

important to the majority of the population because there is no nationwide alternative welfare plan that would take this responsibility away from the SOEs. Reformers have tried to restructure and shift the focus of SOEs to make them more efficient. However, without a well-established alternative for social welfare to match the economic changes, social discontent will arise as a result of the increasing numbers of unemployed. Therefore, until such a time comes and the market economy has matured enough to produce a solid base for social interaction outside work units, SOEs remain the dominant force behind the social stability of urban China.

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Regionalism: The Solution for the Problems of the Nation State

By David Schmook

The international corporations have evidently declared ideological war on the antiquated state...The charge that materialism, modernization and internationalism is the new liberal creed of corporate capitalism is a valid one. The implication is clear: the nation state as a political unit of democratic decision making must, in the interest of 'progress' yield control to the new mercantile mini-powers (Levit)

Regionalism has been developing since before the creation of the nation state, the Custom Unions among the German Principalities and Prussia prior to German unification under Bismarck. The Greek city-state's system was a form of regionalism. The strongest example of regionalism in the 20th century is the European Union. George Ball promoted the rise of regionalism in 1967 as means to deal with the problems that arise out of a global economy: "One obvious solution is to modernize our political structures- to evolve units larger than the nation state and better suited to the present day...What this implies is the establishment by treaty of an international companies law, administered by a supranational body" (Ball 191). Regionalism is not a newly invented concept, but one that has been around the political landscape for centuries.

Even the Marxist, V.I. Lenin predicted the formation of regionalism in 1916: " We notice three areas of highly developed capitalism, that is, with a high development of means of transport, of trade and of industry, these are Central European, the British and the American Areas" (Lenin 110). Lenin predicted the creation of regional hegemony behind three hegemonic powers: Britain, Germany and the United States. The British case being very different from typical geographical regionalism, the British "region" was their vast empire and not geographically proximate Europe. While Lenin and his fellow Marxist view the world from a different perspective, its interesting to note that they predicated an eventual alignment of capitalist nations intoasegional associations.

Regionalism is the creation of a set of agreements among nation states to reduce intraregional barriers to trade, investment and/or security cooperation. Regionalism entails a coordinated monetary policy among its member states and the creation of an arbitrary system, process or institution to settle dispute among member states.

Regionalism will and is developing along three organizational lines. The first, and the most publicized, is Strong Institutionalized Regionalism. A prime example of this form of regionalism is the European Union. The second type, and closest to home, is Regional Hegemony. An example of Regional Hegemony is NAFTA. The third type is Weak Institutionalized Regionalism. I will use ASEAN, the Association of South East Asian Nations as an example of this type of regionalism.

Strong Institutionalism is characterized by a regional association that is driven by an establishment of a supranational governance body with sovereign powers. The member states willingly transfer certain sovereign rights to the supranational organiza-

Hon. In return the supranational institution provides certain collective goods to the member states, such as trade coordination and negotiation with other states and blocs, coordinated monetary policy, immigration and labor laws, independent judicial and problem resolution process, payment of adjustment costs when needed, subsidization of certain sectors of the economy and specific R&D projects, and military protection from outside threats.

There are two competing governance theories developed to support strong Institutionalism. Both theories were developed within the European Community, the only current example of strong Institutionalism. The first and most prominent is Neo-Functionalism. "Neo-Functionalism, developed and refined between 1955 and 1975, remains the most comprehensive and sophisticated attempt to provide a general theory of European integration" (Moravosik 30). Neo-Functionalism asserts that European integration is self sustaining. Ideologically, it is "a form of economic determination based on the end of ideology and the advent of a world in which the technocrat has become the eminence rise of all government" (Moravosik 31). In the Neo-Functionalist world the institutional bureaucracy replaces the nation states as the decision making authority for economic policies. The removal of political decision making is key to the success of the technocrat in shaping policy. The technocrat must be free of ideology or political pressure to make the right policy.

The key to the success of Neo-Functionalism is the spillover effect: "spillover occurs when the existence of supranational organizations sets in motion a self-reinforcing process of institution building" (Moravosik 35). Basically, the concept is that over time supranational institutional functions will be solidified and strengthened through repetition and precedent setting. Eventually, a critical mass will develop to allow the supranational institution to assert itself as the dominant institution in the Region.

Neo-Functionalism is the most advanced theory to explain European Integration, but it does have flaws. It cannot explain growth in power of the European Commission occurred through treaty negotiations, such as Maastricht. The growth in power of the EC was not gradually and linear, but rather expanded through short bursts and followed by lull's.

A competing theory has developed to drive European Integration, Liberal Intergovernmentalism. The theory "has three essential elements: the assumption of a rational state behavior, a liberal theory of national preference formation and an intergovernmentalist analysis of interstate negotiations" (Moravosik). The theory puts less emphasis on the supranational institution and more on state decision making. The Liberal intergovernmentalist is unwilling to accept total transference of national sovereignty to the European Commission. The key player for the liberal intergovernmentalist is still the nation state acting in an integrated and rational manner.

While both theories disagree on the preeminence of the supranational institution, they both support the theory of strong institutionalism. The Neo-Functionalist views the strong institution as the means to strengthen itself and the union. The Liberal Intergovernmentalist does not believe that the supranational institution by itself can achieve transference of power from the nation state. They feel that only through formal agreements will the supranational institution gain the rights to previous national sovereign powers. However, both theories support the view of a strong supranational institution in Europe.

The Neo-Functionalist model can be nicely applied to the accession of the European Court of Justice. While the European Commission receives the major press about integration, it's the European Court's close ties to national judicial bodies that is

furthering integration: "no less important has been the equally growing involvement of the national judiciary in the administration of community law, transforming doctrinal acceptance into processional reality" (Weiler 135). The rise in stature of the European Court is furthering Political Integration, because individuals and firms now can invoke community law through their national judiciaries. "When a national court accepts the ruling, the compliance pull of community law becomes formidable" (Weiler 136). With every case that a national judiciary refers to the European Court of Justice for a ruling the supranational court and institution is strengthened. The ride of a strong independent judiciary is necessary for a strong institutionalist regional regime to survive.

The creation of Airbus is an example of coordinated economic policy under the European Union. The Union decided that it was in their national interests to create and develop a commercial airline producer to compete against the Americans. The Union brought together the three major airline producers in Germany, Britain and France to form Airbus. The Union through its member states provided research and development capital and subsidies to allow Airbus to develop. The national airlines of Europe gave Airbus preference over Boeing and McDonald Douglass in purchasing decisions. The result is that Airbus has replaced McDonald Douglass as the number two commercial airline manufacturer behind Boeing. In fact, McDonald Douglass is almost out of the commercial airline business, because its market share has fallen dramatically in the past few years. The implementation of Airbus is an example of the power that a strong institutionalist regional regime can have in directing industrial policy in the region.

After the fall of the Bretton Woods accords the European Community searched for an alternative system. Their answer was the European Monetary Union, created in 1979. The Bretton Woods Accords provided certain collective goods that an integrated Europe found very useful, such as a fixed by adjustable exchange rate system. The system helped insure that imports and exports among community states would not fluctuate unexpectedly thereby causing disruption in intra-European trade. After the fall of the accords "real exchange rates of industrial countries have been far more volatile in the 1970s and 1980s than during the Bretton Woods period" (DeMelo 3).

The EMU created the Eurodollar and eventually evolved into the concept of a single European currency agreed to in the Maastricht Treaty. The single currency was suppose to be implemented in 1992, but the rising German mark caused Britain, Italy, and other members to pull out of the monetary union. The evolution towards a single currency is going to take longer than anticipated under Maastricht, but steps are being taken by Germany, France and Italy to drive monetary union. Eventually, the EU will be successful in establishing a monetary union and the creation of a single European currency.

The creation of a monetary union is key to all forms of regionalism, but a single currency is a characteristic of strong institutionalized regionalism. The other forms of regionalism, weak institutionalism and regional hegemony, have coordinated monetary policy, but nether moves towards a single region wide currency.

A Regional hegemonic regional structure has one dominant regional actor with one or several secondary actors. They form a regional structure dominated by the hegemon. Regional supranational institutions are weak. Most major policy decisions are made by the regional hegemon in consultations with the secondary actors. The organizational structures are defined by treaty obligations between the hegemon and secondary actors. The regional institutions lacks external focus, the agreements are based on intraregional issues. The institutions developed are to implement and monitor regional initiatives. There is not a coordinated foreign or military policy between the

member states. The regional hegemon takes the lead in defining and providing the foreign and military policies for the region. The hegemon provides security protection for the states aligned within the regional association.

Why does this form of regionalism exist? And why do states voluntarily join as secondary actors? The regional hegemon provides certain collective goods that are appealing to the secondary actors. The hegemon guarantees access to its domestic markets on favorable terms. The hegemon provides negotiating muscle, significantly in excess of the secondary actors' true power, when dealing with non-member states and institutions. The hegemon provides monetary stability to regional currencies and provides military security against foreign threats. Additionally, the attractiveness of secondary actors for foreign direct investment is increased because of its association with the regional hegemon. In an assessment of NAFTA by the United States International Trade Commission found that "existing models of NAFTA find that of the three countries, Mexico has the most to gain" (U.S. International Trade Commission 2-6). The developing economy, Mexico, has the most to gain economically in aligning themselves with the Hegemon, the United States.

What does the hegemon gain by providing these collective goods to the region? The hegemon insures access to regional markets on favorable terms. Providing the collective goods is in the best long term interest of the Hegemon: "The willingness of the United States to sacrifice specific economic interests to long term political goals was manifest in the active promotion of European integration and the toleration of discrimination against the U.S. by Europe and Japan" (Krasner 362). The United States wanted a long term goal of European security and integration as a bulwark against communist Eastern Europe. The Hegemon, the United States, sacrificed short term gains to enable the success of long term goals. Only a hegemon can bear this burden.

The hegemon brings stability to the region, which in turn lessens pressure on immigration: "As Mexico's standard of living improves, we will see fewer illegal immigrants crossing the U.S. border" (Nrona 24). Immigration is a key political issue in the United States. By providing these collective goods to Latin America, these countries' economies will develop and slow the flow of immigration to America. Therefore, a hot domestic political issue, immigration, is cooled down by providing a collective good to secondary actors. Regional hegemonies also increase their international bargaining position, because the hegemon speaks for the region as a whole in international affairs. The addition of the secondary actors can only increase its bargaining position. The hegemon benefits by maintaining hegemonic prerogatives within the region and develops the region along the lines of its cultural and political values, such as capitalism and democracy.

What sacrifices do the secondary actors have to make to join this form of regional association? Basically, there is a transference of sovereignty over economic policies to the hegemon. The hegemon will define the monetary, fiscal, economic and labor policies for the region. While there will be some latitude for adjustment by member states, the overall strategic direction is set by the hegemon.

What price does the hegemon bear? The hegemon must provide the collective goods and implement the collective policies. This means that when a secondary actor's currency needs strengthening its the hegemon responsibility to provide the resources to insure monetary stability. The hegemon absorbs any adjustment cost in the region through subsidies, side payments or the acceptance of unfavorable trade terms. Probably the largest adjustment cost borne by the Hegemon is in labor. The developing nation will attract investment in low or semi-skilled employment that normally would have occurred in the more advanced economy of the hegemon (Fishlow 14). As we

saw in the debates over NAFTA, the largest opponent of expanding free trade are labor unions. Their opposition is of practical realism, low wage and unskilled jobs will move to low wage countries and away from more advanced societies. The loss of jobs diminishes the power of domestic labor unions. When a recession impacts the region it's the hegemon responsibility to prop up not only their domestic markets, but also member states. The price for control is high.

Weak Institutional Regionalism is characterized by a relatively powerless institution set up to govern the regional institution. The member nations have not authorized a transfer of sovereignty to the supranational institution. The institution is more of a confederation of states with common goals, than a truly regional integrated bloc. The institution does not have the authority to interfere with the domestic policies of its member states. Issues such as labor laws, environmental regulation and human rights will not be discussed by the regional institution. These issues are the sole prerogative of the internal political structures of the member states. The focus of the regional institution is on external issues. The institution will take the lead in developing a common foreign policy orientation, although member states will have a wide latitude in adjusting the policy. However, major foreign policy initiatives will be coordinated, such as a decision to stay non-aligned or align with a particular bloc or nation. The institution will take the lead in negotiating trade issues with other blocs and states. A common monetary policy will be developed for member states along the lines of a wide band floating peg to a major world currency, either the yen, mark or the dollar. The institution will define the framework and rules for foreign investment. This is one of the most important collective goods that this type of regionalism provides.

A possible theoretical framework for the weak institutionalized regional organization has been presented by Chong Li Choy in his book *Open self-reliant Regionalism*: "the concept of open self-reliant regionalism consist of three ideas. The first is the idea of regionalism. The second is self-reliance and the third is openness" (Choy 45). Basically, the concept is an argument for a regional institution that is self-reliant, but is open to the world. Choy advocates an orientation along the lines of collective self-reliance, such as a need to pursue a non-aligned military structure. The theory favors international cooperation and relations.

The theoretical framework fits very nicely into a weak institutional regional structure, because it pursues both regional integration and international relations at the same time. The organization's main focus is on limiting the member state's dependence on external international actors, but stays away from domestic political issues. While the institution is developing policies to limit external dependence, the policy calls for continued, even robust, international engagement. This is important for weak institutionalized regionalism, since they tend to be newly industrialized nations with export oriented economies. The domestic political actors will not tolerate any interference in internal political issues by extra national organizations or institutions.

Why does this form of regionalism develop? The member states are individually weak, but collectively strong. For example, ASEAN has a population of over 300 million and a GDP of over \$293 billion growing at 7% a year (Kimura). Individually the states of ASEAN have a significantly smaller share of the world's GDP, but collectively they can command a greater say in world economic institutions, i.e. the WTO, and negotiate better terms with other blocs or states than if they pursued separate individual policies.

A major reason for the development of regional institution is fear. Fear of being left out of major international decisions or being denied access to markets due to a rise in protectionism. Also, fear of a regional hegemon, such as China or Japan, will

cause member nations to integrate themselves into a regional military structure.

A key characteristic of states that will form weak institutionalized regional structures are developing nations whose economies are export-oriented. Who have been or are dominated by a Regional hegemon and have little or no history of democratic domestic institutions.

The key to the success of weak institutional regionalism is the agreement among the member states to keep domestic politics off the negotiating table. As long as the focus of the regional institution is on external issues weak institutionalized regionalism will continue to develop and foster integration among the member states. Once the institution deviates from the external towards solving internal domestic issues the institution will begin to lose support from the member states and begin a process of extinction.

Now that we have looked at the forms of regionalism, we must ask ourselves why do we have regionalism? Economically, regionalism is formed because of national economic forces: proximity, income, policy convergence and intra-firm trade. Political forces that drive regionalism are a preference for regional trade, a desire for regional stability, the desire of hegemon for large state prerogatives and the strengthening of a nation's bargaining strengths through association with like minded states. Fear also drives regionalism. The fear of a hegemon, China or Japan in the case of ASEAN or even the EU out of a fear of an independent Germany. The fear of protectionism and lack of access to markets, NAFTA, ASEAN, MERCUSAR.

This last fear drives less developed countries to secure access to MDC markets. J. David Robinson describes domestic political pressure created by liberalized trade in more industrialized countries;

International trade policy coordination is further complicated by economic developments... a country's competitive advantage increasingly sensitive to sectorial predation by others...causes workers and others correspondingly to bear the burden of sharper adjustments and look to government to turn its trade policy narrowly inward (Robinson 167)

The trend towards protectionism in domestic politics forces developing countries to align themselves with a Regional Hegemon, as is the case with Mexico, align themselves with a Bloc, such as Eastern Europe with the EU or form an Association themselves to improve their international bargaining position, such as ASEAN. The increasing trend of protectionism in MDC is not the only factor driving regionalism, but is a major contributor.

A force behind Regionalism is the continued interdependence of the nation state. States are no longer individual actors on the world stage. The decision by one state effects many other states. What is driving interdependence? The increasing amount of foreign direct investments is the main driver of interdependence: "greatest growth in interdependence has undoubtedly been in investment, both real and financial" (Cooper 20). The LDC are naturally seeking to increase FDI, but what is the advantage to the MDC. On purely economic terms the MDC "by enlarging their trade environments can reap the joint benefits of comparative advantage and the economies of scale" (Nevile 45). The MDC's insure access to developing markets for exports, access to cheap labor, security for investment in developing countries and political prerogatives over developing countries economic policies.

The Prisoner Dilemma game has always forced nations to seek a sub optimal

outcome in International Affairs. The United States after World WAR II tried to institute a liberal trade regime that would produce optimal outcomes in International Trade. The creations of GATT, the Common Market and the Bretton Woods Accords are all steps to increase the likelihood of optimal outcomes in the PD game. No longer can the United States provide enough collective goods to insure optimal outcomes in the PD game. Regional organizations and blocs will assume this responsibility. They will provide the collective goods of information asymmetries and set of defined rules of engagement at a minimum to insure optimal outcomes in the PD game. At a minimum states need regional institutions that follow functional regime theory. The theory "view of international institutions as passive transaction cost reducing sets of rules" (Morfovskik). Without this minimum the PD game will achieve sub optimal outcomes.

While the United States can not act as a global hegemon any longer, this is not unexpected. Eventually the nations that the United States was supporting in a hegemonic relationship would develop, and were developing, at a faster rate than the hegemon itself. This fact is a result of a hegemonic relationship. The hegemon absorbs short term adjustment cost for long term gains. Eventually "two things change when small agents in hegemonic environments grow significantly relative to the hegemon. They begin to act strategically toward the hegemon, seeking to press advantage and avoid its perceived exploitation; the hegemon no longer finds the its provocation's too minor to warrant no response" (Robinson 180). This was exactly what happen to the Bretton Woods accords. Western European Nations took advantage of the fixed gold exchange rate and forced the United States to end the Bretton Woods Monetary system. The cost to the hegemon was too great to burden. However, the long term goals of the United States were achieved. Europe was rebuilt and communism was contained and eventually defeated. A liberal trading order was established and is continuing to be built upon. The United States global hegemonic period was not a failure, there just became a cross over point was the collective goods provided by the hegemon were too great of a burden for the hegemon.

We have discussed why nations would seek to form regional organizations, if you accept the logic behind the argument, then you must ask the question why now? What has changed in the international environment to cause a desire to form regional associations? I have asserted that regionalism is not new, but has been around for centuries. Regionalism is just a political answer to a set of international problems facing the nation state. What are the forces then driving regionalism? The first is the fall of communism. The liberal ideology presented by the United States and its allies has carried the day. The question is no longer how to defeat communism, but how to incorporate former communist countries into the international community under a liberal capitalist model. On purely economic terms the world just got significantly larger. The Soviet Union is no longer a political entity, and Russia does not have the economic resources to support its former allies. Therefore, the former j^v^iet bloc is looking towards western capital for development. However, western capital resources did not grow proportionally overnight. Thus, there is a competition among LDC for foreign direct investment. The competition for FDI is forcing nations to make themselves more attractive to capital rich countries. Regionalism either through alignment with capital rich countries or through an association of developing countries are solutions that developing countries will take to maintain or increase their attractiveness to foreign investors.

If a country is able to secure enough FDI then they will be on a sustainable path of growth. Paul de Graune describes this impact: "once a region is able to attract a significant amount of productive activities, it may find itself on a cumulative growth

path" (Graune 145). He studied the impact of FDI on Italy and Spain after they joined the Common Market: Italy, as a percentage of German GDP, grew from 66% in 1960 to 73% in 1987, Spain went from 28% to 37%. While the actual percentages are not significant, we have to remember that Germany was also experiencing tremendous growth during this time period. Italy and Spain by attaching themselves to a larger unit, the EC, were able to out perform the main economic unit of the EC.

Developing Nations want to make themselves more attractive for FDI. The best way to accomplish this is by associating themselves with a MDC and ensuring access to their markets. The developing countries need a regional association or a hegemon to provide certain collective goods that will make their countries attractive for FDI: "In short, for interdependence to work, there should be a hegemon to ensure that the independent nation are playing by the rules of the game" (Ping 27). I do not believe that only a hegemon can insure rule's compliance, a weak or strong institutionalized regional governance structure can provide the necessary collective goods to attract FDI. The key is that a supranational alignment must occur to provide the collective goods, states can no longer afford to be independent actors on the world stage.

The product cycle dictates that access to cheap skilled labor is important to long term competitiveness: "A commitment to some set of product standards opens up technical possibilities for achieving economies of scale through mass output and encourages long term commitments to some given process...concern about production cost begins to take the place of concern about product characteristics" (Vernon 179). The firms that have access to cheap skilled labor will have a comparative advantage over firms that do not. The source of this labor supply is developing countries. For example, one of the reasons for economic stagnation in France and Britain is it's over inflated wage scale for workers and the enormous rights enjoyed by workers. On a social level its fine to provide liberal benefits to citizens, but when competing on in a global economy the additional costs of labor may make the firm uncompetitive. I believe a key reason for the rise of protectionism in the future will be certain nations or regions will have a diminishing supply of cheap labor and domestic producers will seek relief through protectionist trade practices. However, domestic producers will still seek out relationships with developing countries to insure supplies of cheap labor to increase their competitiveness. The developing countries will be forced to align themselves with the more advanced nations to insure a flow of capital and jobs. This condition is one of the driving forces for an alignment into regional blocs.

Ultimately, it is the force of competition- whether external or internal - that challenges firms and induces responses of technological change, innovation and sustained efforts to increase productivity and reduce cost" (Cordon 254)

The above quote sums up the reason for regionalism, increased competition and growth among firms that has lead to enormous technological change that has made the nation state too small to provide the necessary collective goods to increase and/or stimulate growth. The solution to the problems faced by the nation state is the various forms of regionalism described in this paper. The ascension of regionalism is just a stage in the continued growth of the world economic and political systems. The human race is an ever evolving species. I do not pretend to believe that the forms of regionalism described in the paper are the future answer to all our problems. They are only an intermediate step in the evolutionary process of change.

The pace of technological change and interdependence is growing exponentially. The Nation State provided the necessary economic and political collective goods for over 200 years. The feudal kingdoms of Europe and Asia lasted for almost a millennium. I believe that the forms of regionalism discussed will be the solution to our economic and political problems for only 20-30 years. The pace of technological change and interdependence will make these forms of regionalism obsolete after this period of time. A new set of solutions will then be developed to meet the challenges of the world.

I believe that we are moving on a linear, yet accelerated, path towards a truly global liberal trading order. The development of regionalism is a step towards this eventuality. In the short term regionalism will cause a rise in protectionism and domestic pressures to reduce competition. The rise of protectionism will have a double effect: one will be a negative, the reduction in global competition and a rise of tariffs and non-tariff barriers between regions, the second, a positive, it will force states to join respective regional association to protect access to markets. Overtime, protectionist policies will decrease and discussion on implementing a true global liberal trading regime will take place. This time the number of seats at the negotiating table will be reduced, since the regional associations will represent their member states. The rise of regionalism will reduce the number of voices at the table, thereby increasing the chances for success.

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