The Challenge of European Integration

Internal and External Problems of Trade and Money

Edited by

Berhanu Abegaz, Patricia Dillon, David H. Feldman and Paul F. Whiteley

The Challenge of European Integration

The Political Economy of Global Interdependence

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Preface

This book uses the European Community as a paradigm to address a wide-ranging set of issues concerning regional and multilateral approaches to trade liberalization and economic integration. The contributions are organized around broad themes including the state of the international economy, preferential trade arrangements, monetary integration, and the political dimensions of economic integration. The papers fall into three categories: lead papers which explore broad themes (Eichengreen, Yarbrough, Goldstein and Frenkel, Schmitter), comments on the theme papers, and short papers on selected issues raised but not fully addressed by the lead essays. The introduction by the editors provides a synthesis of the major findings and arguments, including their wider implications.

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PART ONE

Introduction

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Introduction: The Challenge of European Integration

Berhanu Abegaz, Patricia Dillon, David H. Feldman and Paul F. Whiteley

After World War II, most nations—certainly all the prosperous ones—pursued the benefits of multilateral reduction in the barriers to international trade. Against the background of a tripolar political order (i.e., the first, second, and third worlds), the West expected a liberal trade regime, institutionalized in the General Agreement on Tariffs and Trade (GATT), to yield prosperity and stability in international economic relations.

This world has been changed by several significant developments. For the last forty years, Western Europe has been forming itself into a single market with many integrated political functions and plans for monetary union. A number of developing countries, especially in East Asia and Latin America, have emerged as newly-industrialized economies with a promise of serving as future growth poles for the world economy. The U.S. share of world GDP has declined from one-half in 1950 to one-fourth today. By 1991, the Soviet Union had disintegrated, allowing Central and Eastern European (CEE) countries to contemplate radical reforms of their political and economic systems. And by the end of 1993, the Maastricht Treaty on European Union and the North American Free Trade Area (NAFTA) had been ratified, and the protracted Uruguay Round of trade talks were concluded.

As liberal notions have gained favor in the developing world, however, protectionism has grown ever more popular in the West in the

last decade. The old order is disappearing but the new one is still a mystery.

An Overview of the Volume

This book examines the implications for Europe and for the international economy of Europe's economic, political and monetary integration efforts. By forming a powerful single market among a dozen nations, the European Community (EC), has stimulated interest around the world in regional trade agreements. The 1985 Single European Act (SEA) introduced a program to eliminate nontariff barriers by 1992, the last step in turning the EC into a single market. The 1991 Treaty on Economic and Monetary Union, known popularly as the Maastricht Treaty, was designed to solidify a European Union (EU) by including monetary integration, and common foreign, defence and social policies.[1] Both were meant to strengthen the economic and political position of the European Community in the uncertain world of the 1990s, and to stabilize and improve the performance of the economies of member countries. Unexpected events—especially German unification, severe recession and Soviet disintegration—have complicated the already difficult problems associated with deepening Community integration.

This volume focuses on the challenges that the implementation of EC 1992 and Maastricht provisions pose to the solidarity of the Community, and on present and potential challenges posed by the EC to international economic and political relations. The contributions are organized into four parts: the first provides an historical perspective on current events by reflecting on instructive economic history since 1930; the second explores the regionalism/multilateralism issue; the third concentrates on the problems of European monetary integration; and the final section considers Europe's political future.

We begin by looking to the lessons of the past. Part of the world's anxiety about the possibility of a Fortress Europe harks back to the 1930s, when deep recession was associated with the development of economic blocs and eventual warfare. The systemic breakdown and regionalism of the period had devastating consequences for many nations' macroeconomic and monetary performances, for growth prospects across regions, and for political relations between nations and regions. Are there analogies for today? What are the lessons to be learned from trade relations and monetary regimes since World War II? What are the predictable dangers to be avoided in regional trade arrangements, for participants and for outsiders?

The second part focuses on institutional structures of world trade—specifically, on the performance and implications of preferential trade arrangements (PTAs). What factors are important in deciding whether PTAs that begin small (like the EC) are likely to grow in membership, and to succeed? Is the EC the harbinger of a new international regime built on trading blocs, and would this help or hurt world prosperity? How do national and regional trade policies interact, and how do they affect international multilateral agreements? Is there a conflict between regionalism and multilateralism, or can the GATT coexist with PTAs to the benefit of all parties? This section explores the political economy of international trade talks and the difficulties of enforcing GATT rules; the likelihood that regionalization and the resultant trade policy convergence would lead to convergence in various domestic policies; and the interest of developing nations in participating in PTAs as a defensive strategy against potential protectionism in the developed world.

European monetary integration is the subject of part three. What do we know about the criteria for success of single-currency zones? What are the implications of monetary union for macroeconomic policymaking by member nations? Is regional macropolicy coordination a desirable or a practical possibility? What have been the political and economic problems generated by efforts to achieve monetary union in Europe? Given our insights from economic theory and recent experience, can we predict the likely future for European monetary integration? Is monetary union a challenge to the existence of the Community or an important element of EC cohesion?

The final part is concerned with the future political shape of Europe. Will the Euro-polity become a federated system? Current questions of governance and sovereignty raise fundamental constitutional issues about the nature of the Community's authority relative to that of individual member states. Nationalism may call into question the sustainability of transnational institutions that depend upon pooled sovereignty. Europe has demonstrated that economic union can be successful, but Maastricht provisions for political and monetary union have put terrible strains on the Community, and the likelihood of an enlarged membership will certainly intensify them. Under what conditions can the EC continue its process of political and monetary integration as it becomes larger and more diverse?

The papers were written while the Maastricht Treaty was being accepted, reluctantly or marginally by voting publics, or modified by EC partners, and while the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS), meant to stabilize currencies within Europe, was in serious disarray. The ERM ties currencies together,

defining bands within which they can fluctuate relative to each other. It is the first step toward monetary union, which includes plans for a single European currency.

European workers suffered high rates of unemployment during serious recession, European politicians at nearly every level feared for their positions, and political economists enjoyed an abundance of new and complex problems to worry about. Just before the September 1992 conference for which these papers were written, a monetary crisis forced several EC members out of the ERM altogether. In the summer of 1993, another crisis episode resulted in currency bands for all ERM members being widened significantly and the hopes for a single currency seemed dim indeed.

The implementation of the single market via EC 1992 included the removal of capital controls; countries thereafter lost control of their individual monetary policies the more tightly they bound themselves to each other's currencies. The ERM amounted to a pegging of all member countries' currencies to the German deutschmark at the very time when the financing of reunification was threatening to generate inflation, Germany's worst nightmare. Predictably, German interest rates rose as government expenditures soared. Staying within defined ERM bands of 2.25 percent required EC member states to keep interest rates high as their currencies came under pressure; this was both economically and politically costly for governments with depressed economies. The press turned currency traders, going about their usual business of trying to make money by second-guessing central banks and markets, into avaricious conspirators out to destroy the system and a few governments. Britain and Italy were forced to drop out of the ERM in September 1992, Spain devalued twice and Portugal once, and France narrowly escaped devaluation. The Bundesbank refused to lower interest rates, fearing its effects on domestic inflation. The system crumbled, at least in the minds of many, when EC finance ministers widened bands for exchange rate fluctuations to 15 percent in August of 1993.

Following the ratification of the Maastricht Treaty, the EC Heads of State in October 1993 reaffirmed their commitment to the original timetable for monetary and political union and decided that the EC is to be called EU (European Union). Given the problems presently facing the EU, however, the original Maastricht timetable for a single currency looks increasingly irrelevant.

The shaky state of monetary arrangements in the European Community is symptomatic of wider uncertainties. The optimism of the late 1980s, based on expectations for EC 1992 and on the disappearance of the Iron Curtain, has dissipated. Recent developments in Europe are posing challenges to the international status quo in exchange-rate

regimes, in trading systems, and in political structures. In its latest efforts at political and monetary integration, the EC faces internal challenges to its own viability, based on nationalism in member states, the difficulties of implementing monetary union, and the potential complications generated by an enlarged membership. It is an appropriate time to reconsider Europe's efforts to achieve economic, political and monetary union, and to look at the implications of European integration for the world economy.

A Review of Contributions

The International Economy

In "The International Economy: Historical Perspectives and Future Prospects," Barry Eichengreen examines the past to find lessons for the present and the future. He reviews the role of GATT in the growth of national economies and of trade over the last five decades, and predicts that GATT will become an increasingly unwieldy institution as the number of members grows and as trade restrictions become less obvious, and hence harder to remove or reduce.

Western Europe has enjoyed the fruits of freer trade within the EC and Eichengreen predicts ever higher levels of trade between member states as integration proceeds, as well as more trade with liberalizing CEE countries. The prospects for Eastern Europe, however, seem both less rosy and less predictable. The CEE region is rich in human capital but very short on finance, and all of Europe is likely to pull in vast financial flows over time, to the detriment of the developing world. Global volatility in currency markets has been the order of the day since the end of Bretton Woods; and although the EC has tried to reduce internal instability and uncertainty with plans for monetary union, the jury is still out.

We all want stable exchange rates and independent national economic policies; Eichengreen notes that we cannot have both, at least not at the same time. The recent history of the European Monetary System makes that clear. During the 1980s capital controls allowed both objectives to be pursued with some success, but those controls were removed in 1989 as a part of the program to promote a single-market Europe. In outlining the arguments for monetary union and the problems in achieving it, Eichengreen emphasizes that Europe does not look like an optimum currency area.

Eichengreen compares current international monetary disorder to that of the 1930s, arguing that the direction of causation was from

macroeconomic collapse to the disintegration of international commercial and financial systems, not the other way around. The formation of trade blocs and currency blocs diverted trade and generated a great deal of exchange rate uncertainty, but also provided macroeconomic stimulation—on balance, probably a plus for the United States. He reminds us that the trade and monetary problems of the 1930s contributed mightily to the onset of the second World War.

Eichengreen reviews the possibility of a tripolar international regime as a result of a Fortress Europe stimulating the formation of American and Asian trade blocs. He explores probable consequences for trade, for welfare inside and outside the blocs, and for the monetary regime. He argues that such a regime could work and would be less costly than a global system of fixed exchange rates, and that the U.S. could pursue multilateral, unilateral and regional trade liberalization at the same time. But a tripolar world would be costly to outsiders, with dangerous political and foreign-policy implications. The 1930s have shown us the necessity of greater cooperation in such a world.

I. M. Destler expands on the influence of the EC in the shaping of others' trade policies, especially the U.S. NAFTA is just such a response, one important result of difficulties, largely the fault of the EC, with multilateral negotiations. Destler sets out the U.S. trade policy rationale for the creation of NAFTA, and predicts that future U.S. policy directions, whether multilateral or regional, will continue to be strongly influenced by the EC.

In "Some Risks of a Regional Future," David Feldman takes issue with several of Eichengreen's hypotheses; for example, that the dismantling of the world trade regime in the 1930s was macroeconomically irrelevant. Feldman predicts much higher potential costs of a tripolar system both to participating nations and to outsiders. Developing nations might be especially hard hit, along with liberalizing European countries. Regionalism could become a dangerous substitute for multilateralism, rather than a useful complement, depending in part on how successful the GATT can be in future.

Preferential Trade Arrangements

Beth Yarbrough, in "Preferential Trade Agreements and the GATT: EC 1992 as Rogue or Role Model?," uses the European Community to illustrate the difficulties of making predictions about the effects of PTAs on member states, on outsiders, and on the world trading system. She provides an overview of types of agreements—unilateral, bilateral, minilateral, multilateral—and of the implications of different levels of

integration, and surveys the sources of controversy about the welfare effects of trade agreements.

The analysis of the impacts of PTAs is complicated because PTAs incorporate elements of both trade liberalization and discriminatory protection; and estimating effects is made difficult by the inclusion of agreements on rules, procedures and governance issues that go far beyond trade matters. In leading the reader through the range of economic and political factors important in assessing the welfare effects of PTAs, Yarbrough notes that the EC is unique in its acceptance of shared authority, in its pooling of sovereignty whereby EC law takes precedence over national law in agreed areas of community governance. The resultant institutional complexity makes prediction about the future of the European Community difficult.

Are minilateral PTAs—e.g., the EC and NAFTA—likely to grow into larger agreements? How might that occur? Yarbrough surveys the possibilities: the building-block idea, or via various demonstration effects. She provides a rich catalogue of variables important in thinking about such issues, such as the role of domestic economic sectors, the existence of industrial policy, and the incentives to protectionism within PTAs. Yarbrough focuses on EC 1992 throughout her survey of controversies surrounding the effects of preferential trade arrangements on the world trading system.

Gary Hufbauer takes issue with several of Yarbrough's points, including the claim that trade-creation-versus-diversion results are uncertain in current PTAs. He believes that in most cases trade creation exceeds trade diversion by a wide margin, which may nevertheless help or hurt outsiders, and that PTAs should compensate outside losers promptly and cheerfully. He argues further that the EC has in fact diverted energies from GATT for the last few years; other PTAs, however, have not. They instead have probably helped GATT along. Although Hufbauer agrees with Yarbrough that a global supranational system is unlikely anytime soon, he sees the GATT as extremely useful in helping to ease friction between PTAs on specific issues. He doubts that PTAs have increased sectoral protectionism or are likely to do so in the future.

The debate about regionalism versus multilateralism is misguided, according to Hufbauer; the right question is which issues should be addressed in which trade group. The GATT is particularly well-designed for some functions (e.g., large-scale managed trade arrangements, dispute settlement), whereas smaller PTAs can be more effective in liberalizing behind-the-border barriers. This has in fact been the great achievement of EC 1992.

Sylvia Ostry's comments reinforce the importance of domestic issues in the formation of trade policies, emphasizing international spillovers from policy processes within the EC. The basic cause is a unique governance structure: the EC is primarily a political entity, and it has constructed a cumbersome bureaucracy for itself in order to maintain political cohesiveness. This has resulted in spillovers like delays in the Uruguay Round, and subsequent effects on U.S. trade policy. Ostry provides a number of additional illustrative episodes, including some involving CEE trade policies during liberalization, all reinforcing her main point that "trade is the most domestic of policies."

J. Michael Finger, in "Regional Arrangements: GATT, Rules and Property Rights," advances the thesis that it is property rights, not GATT rules, that count in structuring regional trade agreements. He covers the history of GATT regional rules, as well as their substance, logic, enforcement provisions, and applications. He looks specifically at GATT involvement with development of the EC, and with the regional arrangements between the EC and developing countries. His broad conclusion is that GATT's experiences of stewardship over regional agreements have not, by and large, promoted multilateralism according to the usual GATT rules. Instead, GATT's influence is strongest when its rules reflect property rights that parties understand to exist—that is, the right one country acquires, by virtue of earlier GATT negotiations, to access to another country's market. Finger suggests that GATT use countries' respect for already-negotiated market-access rights in dealing with regional questions, instead of trying to make the rules of article XXIV more complicated than they already are.

Geza Feketekuty's remarks, "Regional Blocs: Policy Coordination and Trade Strategy," shift the focus back to governance issues within trade agreements. He argues that the internationalization of production has created the need for greater harmonization of previously rational regulatory policies. EC 1992 was more about reducing regulatory barriers to economic integration than about reducing traditional trade barriers. The growing internationalization of production calls for policy convergence on grounds of practicality, efficiency and competitive fairness. Regional agreements have become the mechanisms of choice partly because the benefits of expanding trade makes the pooling of sovereignty worth it; and partly because production tends to be more integrated regionally than globally, and neighbors usually have similar values. The reduction of trade barriers is the political glue that holds regional agreements together. Moreover, trade policy convergence is expanding to cover formerly domestic policy issues like antitrust, investment, technology and the environment.

Gains from commitments on this wider range of policies have encouraged participation in free-trade agreements. Regional arrangements are now so entrenched that debates on trade diversion versus creation seem less important to members than arguments about policy coverage. Feketekuty believes that more open decision-making procedures are essential for Europeans to accept the inevitable and growing degree of intrusion of the EC; but that the lead in the integration movement has passed into the hands of the business community, and this community will not allow the EC to fail. Successful harmonization is too valuable.

The final piece in the preferential trade arrangements section concentrates on the consequences of North Atlantic trade blocs for developing countries. Berhanu Abegaz, in "The New Regionalism and Developing Economies," argues that adverse trade effects of such blocs are not the danger; it lies instead in the possibility of failure of GATT negotiations, in resurgent protectionism in the North, and in the potential divergence of investment flows away from developing countries. He reviews data on the general composition and directions of inter-regional trade flows and capital flows to help describe and explain the regionalism of the 1980s and 1990s, in contrast to that of preceding postwar decades. Developing countries are nowadays interested in participation in PTAs with the EC and with the United States, in part as a defensive strategy. Why have previous efforts at Southern cooperation failed? Primarily for structural and policy reasons; commitment was difficult to maintain in chronically unstable countries. Abegaz discusses the pros and cons of various forms of these newer PTAs.

Abegaz also reviews trade creation/diversion effects of the EC on developing countries; they vary according to type of product and demand elasticities. He points up potential problems involving the EC and GATT: the divergence of aid and investment to post-socialist countries could hurt some developing countries; and recent trends in the drawn-out GATT negotiations (especially the movement away from affirmative action and toward inclusion of issue areas such as intellectual property rights that impinge on rapid technological transfer), as well as exclusionary behavior by some Northern countries with respect to highly-processed goods, are all providing a fresh impetus for a new round of defensive Southern regionalism. Abegaz ends with a plea for differential treatment for the least-developed countries. By coupling freer trade with well-crafted aid programs, the rich can do much to help build the capabilities of the poor for sustained growth.

Monetary Integration

This section is devoted primarily to the effects of EC efforts to create a monetary union. The lead paper, "The Macroeconomics of Currency Zones," is by Morris Goldstein and Jacob Frenkel. It analyzes the macroeconomic policy implications of a currency zone—that is, the fixing of the currencies of a group of countries to one another, with full integration of financial markets. Goldstein and Frenkel first consider the conduct of monetary and exchange rate policy in a currency union, beginning with a reiteration of the impossibility of simultaneously maintaining free trade, independent national monetary policy, unrestricted capital markets, and a fixed exchange rate. The authors discuss the goals of monetary policy, emphasizing price stability, a balanced current account, and exchange rate stability.

The literature on optimal currency areas provides useful criteria for evaluating the consequences of a country's loss of the use of the nominal exchange rate as a policy instrument; to work well a currency zone requires factor mobility, openness in trade and regional interdependence, production diversification, wage-price flexibility, symmetric structure of shocks, and other cushioning mechanisms (e.g., fiscal policies). Criteria are examined individually, and the empirical and theoretical literature on optimal currency areas is surveyed. The EC is not an optimal currency area and does not look ready for the transition into becoming one.

The transition itself might proceed in various ways; Goldstein and Frenkel consider the arguments for and against different speeds of change—rapid, gradual, or two-speed, using European conditions to illustrate the problems.

Finally, the authors discuss the implications for fiscal policy of membership in a currency union, particularly for discipline with respect to government deficits and debt-to-GDP ratio. They survey various incentives and mechanisms for encouraging discipline in detail, including market-based default premiums that raise the cost of borrowing, fiscal policy rules like setting upper bounds on debt-to-GDP ratios, and multilateral surveillance systems. Goldstein and Frenkel favor reliance on market disciplines with costs imposed for failure, along with peer-group surveillance to encourage adjustments to meet requirements and to discourage fiscal excesses.

Richard Cooper's comments on the Goldstein-Frenkel analysis do not dispute their conclusions about exchange rate management or fiscal policy coordination; he questions instead some fundamental (and common) biases on which the analysis is constructed. Cooper wonders about price stability as a policy objective. High rates of inflation can certainly hurt an economy's ability to grow by distorting incentives. But

"modest and steady rates" may help an economy. We have neither empirical nor theoretical grounds for supposing that such inflation will significantly damage economic performance. Any damage may be due to a failure to index some other important economic variable, such as the exchange rate. One important contribution of modest inflation is as a tax on money balances—in some cases, it may be the only way a government can tax effectively. How well the government uses the funds so generated is another issue. Cooper recognizes that even moderate inflation can be increasingly disruptive of an economy's information system, the more complex the economy; but suggests that the standard theory of money does not capture this effect.

Fiscal discipline is not the great issue that Goldstein and Frenkel imply. Industrial economies have typically exercised discipline; moreover, tightly controlled fiscal policies within a currency union may be undesirable. Cooper argues that within a currency union the use of fiscal policy for stabilization purposes in member countries will diminish as expenditure leakages grow.

What about a tripolar global currency union (the EC, Japan and the U.S.)? Free trade does not require it, but Cooper thinks that such a union might be desirable on efficiency grounds, because exchange rate instability is more likely to distort allocative signals than is moderate inflation; and he sees no reason for worrying about shocks between systems that are already so large and diverse. The claims for allocative gains from flexible exchange rates may well be overrated the more globalized are economies. A currency union is therefore a better idea for major industrialized democracies than for developing countries.

Thomas Willett's contribution, "Some Thoughts on the Political Economy of European Monetary Integration," notes the great achievements of the EC to date and warns of the dangers of equating the political benefits of marginal increases in economic integration via monetary union to the total political gains already realized as a result of economic union. He reviews the economics of the European Monetary System and the arguments for complete monetary union, including the necessary conditions for the latter to be achieved successfully—all pretty much ignored by the designers of the Maastricht Treaty. The point consistently argued by economists is made again: in an interdependent world, countries cannot fix exchange rates and at the same time remove capital controls and exercise independent monetary policy. When inevitable shocks occur, they will generate balance of payments disequilibria, and exchange rates or monetary policy will have to be adjusted. If one or the other does not happen quickly, speculation (and eventually, simple risk avoidance) will shift funds out of weak currencies. This sort of system is crisis prone unless policy adjustments always occur

quickly, but there may be good political reasons that prevent fast (or any) reactions.

Willett reviews the lack of recognition of basic economic arguments and the shortsightedness displayed in the design of the European Monetary Union (EMU). The idea is not necessarily a bad one, but its promoters have badly neglected appropriate transition strategies and conditions for successful implementation.

In his discussion of the political economy of EMU, Willett considers the interrelationships between economic, political, and monetary integration. He argues the case for gains from freer trade in Europe and emphasizes the lack of an economic case for a common currency. The costs of promoting further political cohesion through monetary union are large and very nearly certain.

Michele Fratianni tells us "What Went Wrong with the EMS and European Monetary Union" by further exploring relationships between economic, monetary and political union. Historically, political union has nearly always preceded monetary union; unfortunately, many European politicians saw monetary union as a catalyst for political union. Fratianni argues that the current EMS is not a viable institutional stepping-stone to monetary union, and proposes a more flexible multi-speed approach. He reviews the benefits of MU and its likely costs, and concludes that enthusiasm for MU is based on other than economic issues. It is economically viable for small open economies like Belgium and the Netherlands to tie their currencies together, say, to the German deutschmark. It is currently too costly for the rest of the EC.

After reviewing the weaknesses of the EMS, Fratianni outlines improvements: first, place the burden for commitment to MU on independent national banks, not on the exchange rate; and second, widen exchange rate bands (which has already been done). This implies a two-speed approach. The core group could undertake a common currency arrangement, and both sets of countries would have an inducement to coordinate monetary policy. The economic case for monetary union á la Maastricht is weak; such MUs work best within sovereign states.

In "Ten Days That Shook the EC," Richard Sweeney traces the monetary chaos of September 1992, illustrative of the problems of a currency union, to developments in the CEE region since 1989. Because of shocks to the German economy, other ERM members experienced subsequent shocks that called for changes in exchange rates, largely because of reactions in financial markets. In the absence of changes in rates, countries that attract capital flows suffer higher inflation. The primary rationale for European monetary union is the discipline it would enforce on countries that would otherwise have high and erratic money

growth and more inflation. The major potential cost: the necessity of deflating costs (especially wages) relative to Germany.

The specific shock that caused the September crisis was German unification; Sweeney discusses why unification was such a shock, and how subsequent effects on other ERM members came about. An exchange rate crisis was waiting to happen, and Sweeney explains why it happened when it did.

Finally, he compares the Maastricht Treaty with the U.S. Constitution as exercises in the institutionalization of political union. His analysis is of ratification processes; of arguments, incentives, political contexts and characteristics of delegates; and of the weakening of treaty provisions over time, along with increasing difficulties in interpretation and enforcement. Europe is certainly a long way from statehood, and that is the subject of the final section of this volume.

The Political Dimensions of European Integration

"The Single European Act, The Maastricht Accord and the Emerging Polity" by Philippe Schmitter is the theme paper of this section. The author reviews the Single European Act and the Maastricht Treaty as essential elements shaping the European polity of the future. He describes these two documents, the extent of their implementation, and their likely effects on European political life and structure, suggesting that the Maastricht agreement, in spite of its muddled form, represents the possibility of fundamental reform of monetary, social, political and security institutions for the EC. It implies nothing less than convergence of macroeconomic policies of member states, the pooling of certain sovereign rights, and a common foreign and security policy for the group. It is the first instance of European consideration of monetary and political union at the same time.

Schmitter provides empirical estimates of likely impacts of the Single European Act as of the end of 1992 and of the Maastricht Accord by 2001. He believes, however, that the most interesting effects of Maastricht are hidden in provisions about institutions and decision rules—and that the future Europe will be a "dispersed polity where most decisions will be...taken (and not just implemented) by other than central authorities." In other words, it may well look like a federalist system, in contrast to the supranational state implied by Maastricht.

Maastricht provisions mean a sizable increase in the complexity of systems of representation in the EC and of its levels of decision-making. No theories of integration can predict the shape that the EC polity will take; they all focus on process, not outcomes. Schmitter provides a useful

survey of major theories—neo-functionalist, neo-realist, and pure functionalist. He treats subsidiarity issues in detail.

Finally, he emphasizes four factors that he believes will be most important in determining what the Euro-polity will be like: 1) the community's inability to implement regulation, to get compliance with directives; 2) the increasingly controversial nature of integration as spillovers have increased supranational authority; 3) the difficulties inherent in enlargement of the EC; and 4) the long-run necessity of the region's development of its own security arrangements and the possibility of unforeseen security threats.

Schmitter predicts that by the next Inter-Governmental Conference in 1996, those four problem areas will have registered with the public. The Commission's resources will be stretched to their limits, and the segmentation of policy sites and domains will have reduced community policy coherence. Member states may have failed by then in the convergence of their macroeconomic policies and performances. Governments will know the costs of pooled sovereignty. Europe may have to face up to the nature of its basic political structure. The F-word—federalism—will surface.

The author predicts that entanglements are too advanced to go back on, even if the specific end-state is still far from obvious. Nations have high expectations of and deep commitments to a European Union, but it will not be the entity, the single unit, that its designers expected ultimately.

Geoffrey Pridham reminds us, in his comments on Schmitter's paper, of the many other times, starting in the early 1950s, when the Community has been seen as verging upon disaster. He is hopeful about its future because his vision of the EC polity is relatively modest: at no time in the life of the Community has there been a deliberate effort to establish a full-fledged singular political system (whereas national constitutions always seek to do so). The Treaty of Rome aimed to create a new form of economic arrangement with limited institutional structures; and although its motivation was primarily political, it hardly qualified as a political union. The European Community has continued to evolve over time, but never with a complete institutional framework representing political singularity. The complete ratification of Maastricht, however, does seem to be a turning point in the integration process. The Single European Act and the single market are real achievements, and member states are too involved in the EC for it to disintegrate, even if Maastricht fails in any or all dimensions.

Pridham observes that the Community does have some supranational or federal characteristics, but its development has been deliberately incremental. Although the European Community system is a complex,

highly institutionalized form of intergovernmentalism, its policy concerns have since the late 1980s run ahead of its institutional development. Its political weight is far greater than its institutional capability. In spite of external perceptions, it is not a real system or a complete polity. Furthermore, the complex structure and functioning of the EC have distanced it from the general public; people do not understand how it works and the organization has great difficulty communicating that information.

Although the widening and deepening processes of the 1980s are unlikely to be stopped by political or monetary crises, that period of dynamism may be ending. Pridham's review of the "F" word, federalism; the "S" word, subsidiarity; and the "E" word, enlargement, reflects major aspects of the community's current state of development and of its uncertainties.

Paul Whiteley suggests that Schmitter displays undue optimism with respect to Europe's integrated future and that the Maastricht Treaty could be the high-water mark of the movement toward federalism; the EC may remain a complicated but limited intergovernmental organization. He reviews the flaws in the treaty that make complete integration unlikely, noting that its least ambiguous part relates to monetary union. But monetary integration is not necessary for success of the single market, it may be undesirable on economic grounds, and it could turn out to be impossible to implement politically. Monetary integration was never a viable method for promoting European political integration. Whiteley cites as the main lesson from monetary policymaking in the 1980s the weakness of the effects of monetary and exchange-rate policies on the real economy. Convergence of real economies of member states is a precondition to monetary integration as defined in the Maastricht Treaty, not the other way around.

In Whiteley's view, another major flaw in the treaty is members' ability to opt out of policies. He reviews Schmitter's treatment of this "variable geometry" model in arguing that it weakens the integration process. The security and foreign policy aspects of the treaty have been shown to be misguided in the EC reaction to the Yugoslavian conflict.

Whiteley observes a lack of public commitment to a European "nationalism," a lack of awareness of a European identity. The basic conflict of national and supranational goals remains, and the national commitment is always stronger. As the Community tries to usurp national functions, public resistance is likely to grow. Nationalism continues to be the most significant political force in Europe. The EC has done wonderfully well in promoting international cooperation, but it will never be a United States of Europe.

Per Magnus Wijkman's remarks on Philippe Schmitter's paper concentrate on the issue of community enlargement eastward. Wijkman argues that this would be a major contribution to stabilization in the world order. This process, however, must be accompanied by deepening of the relationships between member states, and therein lies the dilemma. The greater the size and diversity of the EC, the greater the strains on internal integration. Wijkman believes that the only answer is a multispeed Community, with members moving toward common objectives at different speeds. He compares the likely effects of accession of the European Free Trade Association (EFTA) countries and that of the CEE countries. The former would immediately strengthen the Community, whereas the latter would require modification in some policies and would probably impose significant strains on the Community budget. Potentially problematic revisions would be required in the Common Agricultural Policy (CAP), the system of income transfers, and labor mobility policies.

Finally, Wijkman argues that the multispeed alternative can be usefully combined with other procedures—variable geometry, for example, and/or more consensus-based decision-making processes—already built into Maastricht. He agrees with Paul Whiteley's view of the EC as an organic, growing entity rather than a construct based on a grand design, as implied by Schmitter's vision. The biological metaphor seems more fitting than the architectural. Wijkman concludes by reminding us that a heterogeneous Europe, however wedded to market principles and representative democracy, will not necessarily generate political stability. The self-destructive catastrophes of Europe's past have grown out of a lack of tolerance of differences; whatever the shape of the international regime of the future, stability must be built on tolerance.

Conclusions Summarized

From the rich mix of analysis and argument presented by our contributors, a number of key points emerge.

First, while it is theoretically possible for net effects to go either way—preferential trade agreements can create trade and can divert trade—PTAs have typically been beneficial for participants. Although there is disagreement about the extent to which outsiders are relatively disadvantaged, it is not clear that they are worse off than would be the case without such PTAs.

Second, whether one advocates regionalism or is wary of it is determined primarily by whether regionalism is expected to promote or to impede multilateralism. Although there exists no evidence that

minilateral trade groupings necessarily evolve toward multilateralism, the two can coexist successfully and may be mutually reinforcing. These two sorts of trade agreements can perform different sets of functions for member countries.

Third, GATT still plays a crucial international role even though regional trade arrangements sometimes seem to ignore or seriously bend GATT rules. Despite the flaws of the negotiation process and member frustrations with it, our authors express support for GATT and do not favor abandoning it.

Fourth, increased economic integration makes policy coordination between countries an increasingly important issue; current debates center on policy coverage. Greater trade flows can provide political glue within regions. Although nationalism is very strong, the EC will survive its current problems because it provides real economic advantages to members. But a United States of Europe is not in the cards for the foreseeable future.

Fifth, successful economic integration does not require monetary union. Monetary integration has benefits and costs that may vary substantially from one country to another, and is viable where conditions for an optimal currency area hold: factor mobility, free trade, wage-price flexibility, symmetric structure of shocks, and coordinated or similar cushioning mechanisms (like fiscal policies). The European Community is not an optimal currency area. It is not possible for a group of countries simultaneously to maintain stable exchange rates, to remove all capital controls, and to exercise independent national stabilization policies over an extended period of time. Moreover, monetary union is not a good tool for promoting increased political integration in Europe. EMU is not an inherently bad idea, or even an impossible notion; but it has been very poorly planned. The transition period is crucial and cannot occur as outlined in the Maastricht Treaty. European monetary integration, if it is to continue and be successful, will have to involve a limited set of countries initially.

The European Community is our best example of regional economic integration. However, pushing beyond a single market (EC) toward a viable monetary and political union (EU) has so far proved increasingly problematical. We cannot predict whether other parts of the world will be successful in pursuing similar cooperative economic arrangements. It is clear nonetheless that the debate on regionalism and multilateralism will be with us for some time to come.