamentally different from the EU, because no other regional integration scheme is familiar with supranational institutions which are as strong as the Commission or the European Court of Justice. And finally, possible feedback mechanisms on economic demands for and institutional supply of regional integration are worked out. This is the point where regional integration could gain self-sustaining dynamic if initial steps of regional integration change the demand for and the supply of regional integration in a way that makes further integration steps possible.

### *2.1 International Political Economy and the Demand for Regional Integration*

The central precondition for the establishment of a regional economic integration scheme is that the participating states expect significant gains from such integration. States face significant costs when participating in such a scheme, because they must restrict their sovereignty and must adapt to new rules. They will only agree to participate if the expected utility of regional integration exceeds the respective costs. This argument is based on the assumption that states cannot be forced to participate in a regional integration scheme. Thus, integration by force – as happened in the framework of colonialism – is not included in this theoretical approach.

The International Political Economy usually stresses that the utilisation of comparative cost advantages and economies of scale are the main rationale behind

regional economic integration (Mattli 1999, Padoan 2001, Schirm 2002). Accordingly, the aim of regional integration is mainly to abolish step-by-step tariffs and non-tariff trade barriers between the member states – from a free trade area over a customs union, a single market, economic and monetary union and finally to political union (Balassa 1961). Such market integration simplifies intraregional trade, which allows member states to concentrate on the production of goods where they have comparative cost advantages, and to profit from access to larger markets. However, the extent of the gains from comparative cost advantages and economies of scale depends strongly on the structure of the participating economies. The gains from intraregional trade are likely to be higher if participating economies are specialised in the production of different goods and if they are well developed in order to constitute attractive markets for each other. If member states of a regional integration scheme produce similar goods and are less developed, intraregional trade is much less important. For this reason, the International Political Economy often states that the prospects for regional integration are better in the North than they are in the South (Mattli 1999).

However, the utilisation of comparative cost advantages and economies of scale are not the only – and for developing countries probably not even the most important – gains of regional integration (Robson 1993). Instead, regional integration can also be part of a development strategy, wherein participating countries use integration in order to become more appealing to foreign investors or donors of development aid. Small states, which may not be interesting as markets per se, become more attractive for investors if they provide access to larger, regionally integrated markets (Büthe and Milner 2005, Schirm 2002). And instable states, which face difficulties concerning credible commitment to investor- or donor-friendly policies, become more attractive if they bind themselves to certain policies within a regional integration scheme.

Another gain of regional integration is that the participating member states can improve their standing within the international system by belonging to a larger regional integration scheme. E.g. states may choose to form a regional bloc in order to get a better bargaining position within the World Trade Organisation (Mansfield and Reinhardt 2003). Another example is that the setup of regional integration

schemes allows member states to more easily negotiate bi-regional preferential trade agreements with other regions (so-called Interregionalism; Hänggi et al. 2006). Currently, this is regularly done in the Asia-Europe Meeting (ASEM; Bersick 2004), between the EU and the MERCOSUR (Doctor 2007) and between the NAFTA and the MERCOSUR (Gratius 2005).

The problem for a comparison of regional integration dynamics in- and outside of Europe is that the academic discussion has so far mainly concentrated on the first gain of regional integration, whereas the latter two have remained largely unexplored. Thus, it is well known that the abolition of trade barriers among developed countries leads to more international trade, more interdependence and finally to an increased demand for more regional integration. Yet the effects of regional integration as a development strategy or as a tool to increase bargaining power are still uncertain. It is unsure whether interdependence between the participating countries will increase – which would lead to dynamic effects also in the South – or whether it will stagnate or even decline.

## *2.2 New Institutionalism and the Supply of Regional Integration*

Even though the member states join common gains from regional integration, the establishment of a regional integration scheme is not trivial, because they usually also have conflicting interests. Thus, the underlying preference constellation is one of a mixed motives game where some interests converge while others collide. In such a situation, common institutions are an instrument for the member states to commit themselves credibly to their common long-term interests, instead of following their particularistic short-term interests (Krapohl 2008, Moravcsik 1998: 73-77, North 1993, Shepsle 1991). In this respect, regional integration schemes can be understood as a form of international regime (Keohane 1984, Laursen 2005), which helps the participating states to solve their coordination and cooperation problems. However, different kinds of institutions are needed to solve different kinds of problems.

When deciding on common rules, member states often face a coordination problem with distributive consequences ('Battle-of-the-Sexes'). They all prefer common rules to individual measures, but they disagree about the concrete form of

these rules. It may be helpful in such situations if one of the member states is a hegemon, because such a powerful member state could on its own solve coordination problems and provide the club good regional integration (Mattli 1999). Such a regional group of states, which includes a benevolent hegemon, constitutes a privileged group (Olson 1965), because it may be much easier for them to cooperate than it is for other groups in which power is much more symmetrically distributed. Although the smaller member states of a privileged group have to adapt to the preferences of the hegemon, they still profit, because the hegemon can solve coordination problems and may be the paymaster in cases of distributive conflicts. Thus, the structure of the participating states may be very important for the success of a regional integration scheme.

If the member states of a regional integration scheme do not constitute a privileged group, they must establish institutions which help them to solve their coordination problems. Such institutions are secretariats, parliamentary assemblies or expert bodies, which set the agenda for policy-making in the regional integration scheme (Pollack 2003, Tsebelis and Garrett 2001). Even though these agenda-setters may not have formal power, their advice may nevertheless help to overcome conflicts, because it is deemed to be either relatively neutral (secretariats), especially legitimate (parliamentary assemblies) or based on outstanding expertise (expert bodies). Such advice can act as a focal point around which the expectations of actors converge (Schelling 1960). Thus, decision-making becomes easier and blockades are less likely.

When implementing common regional rules, the member states often face a Prisoners' Dilemma. Therein, they all agree that common rules be implemented, but each state faces incentives to act as a free-rider and not to implement the agreement. Because the game is a symmetric one, all member states feel the same temptation to exploit the good will of the others, and thus cooperation could fail. The problem may be mitigated if such games are played repeatedly. In such iterated Prisoners' Dilemmas (Axelrod 1994), actors may learn to trust each other, and may see that reciprocal cooperation pays off in the end. However, cooperation is unstable even in such iterated games, because member states can always be tempted to utilise the short-term gains of defection if unusual pay-offs are at stake. In order to



stabilise cooperation, member states of a regional integration scheme may establish dispute settlement mechanisms, wherein court-like bodies decide about alleged defections of member states. Thereby, commitment expressed in such dispute settlement mechanisms is dependent on the degree of legalisation, i.e. the precision and obligation of legal rules, as well as the independence of their review (Abbott et al. 2000).

A crucial question for some regional integration schemes is what happens if neither a hegemon nor formal institutions for agenda-setting or dispute settlement exist. A first assumption is that these schemes face huge difficulties in finding agreements and in ensuring the implementation of these agreements. Of course, both would significantly reduce the integration dynamic of the respective region. However, a second assumption is that informal institutions could take over the functions of formal institutions (Busse 2000). As sociological institutionalism states, common norms, belief systems or identities may bind actors as much as formal institutions (March and Olson 1998). If such informal institutions emerge within a certain region – or at least among the elites of the participating states –, this may as well indicate a credible commitment towards the adoption of common decisions and the implementation of these decisions. Nevertheless, the strength of such an informal commitment has yet to be proven.

Again, the problem within the academic discussion is that it has so far mainly concentrated on the EU, whereas the institutions of the NAFTA, the MERCOSUR, the SADC and the ASEAN have largely been neglected. It is relatively well known, how independent the Commission is (Steunenberg, Koboldt and Schmidtchen 1996), how much influence the European Parliament has (Tsebelis and Garrett 2001) and how the European Court of Justice has influenced European integration (Alter 2001). In contrast, much less is known about credible commitment in the institutions of other regional integration schemes, let alone the effects of hegemons in some regions or of informal institutions in others. Even though none of the other regional integration scheme is truly familiar with supranational institutions, this does not necessarily mean that the existing intergovernmental or even informal institutions do not indicate any credible commitment.

### *2.3 Feedback Mechanisms, Interaction Effects and Integration Dynamic*

In order for dynamic integration processes to evolve, it is not enough that cooperation demand is met with the respective supply, but it is also necessary that feedback mechanisms occur in order for further cooperation to become possible. If cooperation itself produces the preconditions for further cooperation, one can speak of a self-sustaining integration dynamic which needs not be reinforced by external factors. Generally, such feedback mechanisms may occur on the demand and supply sides of regional integration, as well as by an interaction of both.

The implementation of a cooperation project may have influence on the interests of and within the participating states. E.g. the abolishment of trade barriers in a certain sector may lead to economic structural change within that sector. If only the most competitive export industries survive this change, the former opponents of trade liberalisation leave the market, and the remaining producers prefer freer trade in order to export their goods. The result is that the demand for intraregional trade liberalisation increases further (Keohane et al. 2002). Besides, initial cooperation may not only change interests within the respective sector, but also within other policy areas. Such spill-over relies on the fact that integration of some policy areas has negative externalities for other areas. E.g. the establishment of a single market has deregulatory effects for freely traded goods, and this deregulation must be met with re-regulation at the regional level (Krapohl 2008, Majone 1994, Scharpf 2003). Thus, more demand for regional rules emerges, and the member states may delegate more competencies for regulatory policy-making to the upper level. In the end, both the change of interests within a policy area and the spill-over into other areas may lead to further steps of regional integration, and may consequently initiate an independent and self-supporting dynamic.

The problem is that not all gains of regional integration have the same dynamic effects on actors' interests. Among developed and specialised economies, the abolition of trade barriers will probably have the most direct effects on market participants' interests. Due to increased intraregional trade, interdependence between different economies is growing, and this is likely to produce spill-over effects either within a certain sector or towards other policy areas. However, if regional

integration is part of a development strategy, the effects on actors' interests are likely to be more indirect. If the goal of regional integration is to attract foreign direct investments or development aid, this does not lead directly to increased interdependence and changing interests. Only in cases where the development strategy has some success and the participating economies develop, will more interdependence evolve and interests are likely to change towards more integration. And if the goal of regional integration is to improve the bargaining position in comparison to other regions, the dynamic effects are even more indirect. Even if the respective region is successful in bargaining about preferential trade agreements with another region, this will, first of all, increase the interdependence with this external region. Internal interdependence only grows if the trade with another region leads to economic development and increasing trade within the own region.

An integration dynamic may also evolve if economic demand for regional integration meets changing supply conditions. Institutions may change the bargaining situation within a regional integration scheme by giving access to new actors and by establishing new decision-making rules. Firstly, if the member states set up secretariats, parliamentary assemblies or expert bodies, these may try to set the agenda of decision-making in a way that results in further integration (Pollack 1997). The same applies to dispute settlement mechanisms which may influence the integration dynamic with their case law (e.g. for the case of the European Court of Justice see: Alter and Meunier-Aitsahalia 1994). Further, regional institutions may provide access for private interests, which can then leave their national governments aside and directly articulate their demands at the regional level. And secondly, member states may commit themselves to giving up unanimity vote in some policy areas, which would simplify further cooperation, because not every reluctant member state needs to agree to new policies (Tsebelis and Garrett 2001). Or member states are bound by previous decisions, which they cannot change due to high majority requirements, and which lead to different solutions than an intergovernmental bargaining system (Gehring 2005, Pierson 1996, Scharpf 1989).

All in all, there are various ways in which institutions may influence decision-making in order to make further regional integration possible. Thereby, it is important to state that the institutional dynamic is likely to be as larger, as more credible

commitment the institutions express, because such commitment makes a rollback by the member states more difficult and less likely. In contrast, institutional dynamic is much less likely to occur if regional integration is mainly supplied by a hegemon. In such cases, institutional commitment by the member states is less needed, because the smaller member states have to follow the rules of the hegemon anyway, whereas the hegemon is unlikely to reduce its power by binding itself to regional institutions. Thus, the integration dynamic is mainly dependent on the interests of the hegemon, and institutional lock-ins or spill-overs will probably not emerge.

The most integration dynamic will probably occur in regional integration schemes in which favourably demand and supply factors interact with each other. In such a situation, increasing intraregional trade leads to increasing interdependence and increasing demand for regional rules. This demand can then be addressed to strong regional institutions, which try to satisfy it in order to strengthen their position and influence. As a result of new regional rules, intraregional trade becomes even easier and is likely to increase further. The process starts again – albeit on a higher level of regional integration. In this way, the regional polity becomes step-by-step institutionalised (Stone Sweet and Sandholtz 1997).

### **3. Cases of Regional Integration**

In the following empirical part of the paper, the theoretically deduced variables will be used to build up hypotheses in regard to the integration dynamic of different regional integration schemes around the world. Thereby, it becomes evident on first view that the several integration schemes differ significantly on both the demand and supply side of regional integration (see table 1). Whereas the EU, the NAFTA and the ASEAN + 3 (ASEAN with Japan, China and Korea) are projects of North-North or North-South integration, the MERCOSUR, the SADC and the ASEAN (without Japan, China and Korea) consist only of developing countries. And whereas the EU and the MEROSUR are familiar with a variety of formal institutions, the NAFTA and the SADC are grouped around hegemons, and the ASEAN, as well as the ASEAN + 3 are based on informal institutions.

*Table 1: The Demand for and Supply of Regional Integration  
in Different Regional Integration Schemes*

		Supply of regional Integration		
		Formal Institutions	Hegemon	Informal Institutions
Demand for Regional Integration	North-North or North-South Integration	EU	NAFTA	ASEAN + 3 (with Japan, China, Korea)
	South-South Integration	MERCOSUR	SADC	ASEAN

### *3.1 European Union: North-North Integration and Supranational Institutions*

Even though European integration started in order to preserve peace in Europe after the Second World War, the instrument for this was economic integration. The structure of the economies of the initial six member states allowed for high economic gains by trade liberalisation. The potential for these gains grew even with several rounds of enlargement. Today, the EU mainly consists of highly industrialised and specialised economies and a few less advanced developed countries from Southern, Middle and Eastern Europe, which have comparative cost advantages in labour-intensive production. Consequently, high comparative cost advantages and economies of scale can be utilised by intraregional trade (Mattli 1999, Schirm 2002). Today, around two thirds of all exports of EU countries remain within the region.<sup>1</sup> Intraregional trade is the most extensive of all regional integration schemes.

In Europe, this high economic demand for regional integration meets the highly differentiated institutional structure of the EU, which can be regarded as the most complex international organisation in the world (Gehring 2002). The Commission has the monopoly of legislative initiative, the European Parliament (EP) is a co-equal legislator to the Council for most legislative acts, and the European Court of Justice (ECJ) has far-reaching competencies not only pertaining to disputes between the

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<sup>1</sup> World Trade Organisation (2006): "International Trade Statistics 2006", ([http://www.wto.org/english/res\\_e/statis\\_e/statis\\_e.htm](http://www.wto.org/english/res_e/statis_e/statis_e.htm); 7/4/2008), 66.

member states, but also to claims of private citizens against member states or EU institutions. Thus, not only is the economic demand for regional integration high, but the supply conditions are also very favourable to integration.

The EU is an example for favourable demand and supply conditions which interact and mutually reinforce each other. This led to the dynamic process, which is stressed by neofunctionalists (Haas 1958, Schmitter 2002) and historical institutionalists (Pierson 1996, Stone Sweet and Sandholtz 1997), but this can also be found in the work of intergovernmentalists (Moravcsik 1998). Initial trade liberalisation led to increasing intraregional trade, which in turn led to more demand for regional rules. This demand was not only addressed to the member states, which amended the treaties repeatedly, but also to supranational institutions like the Commission and the ECJ, which successfully aimed to reinforce integration with their competencies in policy-making or dispute settlement. Once a further integration step was adopted, even more trade became possible, which again increased interdependency and the demand for regional rules. This process led from a customs union in the 1960s to the Single Market in the 1980s and later to the Economic and Monetary Union in the 1990s. For this development, it is not so important whether regional integration was supplied by intergovernmental bargaining or by supranational institutions. However, it is more decisive that one step of regional integration makes further steps possible –because it changes the interests of the member states and the rules of future decision-making.

### *3.2 North American Free Trade Agreement: North-South Integration and a Hegemon*

Since its setup in 1994, NAFTA is the world's second largest regional market, after the EU. It is a free trade area with no internal tariffs, but without common external tariffs to non-NAFTA countries. As in the EU, the economic gains, which can be utilised by intraregional trade, are high (Appendini und Bislev 1999). Although one member state – namely Mexico – is still an emerging market, precisely this fact contributes positively to its comparative cost advantage. Labour-intensive production is increasingly outsourced from the US to Mexico, where wages are comparatively low (Chase 2003, Schirm 2002). Due to its access to the US market, Mexico became very attractive for foreign direct investments and experienced an investment boom

from the US and from outside NAFTA in the 1990s (Hufbauer and Schott 2005). This transnational division of labour led to increasing trade within NAFTA. Currently, roughly half of the exports from NAFTA countries remain within the region<sup>2</sup> – which is the second highest number of all regional integration schemes.

This economic dynamic of the NAFTA meets a weak institutional architecture. The NAFTA is based on one comprehensive treaty and two side agreements on environmental and labour protection, but there is no secondary law similar to EU legislation (Kaiser 1998). A trade commission exists, but it has only administrative competencies and is understaffed. The NAFTA is not equipped with a parliamentary assembly, and six different dispute settlement mechanisms have been established instead of a regional court. However, in contrast to the EU, the NAFTA is clearly dominated by a hegemon: which is the US. It is evident that regional integration in Northern America means more an integration of the Mexican market (and to a smaller extent of the Canadian market) into the US market than vice versa.

Regional integration within NAFTA is a demand-driven process, whereas the supply side is unlikely to produce dynamic. Increasing demands for regional rules within the NAFTA can only be satisfied in two ways. The first, which already happened once during the ratification phase of the agreement, is that of intergovernmental negotiations. After the NAFTA treaty was signed, the newly elected US president Bill Clinton placed pressure on Canada and Mexico to accept two side agreements on environmental and labour protection (Hufbauer and Schott 2005, Mayer 1998). Clinton threatened the other states by claiming that ratification would fail within congress if these side agreements were not part of the deal. Canada and Mexico had to accept this in order not to endanger their free access to the large US market. Similar side agreements could again be adopted if these were in the interests of the US, and if the US put enough pressure on Canada and Mexico by threatening to exit the agreement. A second, but less likely, mechanism for the supply of regional integration is the dispute settlement system (Abbott 2000). In some of the six mechanisms, private plaintiffs may bring forward claims against states if these are deemed to infringe on the NAFTA treaty or the side agreements. It may be that the dispute settlement system builds up case law which interprets the treaty or

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<sup>2</sup> World Trade Organisation (2007): "International Trade Statistics 2007", ([http://www.wto.org/english/res\\_e/statis\\_e/statis\\_e.htm](http://www.wto.org/english/res_e/statis_e/statis_e.htm); 7/4/2008), 23.

the side agreements in a way that reinforces regional integration (for the well-known example of the EU see Alter and Meunier-Aitsahalia 1994). However, it can be stated that the bodies which make decisions about such claims are tribunals recruited on an ad hoc basis from the member states so that the member states keep full control over the development of case law. Thus, it is less likely than in the European case that the dispute settlement system is able to significantly influence integration.

### *3.3 Mercado Común del Sur: South-South Integration and Intergovernmental Institutions*

The MERCOSUR, which was founded in 1991, is one of the most promising regional integration projects between developing countries (Vaillant 2005). Its aim is to liberalise trade step-by-step with the goal of achieving a single market and, in the end, an economic and monetary union. Currently, it is formally a customs union, although weak implementation of regional rules leads to the fact that uniform external tariffs have not yet been established (Pohl 2003). Despite its ambitious aims, the MERCOSUR suffers, on the demand side, from the typical shortcomings of South-South integration. Because of relatively similar and less-developed economies, intraregional trade is not as important as in the north (Schirm 2002). Although MERCOSUR managed to double its share of intraregional trade, from only 10% in 1990 to 20 % in 2000, it declined again to 14% in 2006 as a result of the Argentinean economic crisis at the beginning of the new millennium.<sup>3</sup> Thus, it is very important for the MERCOSUR to become more attractive for foreign direct investments and to negotiate about preferential trade agreements with the NAFTA and the EU. And indeed, during the 1990s, the MECOSUR countries experienced a boom of foreign direct investments (Pohl 2003), but again the Argentinean crisis impeded this development. Further, the MERCOSUR negotiated with the NAFTA concerning the set up of a Free Trade Area of the Americas and with the EU concerning a preferential trade agreement, but neither negotiation has yet been successfully concluded.

On the supply side, this uncertain demand for regional integration in the MERCOSUR meets highly differentiated regional institutions, which follow, to some

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<sup>3</sup> United Nations Conference on Trade and Development (2007): "Trade and Development Report 2007", ([http://www.unctad.org/en/docs/tdr2007\\_en.pdf](http://www.unctad.org/en/docs/tdr2007_en.pdf); 7.4.2008), 95.



extent, the example of the EU (Vaillant 2005): The MERCOSUR has a Council like that of the EU; a 'Group of the Common Market', a trade commission and an administrative secretariat together fulfil the functions of the European Commission; a parliamentary assembly resembles the 'old' EP, before this became directly elected by the EU citizens in 1978; and finally, a dispute settlement mechanism and a standing appellate tribunal take over judicial functions like the ECJ (Malamud and Schmitter 2006, Pohl 2003). Although there has been no far-reaching delegation of competencies to real supranational institutions so far, the MERCOSUR is nevertheless designed to dynamically produce legal rules in order to increasingly commit the member states to the goals of market integration (Gratius 2005).

In contrast to the NAFTA, the MERCOSUR is a supply-driven project, but the economic demand is less likely to produce integration dynamic. The low level of intraregional trade indicates that there are few interdependencies between the member states, and that there is consequently little demand for regional rules. This explains why the MERCOSUR suffers from a chronic implementation deficit. Regional rules are adopted for political reasons, but they are often ignored, because there are no stakeholders who push for their implementation. The crucial question for the regional integration dynamic is whether or not the MERCOSUR will be successful with its strategy to attract foreign direct investments, to develop the member states' economies and to create more trade and interdependence between those states. The investment boom and the growing share of intraregional trade in the 1990s point in this direction. However, when the Argentinean economic crisis put an end to this development and the numbers of foreign direct investment and intraregional trade declined, the member states widely stopped the implementation of MERCOSUR legislation (Pohl 2003). Nevertheless, the member states seemed to be willing to stop this 'Mercosclerosis' when they set up the standing appellate tribunal in 2004 (and later the parliamentary assembly in 2007). Thereby, they deepened their commitment in the MERCOSUR in order to once again become more attractive to foreign investors. If this will prove successful, not only foreign direct investments, but also the share of intraregional trade are likely to increase, and the integration dynamic may re-emerge.

### *3.4 Southern African Development Community: South-South Integration and a Hegemon*

Of all the different regional integration schemes in Africa, the SADC is probably one of the few with modest chances for success (Mair and Peters-Berries 2001). SADC's predecessor, the Southern African Development Co-ordination Conference (SADCC), was founded in 1980 by the non-apartheid states in Southern Africa in order to mobilise and coordinate development aid, to support each other and to reduce dependence on hostile apartheid South Africa (le Pere and Tjønneland 2005). However, when apartheid ended in 1994, South Africa became the largest member of the reformed SADC. Since then, economic integration has become an important means for the SADC to foster development. Currently, the SADC is trying to establish a free trade area, but low implementation records of its member states work against the actual achievement of this goal. Like the MERCOSUR, the SADC suffers from the typical problem of South-South integration on the demand side. The participating economies are minimally developed and export mainly raw materials to the North (Hansohm and Shilimela 2006). Thus, the potential gains of intraregional trade are low. Currently, the share of intraregional trade is roughly 8%.<sup>4</sup> The SADC is trying to attract development aid and foreign direct investment, but so far, this has not led to significant more diversification and intraregional trade.

On the supply side, the SADC is distinguished by the presence of a potential hegemon, which is South Africa (Mulaudzi 2006). However, in contrast to the NAFTA, it is uncertain whether South Africa is really willing to fulfil the role of a benevolent hegemon and to provide regional integration on its own. It is also unclear whether such a development even be accepted by the other member states. In recent years, the SADC has also reformed its institutional structure along the lines of the EU (Vogt 2007). The SADC currently has a summit similar to the Council of the EU, a Council of Ministers, a strengthened secretariat, a parliamentary form similar to the EP before 1978 and a tribunal for dispute settlements. Given a chronic understaffing of these bodies and a low implementation record of the member states, it is uncertain, how this reformed institutional structure will influence the future integration dynamic (Oosthuizen 2006).

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<sup>4</sup> United Nations Conference on Trade and Development (2007): "Trade and Development Report 2007", ([http://www.unctad.org/en/docs/tdr2007\\_en.pdf](http://www.unctad.org/en/docs/tdr2007_en.pdf); 7.4.2008), 95.

A self-sustaining integration dynamic in Southern Africa is faced with two fundamental problems. On the demand side, it is unlikely that intraregional trade and thus interdependence will increase between the member states, so that the demand for regional rules is also unlikely to increase. And on the supply side, the role of the potential hegemon is uncertain and it is unlikely that the regional institutions could step in, if South Africa refuses to play its role and does not provide regional integration. However, a regional integration dynamic could nevertheless emerge if it is supported by donors of developmental aid. One of the main goals of the SADC is attract developmental aid, and this gives donors like the EU an instrument to influence the integration process. The EU could use this on both the demand and supply side. On the demand side, it could reinforce interdependence by financing projects (e.g. infrastructure) with a regional scope. And on the supply side, it could strengthen the supranational institutions if these, and not the member states, become the addressees of aid.

### *3.5 Association of Southeast Asian Nations (plus Japan, China and Korea): South-South or North-South Integration and Informal Institutions*

Originally, the ASEAN was founded (in 1967) as a forum for loose regional cooperation and as a security community against the threat of communism in Southeast Asia (Acharya 2001). However, similar to the case of the SADC, the former enemies (Vietnam, Laos, Cambodia and Myanmar) became members of the ASEAN in the 1990s, following the end of the Cold War was (Ufen 2005). As a result of the disappearance of external threat, the ASEAN was in search of a new task, and, in 1992, it decided to establish a free trade area by reducing tariffs to a maximum of 5% by 2002. Currently, this ASEAN Free Trade Area has, to a large degree, been implemented, but sensitive product sectors are still excluded from trade liberalisation (Cuyvers et al. 2005). As in other cases of South-South integration, the problem on the demand side of the ASEAN is that intraregional trade is less important than trade with other regions. Although the share of intraregional trade is roughly 25%<sup>5</sup> (which is the highest share of regional integration schemes in the South), this number is significantly lower if one subtracts trade which is exported to

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<sup>5</sup> World Trade Organisation (2007): "International Trade Statistics 2007", ([http://www.wto.org/english/res\\_e/statis\\_e/statis\\_e.htm](http://www.wto.org/english/res_e/statis_e/statis_e.htm); 7/4/2008), 28.

other regions via the entrepot Singapore. However, the potential for economic gains by intraregional trade are significantly higher in the so-called ASEAN+3, which includes all ASEAN countries with the addition of Japan, China and Korea (Nabers 2005). Though the latter three do not officially participate in AFTA, they are connected to it by a range of bilateral trade agreements with ASEAN countries. Because Japan is a highly industrialised country, and because China represents an enormous market, the potentials for comparative cost advantages and economies of scale are much higher than within ASEAN alone.

However, the ASEAN does not only face problems on the demand side, but also on the supply side of regional integration. Despite the lack of a regional hegemon in Southeast Asia, the ASEAN states have only established very few formal regional institutions. Decisions are passed at intergovernmental meetings of different levels (head of states, ministers or bureaucrats), which are supported by a small secretariat for administrative and coordinative tasks (Ufen 2005). The ASEAN+3 does not even have a secretariat. A parliamentary assembly and a dispute settlement mechanism do not exist in either scheme. Whereas there is an obvious lack of formal institutions in the ASEAN, the importance of informal institutions is repeatedly stressed in the literature (Acharya 2001, Busse 2000). Accordingly, cooperation between the member states is based on a set of informal principles which are summarised as the 'ASEAN way'. This includes informality, organisational minimalism, conflict avoidance, consultation and consensus building (Ufen 2005). The question is, whether these informal institutions are strong enough to replace the commitment to formal institutions. Whereas some scholars argue that the 'ASEAN way' is the reason for ASEAN's success in dealing with intraregional conflicts, critics conclude that it is the reason for the ASEAN's slow success in regional integration.

As in the SADC, a regional integration dynamic in the ASEAN meets problems on both the demand and supply sides of regional integration. Intraregional trade is not very important, and thus, interdependence and demand for regional rules are unlikely to increase as a result of trade liberalisation. And the extremely weak institutional structure of the ASEAN is also unlikely to generate an integration dynamic. However, the situation is somewhat different concerning the ASEAN+3, which some observers believe to become the most important regional cooperation in

Asia (Nabers 2005). Here, the demand for regional integration is more likely to increase, because participation of Japan and China allow for the utilisation of more comparative cost advantages and economies of scale. Nevertheless, it is still an open question, whether the ASEAN+3 will be able to overcome its weakness on the supply side. The informal institutions of the 'ASEAN way' maybe have been adequate for loose coordination in the past, but it is unlikely that they will be able to ensure the necessary commitment for closer integration in the future.

## **5. Conclusion**

The aim of this paper was to present a theoretical approach which is able to overcome two surprising gaps in the academic literature. On the one hand, the New Institutionalism is widely discussed using the example of European integration, but so far it has not been systematically applied to other cases of regional integration. And on the other hand, the International Political Economy has provided some comparative studies concerning regional integration, but it has neglected its dynamic character. The proposed solution is to conceptualise regional integration as a club good, and to elaborate economic demand and institutional supply factors which could lead to the establishment of regional integration schemes. Integration dynamic may occur if one or more of these factors changes due to previous integration steps. In this way, regional integration itself may provide the preconditions for further integration steps. A self-sustaining dynamic may occur, which needs not necessarily to be externally reinforced.

This theoretical approach was then applied to the five most important regional integration schemes in the world in order to establish hypotheses about their integration dynamic. It became obvious that different integration schemes are faced with very different problems during the integration process. Whereas the EU is surely the most successful of all integration schemes – because it scores well on both the demand and supply dimension – the relative dynamic of the others cannot yet be fully assessed. The NAFTA is pushed forward by the economic demands of stakeholders, but needs stronger regional institutions in order to increase integration. The MERCOSUR has these institutions, but its economic future is uncertain. The SADC faces difficulties on both the demand and supply sides, but it could be supported by

outside donors of developmental aid. And the ASEAN faces similar problems as the SADC, but an enlargement of its free trade area to Japan, China and Korea could lead to a new momentum. If at all, one could hypothesise at this stage of research that the EU is the most dynamic regional integration scheme, that the NAFTA and the MERCOSUR take a middle position, and that the SADC and the ASEAN face the most problems in establishing a self-sustaining integration dynamic.

It is obvious that these conclusions are not the result of intensive empirical research, but that they are derived from the theoretical argument. Thus, there is still a lot of work to be done. Firstly, the theoretical concept needs to be further elaborated and operationalised for the empirical work. The list of demand and supply factors is probably not definite, and the same applies to feedback mechanisms and interaction effects. These factors must be operationalised in a way that allows them to be compared throughout all the different regions. And secondly, theory-driven case studies on the NAFTA, the MERCOSUR, the SADC and the ASEAN are necessary in order to prove the hypotheses derived from the theoretical approach. Thereby, it is important that these case studies observe the same variables in all the different regions in order to lay the foundation for a fruitful comparison.

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