CHAPTER FIVE
THE SINGLE EUROPEAN ACT
PART TWO: ACHIEVING THE SINGLE INTEGRATED MARKET

In the preceding chapter we analysed the largely unsuccessful attempts to revive the integration momentum of the Community. We identified the longer term, principally politico-strategic, factors that had underpinned the integration process in the 1950s and 1960s and which also contributed to the move to a single integrated market in the 1980s. We noted that the policymakers of some member states no longer believed that the national interest was best safeguarded by the unflinching defence of national sovereignty and had come to see institutionalised regional economic integration as perhaps a better way of protecting their national interests. We argued that these factors were by themselves insufficient to account for the re-emergence of regionalism in the EC in the early 1980s and that any explanation of the decision by EC member states to establish the single integrated market therefore requires the presence of some additional, shorter term factors.

In this chapter we explore the contemporary, largely economic factors, that together with the longer term factors outlined in the previous chapter, have brought about the single integrated market or SIM. First we look at how the growing concern over the economic stagnation of the EC, the fragmentation of the common market, and the declining international competitiveness of its firms provided the impetus for three sets of proposals in the early 1980s, all of which called for the establishment of a single integrated market. After examining each of these sets of proposals, we analyse the role played by the European Court of Justice in the push toward the single integrated market. Next we discuss the nexus between the strengthening of the Community's common commercial policy and the single integrated market. Then we look at the common policies for innovation and investment. Other factors which were important in this move towards a single integrated market were the desire on the part of certain member states to enhance the Community's bargaining power vis-à-vis its major trading partners, the shift away from Keynesian inspired economic policies to more market driven policies, the budget dispute resolution, and the UK fear of exclusion from the EC. Finally in the conclusion to this chapter we re-examine the propositions on regionalism outlined at the end of Chapter Three in the light of the causal factors that have been identified in this chapter and the preceding chapter.
Overcoming 'eurosclerosis': stagnation, the loss of competitiveness and the 'uncommon market'

Perhaps the most important new factor in the push to integration was the desire by governments and business to overcome three separate but closely related manifestations of the economic recession of the 1970s. The first was the stagnation in economic growth and accompanying high inflation and unemployment. The second was the decline in European competitiveness, particularly in high technology, and the low levels of investment in Europe compared to those in the US, Japan and the NIEs. The third was the increasing fragmentation of the common market itself. Also important was the growing belief that these problems were linked and in some ways particular to Western Europe and hence susceptible to a solution at the EC level. In this section I will briefly discuss in turn each of these effects of the 1970s recession and the responses they generated, responses which relied to varying extents on the establishment of a genuine internal market.

It has already been explained in Chapter Four how the deterioration in European economic circumstances in the 1970s had had an adverse effect on efforts to promote further integration both economic and political. Initially this deterioration was perceived as being both temporary and world-wide and largely the result of exogenous economic shocks. However, by the beginning of the 1980s perceptions had changed. The second oil shock had revealed that the economic crisis was far from temporary. There was a growing awareness that these problems were part of a larger structural shift at the global level, part of a new international division of labour. There was now a stronger sense that the problems of low growth, low levels of investment, high current account deficits, high unemployment and high inflation were a common feature of all countries in the EC. West

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1 Francis (1989, pp.5-20) underlined the difficulties involved in defining and measuring competitiveness. Scholars, he argued, have often failed to distinguish between a country's slow economic growth and the competitiveness of its industries. They have also mistaken measures of industrial efficiency with measures of competitiveness. Francis did not, however, formulate an alternative approach. Fröhlich (1989, pp.21-24) rejected various criteria often used as measures of a country's competitiveness - the current account deficit; and a country's share of world trade - in favour of some measurement of price changes over time. Such a measurement, he argued would have to take into account changes in wages, exchange rates and productivity. Thus policymakers may choose to boost their country's international competitiveness by lowering wages, devaluing the national currency, or raising productivity.

2 According to Delors (1988, p.41), EC member countries were left with three options. They could resort to protectionist measures. This would be self-defeating and a denial of European values and in particular its responsibility to the Third World. They could realign their costs with those of their competitors. This would require a 30% reduction in income and a reduction in imports from the Third World. Or they could increase productivity at the cost of higher unemployment in the short term.

3 The last of the attempts at a purely national solution to these economic problems was that of the French socialist government in 1982. The implications of the failure of this attempt for the establishment of the single integrated market are discussed in more detail later in this chapter.

4 Dahrendorf 1982a, p.7.

5 Thorn 1982, p.x.
Germany which had weathered the first oil shock much better than other EC members was now also experiencing problems.\footnote{6}

There was also a perception that the EC as a whole had not fared as well as Japan and the US either in relation to the economic crisis or in meeting the challenge of the newly industrialised economies or NIEs.\footnote{7} According to the EC Commission both the US and Japan were managing to maintain their economic pre-eminence in the face of challenges from the NIEs.\footnote{8} There was also an alarming investment drain to the US with European investment there four to five times that of US investment in Europe.\footnote{9} EC members obviously preferred investing in the US to investing in each other. As a result EC competitiveness, as measured by unit labour costs had declined between 1960 and 1980 in comparison to that of the US and Japan.\footnote{10} Finally, the decline in the competitiveness of European industry had reduced employment growth. Over the past decade 19 million new jobs had been created in the US and 5 million in Japan but only 2 million in the EC.

The Commission was also concerned by the growing technology gap between the EC on the one hand and Japan and the US on the other.\footnote{11} Europe was said to be missing out

\footnote{6} According to Emminger (1982, pp.25-30), there were several reasons for this: dearer oil, West Germany's relatively higher growth rate, reduced internationally competitiveness due to effect of an overvalued mark and high labour costs, and increased competition from Japan and the Asian NIEs. This concern about the economic situation in Western Europe is reflected in the report to the European Parliament by Albert and Ball (1983, p.6) who spoke of the urgent need for the economies of the ten to emerge from a decade of stagnant economic growth and from the recent years of virtual standstill.

\footnote{7} See in particular the EC Commission proposal 'A Community strategy to develop Europe's industry', in 'A new impetus for common policies', Bull. EC, Supplement 4/81, p.45. See also Story 1990, pp.39-40. According to both Francis (1989) and Fröhlich (1989), economists and other scholars in the 1950s and 1960s had paid scant attention to a country's international competitiveness. In the late 1970s and early 1980s, however, both official concern about and scholarly interest in the competitiveness of European and American industries increased markedly as can be seen by the sudden proliferation of reports and research into the matter. Francis (1989, pp.1, 5) cited the 1983 research programme into the long term competitiveness of British industry undertaken by the Economic and Social Research Council; Can America Compete?, the 1984 study by Lawrence; the 1985 Report of the House of Lords Select Committee on Overseas Trade; and the 1985 Report of the (US) President's Commission on Industrial Competitiveness. Beije et al (1987 pp.311, 320 fn.2) listed a number of documents emanating from the EC Commission that demonstrate a similar concern on this issue.

\footnote{8} Bull. EC 12-1980, p.69. In 1981 the EC's share of world exports of manufactures was falling while that of the US had remained constant and that of Japan was growing. There was a growing gap between the growth in world exports and the growth in Community exports. See Bull. EC, Supplement 4/81, p.47. The trade surplus of both of Japan and the US - excluding energy products - was increasing whereas that of the EC was more or less static. EC productivity growth had slowed, mostly due to inadequate productive investment. Although EC savings were one third greater than those of the US, only one third to one quarter of these were harnessed for productive investment in the Community compared to over two-thirds in the US. See Bull. EC 4-1983, pp.12-14. The Commission blamed the low level of productive investment on the failure since 1962 of member states to agree on the establishment of a unified European financial market.

\footnote{9} Albert and Ball 1983, p.18.

\footnote{10} Bull. EC, Supplement 4/81, p.46.

\footnote{11} Bull. EC 2-1980, p.10. The lower propensity of European firms to invest was seen as one contributing factor to the growing technological gap between the EC on the one hand and the US and Japan on the other. Another factor was the fragmentation of national innovation and research policies that saw the duplication of efforts and the dispersion of financial resources. See below this chapter, pp.155-57, and fn.67.
on the third industrial revolution - the technological revolution. From the beginning of the early 1980s the growing technological gap was also seen as an important, if not the most important, cause of slow economic growth and growing unemployment in Western Europe. The mastery of information technology and particularly micro-electronics was also seen as crucial to boosting the efficiency of industrial products and services and EC industrial competitiveness.

Indicative both of this technological decline and of the absence of European solidarity in the face of this technological challenge from the US and Japan was the relatively low number of joint subsidiaries established by EC firms with firms from another EC member state. Instead of cooperating with firms from other EC countries in order to gain a competitive edge in world markets, firms preferred alliances with US and Japanese firms in order to gain a competitive edge in the European market over their competitors from other EC countries. (See Cecchini 1988, p.87; Albert and Ball 1983, p.52; Mitterrand 1986, p.89). By far the largest proportion of joint subsidiaries (47%) were formed between firms from the same member state. About a third of joint subsidiaries were between an EC firm and a non-EC firm and about only a quarter of those formed were between EC firms from different EC countries. The low number of joint subsidiaries between firms from different EC countries was the result of several factors. First, as a result of the formation of the EC, firms had come to see firms from other EC countries as the main threat in the struggle to maintain and increase their market share. Second, the home countries of these firms used various means to help their own national champions fend off the challenges from rival national champions from other EC countries. In doing so they only added to this atmosphere of rivalry between EC firms. Third, the longstanding failure of EC members to agree on a EC-wide legal company statute made it difficult for two complementary firms from different EC countries to join forces. In the absence of such a statute the new joint firm would have to register as a national company of one of the EC member states, thereby forgoing the psychological and material advantages of being a national company of the other state. According to Albert and Ball (1983, p.74), since 1957 no new European transnational group had been set up and attempts to establish joint ventures had failed.

The implication here is that contra Eden and Molot business at least in Europe was not a driving force for institutionalised regional economic integration and state intervention was necessary to promote intra-regional alliances among European firms. See the conclusion to this chapter, pp.174-75.

According to the Commission, the EC's share of world's markets for advanced technological products was diminishing, while that of the US and Japan was growing. (See Bull. EC, Supplement 4/81, p.36). In 1981 the Community constituted one third of the world market for telecommunication equipment, micro-chips, computers and data banks but was far from being a major supplier to that market. (See Bull. EC 19-1979, p.98). The Commission wanted to set a target of one third of world market share by 1990. The alarm at the so-called technological gap was even greater as a result of the decline of the Community's traditional labour intensive industries. In the new international division of labour that was taking place, Europe was at a disadvantage in the more traditional industries due to its higher social guarantees, higher costs of imported energy and raw materials and wild currency fluctuations. (See Thorn 1982, p.x). Its only way out seemed to be in higher value added production, innovation and increased productivity. But the growing technology gap was making even this solution less and less viable. For a discussion of innovation as a strategy to increase international competitiveness, see Fröhlich 1989, pp.27-29.

According to Albert and Ball (1983, pp.29-30, 82), the technological shock had been far greater than the oil shock. The EC, they argued, was falling badly behind in the crucial area of information technology and this had serious implications for economic growth and employment in the Community. Albert and Ball found that six out of eight personal computers were imported from US and nine out of ten video-recorders from Japan. They also found that while the number of jobs lost in electronics was multiplying in Europe, the number of corresponding jobs in the US and Japan was increasing. In a report to the EC Commission, the American consultant McKinsey had estimated that Europe could gain an extra 2 million jobs by 1990 if the European information technology industry developed as it had in the US, but that, if instead it continued to weaken and became dependent on other countries, 2 million of the existing 5 million jobs in the industry would be lost.

According to Etienne Davignon (1982, pp.134-35), EC Commissioner for Industrial Affairs, Energy, Research and Science, the EC represented 25%
Technological and industrial stagnation was increasingly being seen as a specifically European problem known as eurosclerosis or eurostagnation. In the early 1980s, the decline in European competitiveness was a common theme in Commission documents, in reports of the European Parliament, in European Council statements and other statements by heads of governments, government ministers and businessmen, and in media reports. Many also saw the reasons for the failure to invest as being in part psychological, a lack of confidence in the ability of Europe to overcome its economic decline. This became known as europessimism. Once the problem became seen as a European one this opened the way for a European or in this case an EC solution: the single integrated market.

At the same time there was growing concern about increasing fragmentation of the common market, which together with the Common Agricultural Policy had been the main achievements of the EC. The 1970s had seen intra-EC trade decline after the increases of the 1960s. Thirty years after the signing of the Treaty of Rome a truly common market still did not exist. Barriers to intra-EC trade were increasing, particularly so-called non-tariff barriers, as countries adopted separate national measures to deal with the deep economic recession and stagflation that they were all experiencing in the 1970s and to offset the increasing competition from East Asia in labour intensive industries such as textiles, steel and automobile manufacturing. There was still considerable uncertainty among exporters even about existing access to national markets as member states retained the right to re-impose temporary tariffs and quotas, in case of serious injury to domestic producers or critical overseas payments imbalances. The market was being fragmented even further through the use by member states of more advanced instruments of trade policy such as export credits, joint ventures, trade promotions and public procurement to...
favour their firms against firms from both member and non-member countries. The disintegration that Cooper had described as occurring at the broader international level in 1968 now seemed to be happening at the level of the EC.

In short in the battle of rhetoric and in part in actuality, the common market had become the 'uncommon' market and the EC 'non-Europe'. Attention was being drawn to the costs of 'non-Europe' in terms of the competitiveness, growth and employment. Fears were expressed about a return to the 'beggar-my-neighbour' policies of the 1930s. In terms of tariff barriers, the different GATT Rounds had reduced barriers between member and non-member states to a degree that had reduced substantially the advantages of belonging to the EC. There was also concern about the possibility of negative spillover and the unravelling of the common market due to the growing disaffection and indifference of the general public with the European idea and its association with growing unemployment and recession. Both the Commission and political leaders felt that the common market was under serious threat from the resurgence of protectionism and that action was needed to preserve it.

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20 Donges 1981, p.11; Dahrendorf 1982b, p.256. Dahrendorf argued that these more advanced instruments of trade policy should be employed instead at the Community level. The fragmentation of national innovation and research policies that saw the duplication of efforts and the dispersion of financial resources was seen as one contributing factor to the growing technological gap between the EC on the one hand and the US and Japan on the other.

21 The failures of the customs union were becoming increasingly obvious. (See Donges 1981, p.11). Differences in indirect tax rates such as VAT and in technical standards meant that there was no completely free and undistorted movement of manufactured goods. The process of harmonisation of technical standards that had begun in 1968 had slowed down due to the deterioration in the economic climate and bureaucratic blockages. (See Bull. EC 7/8-1980, p.14). The Commission was well aware of the barriers to trade within the EC and had made hundreds of separate proposals to harmonise the regulations and product specifications of the different member countries. Very few of these had been accepted. Up till 1985 only 170 EC standards had been set while national standards were proliferating at the rate of several hundred a year. (See The Economist 11 May 1985, p.52; Bull. EC 1-1980, p.14. See also Pinder 1989, p.97). The Commission criticised member states for using the introduction of technical standards as barriers to protect their industries from outside competition on the part of both intra- and extra-community firms. (See Bull. EC 7/8-1980, p.14). It stressed the link between the erection of technical barriers to intra-EC trade and the declining competitiveness of EC industry. In erecting such barriers, it argued, member states had reduced the home market of their firms to that of their own national territory, thereby depriving both consumers and firms of the benefits to be derived from the greater economies of scale and increased competition that a larger unified European market would bring. Such action, it maintained, disadvantaged European firms unable to exploit the 'Community dimension' in their struggle for world market share with their Japanese and American competitors who already had unimpeded access to a vast home market.

22 Albert and Ball 1983, pp.73, 102
24 Dahrendorf 1982b, p.256.
The proposals for institutional reform and the decision to complete the internal market

In the preceding section we saw that in the early 1980s there was increasing concern about European economic and technological stagnation, declining competitiveness with US, Japan and the Asian NIEs, and the growing fragmentation of the common market. The perception that the problems were to some extent specific to Western Europe, together with the desire of some - in particular the EP and the Commission - to advance further on the path of integration, led to the formulation of three categories of proposals to relaunch the EC and strengthen European cooperation. Some proposals were aimed specifically at halting the process of fragmentation partly through the establishment of a genuine internal market. Others called for new common industrial and research policies for advanced technology but nevertheless saw a genuine internal market as vital to the success of such policies. Still others called for institutional reforms aimed at increasing the supranational nature of the Community.

We have already seen in Chapter Four that the stagnation of the EC in the 1970s had given rise to a number of proposals for reforming the decision-making procedures in the Council of Ministers and changing the balance of power between the different institutions of the EC. Yet, as we have already noted in the preceding chapter, in addition to their concern with institutional reform, all these proposals called for the completion of the single integrated market. The institutional reform elements of the SEA have already been discussed in Chapter Four so discussion in this chapter is limited to those proposals specifically concerned with completing the single integrated market and those for calling for new common policies in the areas of research and advanced technology. Yet, the push for institutional reform - and in particular the fact that certain member states insisted on linking their approval of the proposal to complete the internal market to an agreement to proceed with institutional reform - must be considered as an important factor in the success of the internal market initiative.

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26 See above Chapter Four pp.130-33. These proposals were the European Parliament's draft treaty for establishing the European Union; the 1981 joint Italo-German proposal for a European Act; the 1983 Stuttgart Solemn Declaration; and the 1985 Report of the Committee for Institutional Affairs. The European Parliament's 1983 proposal had called for the achievement of a genuine internal market according to detailed and binding programmes and timetables. These would establish the free movement of goods and persons within two years of the draft treaty's entry into force, that of services within five years and that of capital within ten years. See Bull. EC 9-1983, p.11.

27 See Chapter Four pp.112, 134-35. Nevertheless, it should be remembered that many of those who supported such proposals often maintained that some institutional reform of the decision-making practices of the Council of Ministers was necessary for their successful implementation. Failure to complete the single integrated market and to introduce new common policies in the past, they asserted, were due also to the ability of a single member through the use of its veto to block the adoption of new measures and policies. Legal restrictions on the practice of unanimous voting were essential if further progress towards integration were to be made. Lord Cockfield (1990, p.5), the EC commissioner responsible for drawing up the programme and timetable for the completion of the internal market, believed that such restrictions were necessary if the timetable was to be kept.
The role of the European Commission in completing the internal market

This section examines one set of proposals advanced by the EC Commission in response to the economic problems facing the Community - those specifically concerned with completing the internal market. It identifies the principal arguments that were employed by the Commission to support its proposal for the single integrated market. Then it considers the crucial role of the Cassis de Dijon ruling by the European Court of Justice in overcoming a major obstacle to the completion of the internal market - the inability of the member states to agree on a common set of regulations and standards for intra-EC trade. The section will conclude by showing how the agreement to establish a single integrated market became possible only after the agreement by the EC member states to strengthen the Community's common commercial policy. The following section will then give a brief overview of another set of proposals by the Commission to overcome these problems, proposals for the establishment of new common policies in innovation and investment.

The arguments of the Commission for completing the internal market

In response to the growing alarm at both eurosclerosis and the fragmentation of the market, the Commission in the early 1980s made various proposals aimed at accelerating progress to a single integrated market. Yet although the leaders of the member states generally accepted the need for a single integrated market they found it difficult to agree on the specific proposals that would bring it about.

The eventual success of the Commission's efforts to complete the internal market is largely attributable to the fact that it gradually became seen as the common solution for a wide range of problems. By 1985 there was a shared belief by the EC leaders that only a single integrated market would enable member states to tackle the problems of growth, declining industrial strength and unemployment and to meet the challenge from Japan and the US.

In support of its case for the completion of the internal market the Commission drew on arguments from a variety of sources. These included the literature on customs unions, various analyses comparing the performances of the EC, Japan and the United States, theories purporting to explain economic decline and supply-side economics.

28 According to Lord Cockfield (1988, pp.xiii-xiv), in his foreword to the Cecchini Report (which was a 1988 document designed to bring out the virtues of a SIM), 'the completion of the single market will open up: opportunities for growth, for job creation, for economies of scale, for improved productivity and profitability, for healthier competition, for professional and business mobility, for stable prices and for consumer choice. In short a prospect of significant inflation-free growth and millions of jobs.' See below, fn. 32, for details concerning the contents of the Cecchini Report.

29 Thatcher 1984, p.74. This belief was reflected in the Cecchini Report which found that a single European market would boost intra-EC trade by 4.5% over 10 years, reduce prices by 6.1%, increase employment by 2 million and reduce national budget and external deficits. See Delors 1988, p.56. For the Cecchini Report, see below.
One familiar source was the literature on customs unions and past arguments about the economic benefits to be gained from a large market which we have already canvassed in Chapter Two. In short, a wider market would boost economic growth and employment creation and increase the productivity and efficiency of firms, while reducing consumer prices and inflation. These arguments had played a relatively minor role in the establishment of the EC which as we saw in Chapter Two had been largely the result of politico-strategic factors. But now in these difficult economic times the increased growth, employment and competitiveness that were said to result from the creation of a single integrated market were suddenly very appealing.

Another argument frequently used by the Commission was that single integrated market would enable EC firms to compete on equal terms with their US and Japanese rivals. This concern with inter-regional competition was a principal factor, along with economic decline, in the push for reform. In the early 1980s the various arguments drawn from customs union theory concerning the economic advantages of a wider market were given added force by the relative success of the United States and Japan in terms of economic growth, employment creation and technological innovation. More and more the Commission and EC leaders came to see the success of the US and Japanese firms in meeting world competition as the result of their having a large home market in which they could develop new products for export. They argued that if European firms were to compete successfully with US and Japanese firms they would require the large technological, financial and sales base that only a continental scale market could provide. A continental scale market, the Commission claimed, would also help bring the level of investment by EC firms closer to that of their US and Japanese competitors.


See Chapter Two, pp.26-27.

Perhaps the best example of the case for a single European market based on customs union arguments is the Cecchini Report (1988), which was written to convince business and the general public of the benefits of the internal market. The report (pp.71-72) divided the effects on increased economic integration into two categories: micro-economic and macro-economic. In terms of micro-economic effects, increased competition would bring about a reduction in the price and improvements in both the variety and quality of goods and services for consumers. For producers lower input costs would help to offset a short term reduction in profits from monopoly and protected positions, while in the medium and long term their profits would increase due to greater economies of scale of production and learning. As for the macro-economic effects, the report (p.xix) argued that a single integrated market would produce a self-sustaining virtuous circle. Lower production costs and increased productivity would lead to lower prices (lower inflation). Lower prices would increase purchasing power (demand) and the competitiveness of EC firms in relation to non-EC firms, thereby reducing unemployment. Demand would be boosted but inflation lowered. The regeneration of the economy and the decrease in public procurement expenditure would reduce public deficits.

See Mitterrand 1986, p.198. It was argued that, whereas US and Japanese firms had the advantage of free and open access to all consumers in their respective home markets, European firms faced extra charges in the form of customs duties, delays at customs posts and so on. Albert and Ball (1983, p.77) put the cost of passing intra-EC frontiers for EC firms at 2% of Gross European Product. Cecchini (1988, p.3) estimated it as being equal to as much as 25% of company profits in some sectors. It was further argued that, whereas US and Japanese firms enjoyed considerable economies of scale by being able to supply all...
A third source of support for arguments in favour of completing the internal market was to be found in the theory of Mancur Olson concerning the role of special interest groups or distributional coalitions in economic decline.\textsuperscript{35} In 1982 in his book \textit{The Rise and Decline of Nations} Olson developed his argument further.\textsuperscript{36} He maintained that there was a definite link between the strength of distributional coalitions in a particular country and that country's growth rate. According to Olson, 'the countries that have had democratic freedom of organisation without upheaval or invasion the longest will suffer the most from growth repressing organisations and combinations'.\textsuperscript{37} Conversely, countries where such common interest groups have been considerably weakened or abolished as the result of invasion, totalitarian government or political instability will experience rapid rates of growth after the establishment of a free and stable legal order.\textsuperscript{38}

There seems to have been some awareness within the Community in the early 1980s of Olson's ideas.\textsuperscript{39} Of particular relevance to those reflecting on the decline of the EC in the 1970s and early 1980s was the claim by Olson that 'distributional coalitions slow down a society's capacity to adopt new technologies and to re-allocate resources in response to changing conditions, and thereby reduce the rate of economic growth'.\textsuperscript{40} The ideas of Olson were to have an important impact on the debate about Europe's decline, particularly...
in the area of innovation, and reinforced the Commission’s view that the internal market was the answer.41

The fourth and final major source of support for the proposal to complete the internal market was provided by the theories of supply-side economics and monetarism.42 The supply-siders shared many of the arguments of Olson concerning the need to stimulate competition and break up distributional coalitions.43 Their influence is also particularly noticeable in the Cecchini Report, which talks of the removal of barriers as providing a supply shock to the economy.44 Like supply-siders, monetarists stressed the need to keep government intervention in the economy at a minimum and to give freer rein to market forces.45

The Cassis de Dijon decision of the Court of Justice

So far we have seen how the decision of the Commission to propose the completion of the single integrated market as a way of overcoming the economic woes of the EC was the result of the common conclusion of varying arguments drawn from theory and empirical observations that a larger market would boost economic growth, efficiency and competitiveness. While these arguments were being made, EC institutions continued their efforts to harmonise economic policies and trade rules. Yet a landmark decision of the European Court of Justice in 1979 actually opened the way in the early 1980s for the arguments for a single integrated market to prevail and to be implemented.46

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41 This point was made by Charles Oman in an interview with author at the OECD in 1992. The influence of Olson’s ideas is particularly visible in the Cecchini Report which saw the single integrated market as creating a situation of constant competitive renewal and innovation, in which the profits derived from monopoly or protected positions would be squeezed. See Cecchini 1988, p.xx.

42 The growing adherence by member governments to economic policies inspired by supply-side economics and monetarism was an important factor in the success of the single integrated market proposal and will dealt with more fully later in this chapter.

43 According to the Macmillan Dictionary of Modern Economics (1992, pp.416-17), supply-side economics is ‘(a) body of thought which emphasises that the principal determinant of the rate of growth of national output in both the short and long run is the allocation and efficient use of labour and capital in the economy. Accordingly it focuses on impediments to the supply of and the efficient use of factors of production. ... Chief among these impediments are believed to be disincentives to work and invest as a result of the level and structure of taxes and institutional and customary barriers to the efficient allocation of resources such as the restrictive practices of union. The policy prescriptions that flow from this analysis typically take the form of lowering tax rates and introducing measures designed to increase the degree of competition in labour and product markets.’

44 Cecchini 1988, p.xix. According to Fröhlich (1989, p.37), the best way to encourage innovation (and hence boost a country’s international competitiveness) is to create supply side conditions.

45 According to Cagan (1987, pp.492-497), ‘monetarism is the view that the quantity of money has a major influence on economic activity and the price level and that the objectives of monetary policy are best achieved by targeting the rate of growth of the money supply. ... (It) shares with laissez-faire a belief in the long-run benefits of a competitive economic system and of limited government intervention in the economy.’

46 Bull. EC 2-1979, p.102. See also Pinder 1989, p.97; Cameron 1992, pp.52-53. In its decision of 1979 in the Cassis de Dijon case the Court had ruled that the refusal of the West German alcohol monopoly authorities to authorise imports of a French alcoholic beverage, on the grounds that it did not meet the West German minimum alcohol requirements, constituted a hindrance to intra-Community trade and therefore an infringement of Article 30 of the EC
According to the Court, 'any product legally manufactured and sold in a Member State must in principle be admitted to the market of any other Member State'. This rather broad definition of the obstacles to free trade outlawed under Article 30 has been seen as an important breakthrough in the fight to remove technical barriers to intra-EC trade. It was to provide the basis for the so-called principle of mutual recognition that was proposed by the ad hoc Committee on Institutional Affairs - the so-called Dooge Committee - in its report to the European Council in December 1984. In accordance with this principle a member state would be required to recognise the national technical standards of the other member states as legally equivalent to their own. This principle of mutual recognition or acceptance was to form the basis of the new approach to harmonisation adopted in the Single European Act of 1986. Thus the Court Decision was the trigger to free trade under the proposed single integrated market and gave a legal basis to the substance of that decision.

Yet the Commission was rather slow in recognising the full potential of the 1979 Court ruling. Its initial proposals were much more limited in scope and there was a reluctance on the part of the Commission to abandon the long established practice of bureaucratic harmonisation whereby existing national standards were to be replaced by uniform European ones. It was not then until January 1985 that the new Delors Commission adopted the Court principle of mutual recognition to forward the objective of freer trade.

The strengthening of the Community's common commercial policy

Despite the successive resolutions of the European Council calling for the completion of the internal market, little progress had been made on the adoption of either this or any of the other proposals put forward by the Commission. Some countries were linking

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48 Commission of the EC 1985, p.22; Cecchini 1988, p.28.
50 Thus the new approach to Community policy on technical barriers that the Commission had adopted in January 1980 in response to the 1979 Court ruling was concerned only with new technical standards rather than existing ones. The proposal’s aim was to broaden the activities of the Commission by placing as much emphasis on the task of preventing new barriers as on the task of removing existing ones. It would require the work programmes and draft standards drawn up by national standards institutions to be submitted annually to the Commission and to member states so that industry in other member states could prepare for their introduction. See Bull. EC 1-1980, pp.12-15; Bull. EC 7/8-1980, pp.13-15.
51 The reluctance on the part of the Commission to abandon the long established practice of harmonisation may have been due to the inability of the Commission to forgo its basic inclination to centralise powers in Brussels. It may also have been the result of a judgement that some member states were not ready as yet to countenance such a radical approach to the harmonisation issue. There is also a link here between the shift by member states to neo-liberal economic policies and their eventual acceptance of the mutual recognition approach. As member states embraced deregulation as a means of promoting economic growth and of increasing productivity in the early 1980s their opposition to the mutual recognition approach declined. For a discussion of the shift to neo-liberal economic policies as a causal factor in the establishment of the single integrated market, see below this chapter, pp.162-67.
51 See the Commission report on European Union for the European Council in December 1982 in Copenhagen (Bull. EC, Supplement 7/82, p.22); and Bull. EC 11-1982, p.15.
progress on the development of the Community's commercial policy to that on the internal market and it was apparent that they would not abandon their powers to protect their firms by restricting the entry of foreign goods to their national markets unless the EC was endowed with similar powers.  

The member states were divided over this question. France and Italy were in favour of strengthening the Community's commercial policy instrument while West Germany, the Netherlands and the UK tended to be opposed. France had been particularly insistent on linking the single integrated market proposal to the proposal to strengthen the Community's commercial policy instrument. It feared that freer movement of goods might be used as 'a way of circumventing protective measures adopted nationally against produce from non-member countries' and insisted that steps be taken 'to ensure that the unification of the common market is primarily of benefit to European undertakings and products'. The Community's policy towards non-member countries, it stated, should be as dynamic as that of its main competitors and the Community had to introduce measures similar to the United States Trade Act to halt the sudden influx of imports.

Given the failure of previous European Councils to reach unanimous agreement on any of its proposals for reform, in 1982 the Commission decided to try a new approach which tried to meet some of France's concerns. It pointed out that a certain differentiation in the treatment of Community products and non-Community products in terms of technical standards was inherent in the very nature of the Community. Efforts to complete the internal market, it argued, would be pointless without a common commercial policy capable of defending the legitimate interests of the Community.

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52 According to Pearce and Sutton (1986, pp.4-9), while both the 'Europrotectionists' and the 'liberals' agree on the need to lower the barriers to intra-EC trade, the 'Europrotectionists' maintain that this should be accompanied by greater external protection and industrial policy at the EC level.

53 In its November 1981 memorandum on revitalisation of the Community the French government had maintained that a real commercial policy was needed if the Community was to assert itself externally. (See Bull. EC 11-1981, pp.92-100).

54 Albert and Ball 1983, p.76. The Commission called on the Council of Ministers to give priority to three sets of proposals. (Bull. EC 11-1982, pp.15-16; The Economist 3 July 1982, p.55). One set of proposals involved the adoption of the new procedure for sharing information about new proposed national standards. A second set was concerned with the simplification of frontiers formalities, and in particular the replacement of the variety of administrative documents required for intra-EC trade by a single customs document. A third set dealt with the treatment of products from non-member countries in relation to Community certificate arrangements stemming from technical harmonisation directives. Of the three, the Commission placed particular stress on the problem of access to Community certification for products by non-member countries, which it blamed for the blocking of some 20 directives aimed at removing technical barriers to trade.

55 Bull. EC 11-1982, p.15. Other members were also coming to accept that there was a need to strengthen the Community's common commercial policy, largely as a result of the deterioration in US-EC trade relations. (See The Economist 3 July 1982, p.55). Thus at the European Council meeting of June 1982 the leaders of the member states had agreed that the Community should aim to defend its legitimate interests as vigorously and with as much speed and efficiency as its trading partners. (See Bull. EC 6-1982, points 1.5.1 to 1.5.10). At the following meeting of the European Council in December 1982 in Copenhagen they accorded the Commission the right to define and implement VERs on the export by Japan of sensitive products into the Community. See Bull. EC 12-1982, p.10; Pearce and Sutton 1986, pp.5, 44, 48, 59-60. According to Pearce and Sutton, at the Copenhagen meeting Thatcher
Yet despite the efforts of the Commission the member states still could not agree on the new commercial instrument. Denmark, West Germany and the Netherlands remained unconvinced about the need for a new commercial policy instrument. Both France and Italy, however, continued to oppose the establishment of a single integrated market without some strengthening of the Community's common commercial policy. But the failure of the Athens meeting of the European Council in December 1983 to resolve the budget crisis (see discussion below) increased the pressure on member states to compromise on a whole range of issues, including that of the common commercial policy and on April 9 1984 agreement was finally reached on the establishment of a new common commercial policy instrument.

57 In an effort to meet the demands of France and in response to the declaration by the June 1982 European Council, the Commission had submitted a proposal to the next meeting of the European Council on March 1 1983 to extend the range of trade protection instruments available to the Community. (See Bull. EC 2-1983, pp.11-12). Like its US equivalent, Section 301 of the Trade Act of 1974, the new policy was intended to give producers as well as member states the right to submit complaints and allow for swift decision-making procedures. Under Section 301 the US President was empowered to take retaliatory action against any country that 'maintains unjustifiable or unreasonable tariff or other import restrictions' against US goods or whose export subsidies substantially reduce the sales of a competitive US product. (See Destler 1992, p.126). Unlike existing EC arrangements, it also aimed to improve access by EC products to non-member markets in a way similar to the US Section 301. (See Bull. EC 4-1984, p.50). Section 301 is another indication of the tendency of the US in the 1970s and 1980s to shift away from classical free trade towards managed trade. (See Chapter Three, pp.85-87). Thus the out of area rise of protection found a vigorous response in the EC.

58 Bull. EC 6-1983, p.34. Together with the UK, Denmark, West Germany and the Netherlands were opposed to the Commission being able to act on a complaint without the support of a majority in Council. At the June 1983 meeting of the European Council in Stuttgart, member states had appeared to shift closer towards the French position when they formally linked the completion of the internal market to the reinforcement of the trade policy instruments. But progress on this question slowed as the member states turned their attention to solving the disputes over Community finances, which were threatening the very survival of the Community. (Bull. EC 6-1983, p.21). See also Pearce and Sutton 1986, p.48. For further discussion of these and other points concerning proposals for a new commercial policy instrument in the early 1980s, see Pearce and Sutton 1986, pp.45-46, 64-65.

59 Davignon 1983, pp.8-9; Trente Jours d'Europe, No. 306, Jan. 1984, p.10. Again a major source of resistance seemed to be the fear by France and Italy that the removal of technical barriers would benefit American and Japanese firms as much as it would Community firms. (See The Economist 5 Feb. 1983, pp.63-64). In its memorandum of September 1983 on the future directions of the Community, France fully endorsed the Commission's proposal for a new commercial policy instrument. Such a policy, France argued, was needed to foster the development of infant high technology industries and to limit the abuse of the right of free movement by goods assembled but not produced in the Community. According to Mitterrand (1986, p.200), community preference was the very basis for the existence of the Community and its success.

60 Bull. EC 4-1984, pp.49-50. The very next day Council approved 15 directives on harmonisation of technical regulations on certain industrial products after France, which had linked approval of the directives to the adoption of the new commercial policy instrument, withdrew its reservation. See Bull. EC 4-1984, p.21. Having finally resolved the budget problems, the European Council in its meeting in June 1984 at Fontainebleau called on the Commission to submit new measures on a whole range of issues relating to the establishment of a genuine internal market. These measures were to provide the basis for the White Paper
It is clear then that the struggle to establish a common commercial policy was a necessary, but not sufficient, condition for the establishment of the single integrated market, not the least because France would not agree without this.

**The adoption of new common policies in investment and innovation**

The single integrated market proposal was the result of efforts by the Commission to overcome the economic problems confronting the EC in the 1970s and early 1980s, it was advanced by the *Cassis de Dijon* decision and some member states had only agreed to the completion of the internal market after the Community's common commercial policy instruments had been strengthened. Alongside the battle to get these advances were the battles to establish common policies in innovation and investment that were aimed specifically at closing the technological gap between the EC countries on the one hand and the US and Japan on the other. They will be discussed here not because they feature prominently in the Single European Act but because of the role they played in winning support for the completion of the internal market.

The adoption by the EC of common policies in innovation and investment increased support for the single integrated market in several ways. First, the arguments for the on Completing the Internal Market and the internal market component of the Single European Act.

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61 Subsection V of the Single European Act on research and technological development states that the aim shall be to encourage European industry to become more competitive on an international level. See *Bull. EC*, Supplement 2/86, p.14. For a discussion of innovation as a strategy to boost international competitiveness, see Fröhlich 1989, pp.27-29, 36-39.

62 They were particularly important in gaining French support for the internal market initiative. See below. This is a further example of the role of the Commission in linking issues to increase the chances of its proposals being adopted by the member states.

63 The proposal by the Commission to overcome the problem of Europe's technological decline sought to remove the major constraints on innovation in the Community. It recommended stimulating the formation of ad hoc groupings of European firms in key areas of advanced technology by giving such groupings preference in Community technology programmes that were to be established specifically for this purpose, and by guaranteeing such groupings preferential access to all government procurement. In December 1982 the Council of Ministers agreed to a Commission proposal for a pilot scheme for its European strategic programme for research and development in information technology (ESPRIT). See *Bull. EC* 2-1984, pp.36-37. Gaining approval for the full ESPRIT programme proved much more difficult. Although Council had endorsed the priorities and goals of the programme itself, the UK had made its approval for the financing of the programme conditional on acceptance by
SIM and common policies in advanced technology and innovation were very similar and therefore mutually reinforcing. The common policies, like the single integrated market, were seen as essential if Europe was to reverse its economic decline and overcome the related problems of low economic growth and unemployment. New economic theories stressed the importance of innovation and so-called strategic industries in boosting international competitiveness of a country's firms and in stimulating economic growth. They also highlighted the role played by government in creating an environment that was conducive to innovation and encouraged the development of strategic industries. Many within the EC blamed Europe's economic decline on its failure to keep up with the US and Japan in the area of innovation and the development of new technologies. Thus, like the SIM, the common policies were a response to the heightened perception by EC political and business elites of growing inter-regional rivalry and of the widening technology gap between the EC and its economic rivals, the US and Japan. There was a growing conviction among these elites that the problem was not due to a lack of government intervention in favour of advanced technology industries, but to the fact that the scale of

64 Bull. EC 2-1980, pp.10-11. According to the EC Commissioner for Industrial Affairs, Energy, Research and Science, Etienne Davignon (1982, p.136), because Europe was no longer able to compete in traditional industries on the basis of labour costs, its only option was to make the search for added value, innovation and productive performance the source of its competitive advantage.

65 Support for the strategic importance of new technologies was also found in the theory of the product cycle. According to the Commission (Bull. EC, Supplement 4/81, p.35), the product life cycle of traditional products was declining, thereby increasing the pressure for innovation.

66 Many of the new theories on the functioning of markets that were emerging in early 1980s were concerned with the failings in conventional economic models that assume constant returns to scale and perfect competition. According to Krugman (1983), these failings were particularly significant in high technology industries and suggested that because of these failings considerable benefits could be obtained by government targeting of these industries. For a more detailed account of these new theories on the functioning of markets, see Chapter Three, pp.91-92, fn.116.

The influence of this new thinking concerning industrial targeting and comparative advantage is evident in the policies and statements of both the Commission and national governments in the early 1980s. See Bull. EC, Supplement 4/81. p.37. The Commission argued that US firms had benefited from large, particularly defence-related, public contracts and Japanese firms from a research and development planning framework that was based on a consensus between government and industry. The fact that the Commission modelled its own collaborative programme in information technology on the Japanese Very Large Scale Integration programme of the mid-70s is an indication of the extent to which Commission thinking had been influenced by the Japanese experience. See Margaret Sharp 1990, p.106. The role of government in promoting innovation was particularly stressed by Etienne Davignon, EC Commissioner for Industry from 1977-1985 and for Research and Technology from 1981 to 1985, and a major force behind the push for common policies at the Community-level in the research and development of advanced technology. According to Davignon (1982, pp.120, 132), the shape of the new international division of labour 'must not be the result of fate or chance, but of coherent industrial and financial policies based on innovation and judicious decisions in investment and research.' Europeans, he argued, must decide whether they want to play an active part in the race for innovation or are content to be passive observers of their US and Japanese competitors. French President Mitterrand (1986, p.14), who shared Davignon's opinions on this matter, believed that to choose the latter was to accept a subordinate role and put one's national autonomy at risk.
that intervention was not large enough to be as effective as that of the US and Japan. All the EC member states had programmes to fund R & D and to assist national firms - the so-called national champions. But by the early 1980s it was evident that the national champion strategy had failed and there was a growing conviction among EC political and business elites that some kind of common approach to promote the development of new technologies was necessary to close the technology gap.

Support for the common policies had been growing among member states. This was particularly the case with France. Indeed it could even be argued that France was

67 The various statistics relating to this relative decline have already been given in a previous section in this chapter. (See pp.148-49). It was generally agreed that the growing technological gap between the Community member states on the one hand and the US and Japan on the other was not due to a smaller financial capacity or a lower level of expenditure by EC member states on research and development. According to Albert and Ball (1983, p.81), the financial resources of EC members were far superior to those of Japan, and total expenditure by EC member states on research and development equalled that of the US and was twice that of Japan. Rather, it was due to two factors that placed advanced technology firms from EC member states at a disadvantage in competing with their Japanese and US counterparts. First, unlike their US competitors, EC firms did not enjoy the benefits of a continental-scale market. Second, state expenditure in the EC on research and development in advanced technology, although comparable to that of Japan and the US, was far less effective. The failure of member states to coordinate their national research and development programmes meant that resources were often wasted through needless duplication and dissipation of effort. See Bull. EC, Supplement 4/81, p.46; Thatcher 1984, p.75; Albert and Ball 1983, p.81; Davignon 1982, p.130. The division of the EC into separate national procurement markets reserved for national firms placed European advanced technology firms at a considerable disadvantage in relation to their Japanese and American competitors, who had access to much larger domestic procurement markets. The problem was further compounded by the rising costs of advanced technology research and development. It was becoming increasingly apparent to member states that no individual state had the resources or the national market to sustain the investment level required in certain key fields. This was even more the case in the early 1980s when governments were faced with severe budget constraints. See Bull. EC, Supplement 1/81, p.10; Bull. EC, Supplement 4/81, p.27; Howe 1984, p.190.

68 Davignon 1983, p.9. Indicative of this change in attitude to community-wide industrial policies was the decision by the Council of Ministers in 1979 (Bull. EC 7/8-1979, p.26) to finally adopt a proposal that the Commission had made three years earlier for a programme lasting several years to promote research, industrial development and the application of data processing. At the same time it also requested proposals for action to develop microelectronic technology. Further evidence is provided by the call by the 1979 November meeting of the European Council (Bull. EC 9-1980, p.10) for the Council of Ministers to study a common strategy for the development of information technology.

69 Both West Germany and the UK were showing increased interest in proposals to enhance Europe's advanced technology capabilities. There was growing concern that West Germany was falling behind the US and Japan, and that US defence subsidies and Japanese industrial targeting were in part responsible for the decline in West German competitiveness. See Pearce and Sutton 1986, pp.73-75. Responding to this concern the West German government agreed to a four-year national programme of direct and indirect financial support for high technology industry. At the same time it supported proposals for joint efforts at the Community level in applied research and development in specific sectors such as information technology. In a speech in June 1983, West German Chancellor Kohl (1984, p.217), made it clear that the Japanese challenge could only be met by Europeans acting together. The British government also shared to some extent the French concerns about the need to stimulate Europe's research and advanced technology capabilities. Britain's enthusiasm for such ideas, although in part as an attempt to counter the negative image it had acquired with other member states as a result of the long drawn out dispute over the Community's finances in the early 1980s, also reflected a preoccupation with the UK's declining industrial base and the growing gap in high technology between its own firms and those in Japan and the US. See Pearce and Sutton 1986, pp.78-85. Like the West German government, the British government had responded by establishing a special programme to support the computer and micro-electronics industries. The Thatcher government (Thatcher 1984, p.75) also supported
attracted to the Commission proposal for completing the internal market primarily because it committed member states to the establishment of common policies to promote the development of high technology industries. The French government tended to see the internal market as necessary for the success of these common policies and its support of the internal market was largely a consequence of its commitment to these common policies. The new socialist government in its 1981 memorandum on the revitalisation of the Community stated that the only way European countries could overcome the economic crisis and hold their against competitors in the current technological revolution was by making a sustained, coordinated effort in the field of research and technological development.  

The support shown by large national high technology enterprises for the Commission proposals no doubt facilitated their endorsement by national governments. These firms had been the principal beneficiaries of the national champions programmes and had lobbied hard in the past for their continued existence. But they too had come to see that such an approach had failed to stop Europe from falling further behind Japan and the US in terms of technological advances, job creation and investment. Their willingness to

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70 Henri Aujac (1986, pp.18-19), a scientific counsellor to Mitterrand, stressed the increasing constraints EC membership and French participation in international industrial cooperation such as Concorde have imposed on France's freedom to conduct national industrial policy.

71 'French Government memorandum on revitalisation of the Community', Bull. EC 11-1981, p.97. It also called on the Community 'to encourage the industrial development of Europe and the creation and development of advance technology sectors'. Mitterrand saw industry as the modern battlefield and believed that Europe would only be victorious by joining forces. In his speech before the West German Bundestag in January 1983, Mitterrand (1986, pp.199, 201-202) stressed the need for an industrial renaissance in Europe and for the creation of new common policies in the area of advanced technology to make this possible.


73 Dekker 1990, p.17. Business elites had also come to see the establishment of the SIM as crucial to their efforts to remain competitive. Acting on an initiative by Davignon three leading European industrialists, Pehr Gyllenhammer of Volvo, Umberto Agnelli of Fiat and Dr Wisse Dekker of Philips, decided to set up the European Roundtable of Industrialists in April 1983. (See Dekker 1990, p.17; The Economist 26 May 1984, pp.79-80; Sandholz and Zysman 1989, p.117). Among the founding members of this grouping of industrial leaders also were the heads of many of Europe's leading companies such as Olivetti, Nestlé, Saint Gobain, Bosch
sacrifice the protection afforded them by the national champion strategies for the economies of scale and other benefits that the Commission proposals seemed to promise made it easier for their governments to abandon the national champion strategy in favour of a collaborative research and development strategy at the Community level.74

Second, some member countries such as France and many within the Commission itself felt that a single integrated market in itself was not enough and that common industrial policies would be required to ensure that EC firms were to reap the benefits of such a market.75 They were therefore reluctant to countenance the removal of all internal barriers to trade until such common policies were in place.

Third, once the EC member states had accepted the need for common policies in advanced technology and research and development, the Commission, member governments and business elites realised that the success of such policies depended on the completion of the internal market.76 This link is clearly established in the Single European Act itself, which states that one of the ways that the Community will achieve its objective of strengthening the scientific and technological basis of European industry is by enabling

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74 The Commission, and in particular Commissioner Davignon, played an important part in this change of attitude on the part of the large advanced technology firms. The Commission had initiated a 'roundtable' of representatives from the leading firms in the information technology field to help it elaborate the ESPRIT programme. See Bull. EC, Supplement 4/81, p.40; Bull. EC 2-1984, p.36. By bringing the industrialists together the Commission no doubt helped convince them of the benefits that could be obtained through collaboration with their rivals from other member states. See Sharp 1990, p.116.

75 Davignon 1982, p.133; Mitterrand 1986, pp.201-202. This argument is also made in Lord Cockfield's White Paper entitled Completing the Internal Market (Commission of the European Communities 1985). On page seven of the White Paper it is stated that 'in order to facilitate the key role which the internal market can play in the policy for the recovery of industrial structures, the suspension of internal borders must be accompanied by actions which strengthen research and the technological base of the Community's industry. Such actions will allow firms to benefit from the size of the single integrated market. It is within this context that the present work of strengthening the Community's technological base should be seen.' Stegemann (1989, p.76) argued that the formation of the EC had increased the awareness of governments, particularly those of EC member states, of the rivalry between their own firms and those of other states in terms of markets and investment, and of the usefulness of industrial policies in enhancing the international competitiveness of their firms.

undertakings to exploit the Community's internal market potential to the full, in particular through the opening up of national public contracts, the definition of common standards and the removal of legal and fiscal barriers to the efforts of undertakings to cooperate with one another.\(^7\)\(^7\)

Thus declining EC competitiveness and the challenge of Japan convinced the Commission, the governments of member states and leading European industrialists of the need for common policies in the research and development of advanced technology. The increased support for such policies mobilised support for the completion of the internal market. The link between the two agendas had been established from the very beginning. The Commission had always insisted that the success of its common policies in industry, research and development, and innovation depended on the proper functioning of a continental-wide internal market.\(^7\)\(^8\) Member states, such as France, who initially had shown less enthusiasm for the proposal to complete the internal market became far more supportive when they realised that it was essential to the success of the common policies.

**Other factors behind the push toward the single integrated market**

In the remaining sections of this chapter I will examine other factors that led to adoption both by the Commission and the member states of the single integrated market project. First I will look at the conviction that the completion of the single integrated market would enhance the bargaining power of the EC in its bilateral and multilateral trade negotiations with Japan and the US. Next I will discuss how the shift away from Keynesian inspired economic policies to more market-driven economic policies created a policy environment that was highly favourable to the proposal for market liberalisation at the EC-level. I will also attempt to show how this shift was particularly important with regard to the attitude towards the single integrated market proposal of two important players, the UK and France. I will then seek to explain why the resolution of the budget dispute was a significant factor in the success of the single integrated market proposal. Finally I will examine the importance of the British fear of exclusion from any future

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\(^7\)\(^7\) Bull. EC. Supplement 2/86, p.14. The argument that the completion of the single integrated market was crucial to the reduction of the technological gap was based on the belief that larger markets provide a more favourable environment for innovation. See Bull. EC, Supplement 4/81, pp.35,38; Kohl 1984, p.217; The Economist 24 Nov. 1984, p.14. Larger markets were seen as encouraging innovatory behaviour among firms in two ways. Firstly, a larger market means increased economies of scale. As the costs of research and development of advanced technology increase so does the size of the market that is needed if firms are to recoup their initial investment. Thus a European firm with access to a small national domestic market is said to be less willing to risk large sums of money on innovation than an American firm or even the same European firm with guaranteed access to a large continental scale market. The second way in which larger markets increase the incentive to innovate is by boosting competition. See Cecchini 1988, p.85. Firms are more likely to engage in innovatory behaviour if they are engaged in vigorous competition for market share. The increased competition of a larger market will also reduce the risk of monopoly situations which tend to discourage innovation and make firms less competitive. See Albert and Ball 1983, p.80.

\(^7\)\(^8\) Bull. EC 11-1982, pp.14-17.
deepening of the Community in both its willingness to compromise with regards the dispute over the Community's finances and its reluctant acceptance that the completion of the internal market should be accompanied by certain revisions to the original treaties.

*Increasing the EC's international economic bargaining power*

The single integrated market was seen by the Commission and member states as a way of increasing the EC’s bargaining power both within the GATT and with extra-EC trading partners such as the US and Japan.\(^79\) It could also have been seen as a way of avoiding the further fragmentation of the Community market that could arise should the US succeed in its push for a further GATT Round to liberalise trade in services and high technology.

Once the single integrated market was completed, it was argued, the EC could demand reciprocal access to other major world markets. The Albert-Ball report argued that in return for allowing US and Japanese firms participating in Community-funded research programmes the Community should demand from the US and Japan complete reciprocity in all fields, including public purchasing, investment and standards.\(^80\) In a similar vein Delors maintained that Europe must have the means to assert its rights and demonstrate its willingness to use them effectively in accordance with the principles of fairness and reciprocity. Non-members, he maintained, should be granted access to government tenders and the right to establish banks on a reciprocal basis.\(^81\)

External pressures also reinforced the push for the completion of the internal market. The fact that the US and Japan had been talking about a reciprocal agreement on public service markets seemed to give the single integrated market proposal added urgency. If the European countries failed to do the same, the Albert-Ball Report argued, they risked relegation to second division in the international industrial league.\(^82\)

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79 Story 1990, p.39. According to Story, since the end of the 1970s the Commission had seen the completion of the single integrated market as essential to the success of its efforts to bring a halt to the growing trade imbalance between its members and Japan and the Asian NIEs, an imbalance that, it believed, was due to the unequal access of Japan and the Asian NIEs to its markets. As we have seen in the preceding section, this motivation for the completion of the internal market was also shared by leading European firms.

80 Albert and Ball 1983, p.83. Similar views were also expressed by West German Chancellor Kohl and in the Cecchini Report. In his address to the West German Bundestag concerning the outcome of the European Council meeting held in Stuttgart in June 1983, Kohl (1984, p.218) declared that the large internal market could be used as an incentive to get other trading partners to open their markets. This, he said, would enable West Germany to resist pressures for increased protection. The Cecchini Report (1988, p.xx) called for market opening measures to be extended internationally on firm basis of reciprocity.

81 Delors 1988, p.68. Yet the French attempts after 1986 (supported by Delors) to make reciprocity the condition for access of non-members to the single integrated market met with accusations of Fortress Europe on the part of the US and Japan and the French were forced to retreat. Nevertheless, this debate within the Community strengthened the apprehensions of the EC’s trading partners and foreign companies that the EC was becoming a closed trade bloc, thereby increasing interest in the creation of rival groupings such as NAFTA, APEC and AFTA. See Chapter Seven, pp.253-57, and Chapter Eight, pp.287-95.

82 Albert and Ball 1983, p.80. As noted above, a further source of external pressure was the US push for a new GATT round to liberalise world trade in services and high technology products. (See *The Economist* 28 Jan. 1984, p.40). Aware that their inability to agree amongst themselves on the issue would make it impossible for them to present a common front at any
The shift to more market-driven economic policies

While the desire to reverse the decline in European competitiveness and the ever increasing costs of research and development were important factors in the decision to adopt the single integrated market proposal, they were not sufficient in themselves. A further important factor in the decision to complete the internal market was the shift by governments away from Keynesian inspired economic policies to more market-driven economic policies. The conversion of governments to economic rationalism was a result of eurosclerosis and the perceived failure of previous Keynesian inspired economic policies to overcome it. And in this the shifts in Britain and France in economic policy in the 1980s were crucial since it is hard to imagine the adoption of the single integrated market without either British and French support. Traditionally the UK had been wary of increasing integration which it saw as a threat to its economic and political sovereignty. France had also been wary of certain types of integration that would threaten not only its political sovereignty but also its particular model of economic planning. Yet by 1985 both the UK and France had become firm supporters of the single integrated market even though it would entail a loss of some economic and political sovereignty.

An important factor in the decision of France and Britain - and indeed of all the EC member states - to agree to the single integrated market proposal was the adoption by member governments of policies inspired by economic rationalism. Such policies stressed the need for low inflation, tight monetary policies and increased competition through greater emphasis on market forces, deregulation and privatisation. As a result of this shift in economic ideology many governments came to see the single integrated market as the perfect way to liberalise their national markets and increase competition.

The shift was brought about in part by the failure of traditional Keynesian-style policies to solve the economic problems of the 1970s: slow or stagnant growth, unemployment, high inflation and soaring budget deficits. According to Delors, this had given new impetus to the theoretical debate about economic management and favoured what he called the liberal counter-reform. Although the various member states all initially

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83 Indeed, according to Monnet (1976, p.455), one reason why Britain did not join the precursor of the EC, the European Coal and Steel Community was the refusal by then Labour government to countenance any interference by a supranational authority in its socialist experiment. According to Harrop (1989, p.16), it had been particularly disinclined at the time to cede control of its recently nationalised coal and steel industries. See also Dell 1963, p.81; and Noredge 1983, pp.22-23.

84 This argument is made by a number of scholars. See for example Grahl and Teague 1990, pp.17-51. Story (1990, p.47) argued that EC 1992 'may be understood as a state strategy ostensibly aimed at making markets operate more efficiently, but enacted in a multi-state community whose members are sovereign.'

85 Delors 1982, p.47.
reacted in different ways, by 1983 all had eventually moved away from policies inspired by the welfare state and Keynesianism to policies of austerity inspired by monetarism, Reaganomics and economic rationalism. Governments adopted policies that emphasised control of inflation, budgetary rigour and market oriented initiatives to improve the functioning of economies in the belief that the economy would then find the natural balance that had been disrupted by excessive interventionism.

The adherence of the new Thatcher government to economic rationalism was an important factor in ensuring British support for the single integrated market. The UK had previously opposed other initiatives that sought to strengthen European integration. It had refused to join the European Monetary System in the late 1970s. Yet the economic ideas behind the single integrated market were very much in line with those of the new Thatcher government. As Wallace has argued, it was the first core Community issue for over a decade to catch the imagination of both British policymakers and their counterparts on the continent. It seemed to offer the UK the best opportunity since it had joined the Community of moulding the Community in a way that suited its own interests. For the UK, not only could the single integrated market be used to force other European countries to abandon their state interventionist, mercantilist policies and adopt policies more akin to its own, it could also move the conception of the Community closer to the one originally espoused by the UK in the late 1950s, namely a free trade zone.

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86 Damgaard et al. 1989, pp.187-191. There was also a move from reactive and consensual politics to a politics based on innovation and conflict, and a shift to a more active, entrepreneurial leadership style.

87 OECD 1988, p.11; Delors 1982, p.47. The move towards more market oriented economic policies occurred first in the UK in the late 1970s, then in Belgium, Denmark, the Netherlands and West Germany between 1981 and 1982, and finally in France in 1983. See also Cameron 1992, pp.57-58.

88 For a study of UK EC policy under Thatcher, see Peterson 1992, pp.152-69. Holmes (1989, p.9) defined Thatcherism as essentially 'the advocacy of a market economy, where the state fulfils strictly limited functions such as monetary control, the upholding of the rule of law, and the provision of the defence of the realm. ... As an intellectual descendant of Adam Smith's free-market vision, Thatcher could not help but challenge the post-war consensus based on nationalisation, Keynesian economics, government regulation and planning, the provision of universal, rather than needs-based, selected welfare.'

89 Wallace 1986, p.590.

90 Wallace 1986, p.590.

91 Story 1990, p.41. The decision by the British government to take up the proposal for a single integrated market was taken for tactical as well as ideological reasons. First, the proposal was partly aimed at overcoming the widespread view held by other member governments that the UK government had a negative attitude towards the Community. Thatcher's intransigence over the budget dispute was largely held responsible for the paralysis of the Community in the early 1980s and the British were keen to show that they could play a positive role in the EC rather than always opposing new initiatives. Second, it believed that the proposal would provide it with an alternative to the proposals by other member states for greater political integration. (See Peterson 1992, p.153. As we have already seen, by 1983 a serious debate had begun among the members of the EC about the future directions of the Community. The 1983 Stuttgart declaration had called for a relaunch of the Community and it was becoming clear to the British government that it could no longer afford to ignore the proposals of other key member states concerning the future direction of the Community. The UK responded by presenting its own proposal which made the establishment of a genuine common market as the number one priority. See Howe 1984, p.190. The proposal to complete the internal market was given similar prominence in a paper presented by Thatcher (1984, p.74) to her fellow
Conversely it could also ensure that future UK governments did not try to return to the bad interventionist policies of the past. The single integrated market would act as an externally imposed discipline that would force future governments regardless of their political colour to pursue rational economic policies and hence prevent them from pandering to special interests such as organised labour. The economic rationalist or Thatcherite vision of the Community was that of a collection of largely politically independent states compelled by the discipline of the single integrated market to compete with each other in order to provide the most attractive environment for business. Economic rationalism had redefined the boundaries of economic sovereignty to the extent that the powers that Thatcher was surrendering in accepting the single integrated market were powers that she believed no government should exercise. Thus Hayek's vision (see above Chapter Three) found its strongest proponent in Margaret Thatcher.

Yet despite her sympathies for the single integrated market the first objective of Thatcher's EC policy remained the resolution of the budget dispute on terms favourable to heads of government at the historic 1984 Fontainebleau meeting of the European Council in June 1984. The paper, 'Europe - the Future', argued that the success of the United States in job creation had been achieved by the reduction of barriers to business and trade, and called on the Community to follow the US example. Another indication of the enthusiasm of the Thatcher government for the single integrated market proposal is the prominent role played by the former British Secretary of State for Trade, Lord Cockfield, both in drawing up the Commission programme for the single integrated market and in ensuring that that programme was implemented. For an account by Lord Cockfield of his role in the process, see Cockfield 1990, pp.1-8.

Taylor 1989, p.23. Thatcher's vision of the Community is reflected in the justification that she gave for her refusal to endorse a social dimension for the Community in a speech at Brugges in September 1988. See Thatcher 1989, pp.260-64. Her government had not successfully rolled back the frontiers of the state in Britain, she argued, only to see them re-imposed at a European level. The Treaty of Rome, she maintained, had been intended as a charter for economic liberty. The aim of the Community, she declared, should not be more and more detailed regulation from the centre but to deregulate, to remove the constraints on trade and to open up. Thatcher's speech was a response to the increasing pressure from some member states in the second half of the 1980s to replace national regulation by supranational regulation. In a address at Chatham House in January 1989, British Chancellor of the Exchequeur, Nigel Lawson, declared that 'there are those in Europe who have only begun to realise - rather late in the day, after they have signed up to it - that this liberal, free market vision of 1992 is not altogether to their taste. So they are trying to claw back lost ground, substituting a concept of 1992 based on supranational regulation.' Quoted in The Economist 28 January 1989, p.46. However, Thatcher was beginning to suspect that it was she and not the other leaders who had misread the true nature of the SEA and that she had been tricked into surrendering British sovereignty. See The Economist 20 May 1989, p.69.

Garrett (1992, pp.541-2, 545-46) argued that the SEA was the result of interstate bargaining among the member states over both the extent to which national economies should be deregulated and the extent of re-regulation that should occur at the EC-level. The two principal players, France and West Germany, he claims, wanted qualified majority decision-making in order to ensure that the UK would not be able to veto a more interventionist internal market. Thatcher, though initially not in favour of institutionalised qualified majority voting, was concerned that other member states, particularly Greece, might veto measures that she believed were needed to complete the internal market.

It is clear, however, from Thatcher's stand against the federalising tendencies of the Commission in the late 1980s and from her outspoken defence of British sovereignty that her acceptance of the loss of sovereignty that would result from the creation of the single integrated market was motivated by her neo-liberal convictions and certainly not out of any desire to increase the powers of the EC institutions. Hence Thatcher's reluctant acceptance of majority voting in the Council of Ministers for decisions related to the implementation of the single integrated market provisions.
the UK and it was only after that dispute was finally settled in June 1984 that the UK was able to concentrate its energies on the achievement of a single integrated market.94

Yet a more important factor in the success of the SIM proposal was the economic crisis that shook France in the early 1980s. The measures that the French socialist government adopted to deal with this crisis reinforced France’s European disposition. Faced with a choice between a socialist France and a liberal Europe France chose the latter.

While the election of Thatcher Conservative government in 1979 had brought to power a government that was ideologically predisposed to the single integrated market proposal, the Mitterrand Socialist government in 1982 had been elected on a programme that seemed antithetical to the single integrated market proposal based on deregulation. Its Keynesian policies designed to stimulate employment growth and increase social welfare were in conflict with those of the other members of the EC who were intent on reducing government expenditure and economic growth in order to keep inflation under control.95 However, French membership of the Community meant that much of the increased spending went on imports. The new socialist government had underestimated the degree to which France was integrated in the international system.96

By 1983 it was clear that the situation had become untenable. Faced with a choice between its programme and the suspension of its membership of the European Exchange Rate Mechanism and perhaps of the European Economic Community itself, Mitterrand chose Europe.97 The decision no doubt was influenced by the arguments of economic rationalists but more important were the political, financial and economic benefits that France enjoyed as a result of its membership of the EMS.98 Finally, a decision by France to leave the EMS would not only cast doubt on its commitment to the Community but would seriously undermine its privileged relationship with West Germany at a time when France was becoming increasingly concerned by the growing mood of pacifism and neutralism among the West German public.99

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94 On her return from the Fontainebleau meeting of the European Council, Thatcher reported to Parliament that the way was now clear for the completion of the Common Market in goods and services. Quoted in Young 1990, p.388.
95 OECD 1988, p.11.
96 Delors 1988, p.71. Because of the weakness of the French productive apparatus most of the benefit of the government's reflationary policies went to external producers. The French trade deficit rose dramatically and the French franc came under pressure. As a result the French currency had to be devalued several times.
97 OECD 1988, pp.61-62. The failure of the French attempt to use Keynesian demand stimulation to overcome the twin problems of stagnant growth and high unemployment brought with it the realisation that France's economic future - as implied by the title of Delors' book: 'la France par l'Europe' or 'France through Europe' - was tied inextricably with that of the European Community. For Mitterrand (1986, pp.14-15), the success of France quite clearly presupposed the success of Europe and he criticised previous governments for ignoring this fact.
98 The EMS provided financial help to members who were facing balance of payment problems. The external discipline imposed by membership of the EMS was thought to be important in controlling inflation.
99 In the television and radio speech that he made to announce the new measures, Mitterrand stressed that France should not 'isolate itself from the European community or distance itself from the Atlantic alliance'. The Economist 26 Mar. 1983, p.48. Thus the question of France's
Mitterrand was now firmly convinced that the European Community was the most appropriate framework for his plans to modernise French industry. Mitterrand had already realised the advantages that could be gained from common Community advanced technology programmes. His adoption of Delors’s strategy of market liberalisation increased his support for the proposal for a single integrated market. Such a market, he maintained, would put an end to the shameful protectionist practices that had allowed uncompetitive firms to survive and had seriously weakened the French economy.

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100 We have already argued earlier in the section of this chapter dealing with the push for common innovation and investment policies that French support for the proposal to complete the internal market was due to a large extent to the linking by the Commission of this proposal to the establishment of common policies in innovation and technology and to the acceptance by the French government of the argument that the completion of the internal market was necessary if the common policies were to achieve their objective of increasing the international competitiveness of European firms.

101 Already in 1981 Delors (1982, pp.67-68) had argued that solving France’s economic problems would require both the freeing up of market forces and the relaunching of European cooperation. According to Delors, both France and its EC partners were confronted by the same dual challenge. The internal challenge was to overcome the inadequate functioning of markets, growing rigidity and disorderly state intervention. Structural reforms were needed to bring about real decentralisation, effective competition in the market and flexible planning oriented towards stabilising structures and seizing the potential of the new industrial revolution. At the same time the EC member states were faced with an external challenge due to ‘the profound change in world economy and the outbreak of a new industrial revolution’. To overcome this challenge, France, he argued, ‘must find support in relaunching European cooperation, in particular in the fields of industry, energy and research, relying on a truly common market’. Delors’s argument here clearly combines the liberal economic claims that a larger, more integrated market would increase the competitiveness, efficiency and dynamism of firms with the traditional French predilection for planning in the form of industrial policy, a predilection that was both strengthened and modified by the arguments of strategic trade theory about the role of government in promoting technological innovation. All this was seemingly directed towards a realist objective: to maintain and increase the power and influence of Europe and thus France in the world.

102 Mitterrand 1986. p.86.
would, he argued, make French industry more world competitive by allowing the more
dynamic firms to expand and force the less competitive firms to fold.¹⁰³

Mitterrand’s shift in economic policy was therefore followed by a shift in French EC
policy. After 1983 Mitterrand aligned himself more closely with those within the
Community who were calling for institutional reform and a new Treaty more clearly
oriented towards political union.¹⁰⁴ This shift in Mitterrand’s position brought about a
new balance of power in favour of those member states who supported institutional reform
and political union and was eventually to result in the historic vote at the June 1986
meeting of the European Council in Milan in favour of holding an intergovernmental
conference on institutional reform.

This section has shown how the shift in economic ideology from Keynesianism to neo-
liberalism and monetarism was an important factor in gaining the support of EC
governments for the proposal to complete the internal market. This was particularly the
case for the British and French governments. Both had been traditionally wary of
proposals for increased integration on the grounds that they threatened their national
independence. The adoption by both governments of economic policies that sought to free
up market forces could only make them more favourable to a proposal that called for the
liberalisation of markets at the Community level. However, no progress on this objective
could be made until the EC budget dispute was resolved. The resolution of the budget
dispute in turn depended on a change in British EC policy.

The resolution of the EC budget dispute and the British fear of exclusion
In previous sections of this chapter we have shown how various factors slowly
developed a consensus among the Commission, member governments and business elites
that the internal market should be completed. Yet despite this emerging consensus member
state governments were slow to give formal approval to the proposal. This was due largely
to two related factors: the linking by some governments of approval of the proposal to
progress on other issues, and the general preoccupation with resolving the dispute over
Community finances. We have already seen in the section on the single integrated market

¹⁰³ The 1982-83 French economic crisis increased French support for the single integrated
market project for another more pragmatic reason. The dramatic increase in France’s trade
deficit had increased French awareness of its unhealthy trade deficit with West Germany,
which in 1982 had accounted for 42% of the total deficit. The French trade minister at the
time, Edith Cresson, blamed the deficit in part on protectionist German industrial standards. See *The Economist* 21 May 1983, p.66. According to Story (1990, p.54), France began to see
the single integrated market as an opportunity to eliminate the non-tariff barriers that it
believed were reducing its exports to West Germany.

¹⁰⁴ Mitterrand 1986, p.77. The 1981 French memorandum on revitalising the Community had
emphasised the need for the Community as a whole to adopt social and economic policies
similar to those of the new Socialist government in France. Although the memorandum had
called for more extensive application of the existing provisions for majority voting in the
Treaties, it did not see a need for institutional reform. See Lequesne 1989, p.153; *Bull. EC* 11-
1981, pp.92-100; *The Economist* 12 Sept. 1981, pp.73-74. But in a speech to the European
Parliament in May 1984 Mitterrand (1986, p.296) called for a new treaty to cover political
union and evoked the possibility of a conference of those member states interested.
proposal how France had linked the completion of the internal market to the strengthening of the EC's common commercial policy and to the adoption of common research and development policies. France did not want to accept a reduction in its own powers to respond to unfair practices by foreign firms unless the EC acquired similar powers.

Yet this was not the only reason for the delay in adopting the Commission proposals. The 1980s was also the time of a long drawn out disagreement among member states over Community finances, a disagreement that had brought the Community to the brink of collapse. It was clear to all those involved that the question of whether the Community had a future at all would have to be resolved before any decisions could be made about what form that future should take. A lot of time and energy that could have been devoted to proposals such as the single integrated market were absorbed by efforts to resolve the more pressing problem of the Community budget. Yet this section will show that the resolution of the budget dispute was not only an important precondition for the adoption of the single integrated market initiative but was also partly a consequence of that initiative. We will see how Britain's fear of being excluded from a more politically and economically integrated Community made it more ready to compromise in the budget dispute.

The budget dispute which had been gradually paralysing the Community since 1979 pitted the UK against the other member states. It saw the linking by the UK of three issues: the size of the British contribution to the Community budget, the ever increasing cost of the Common Agricultural Policy (CAP), and the need to increase the Community's own resources. The UK had long felt that its contribution to the Community budget was far in excess of the benefits that it received from the Community programmes that the budget funded. The British government devised a two pronged strategy to remedy the problem: the payment by the Community of annual rebates to the UK and reduction of Community expenditure on the CAP. It would not, it declared, approve any further increase to the Community's budget until its strategy had been adopted.

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106 Over two-thirds of the Community budget was spent on subsidising agricultural production in the EC under the CAP. The budget was financed by the income raised from customs duties on imports from non-EC members, levies on agricultural imports from outside the EC and VAT contributions. As a large importer of agricultural produce, the UK contribution to the budget was considerable. But because the British farming sector was relatively small and efficient, the benefits that the UK obtained from the CAP as a proportion of its contribution were much less than those obtained by other member states. See Pinder 1991, p.153; Tsoukalis, 1991, pp.232-48. For an account of the history of the CAP, see Pinder 1991, pp.77-93. See also above Chapter Three, fn.75
108 By 1983 it was apparent that the existing Community finances were no longer adequate to meet the soaring cost of the CAP and other members were calling for the creation of new resources by raising the Community's share of VAT. The UK government made its approval of any new resources conditional on both the introduction of reforms to curb increases in CAP expenditure and the establishment of a permanent mechanism to determine the level of the annual budget rebates payable to the UK. (See The Economist 25 June 1983, pp.59-60). After the failure of the Athens European Council to solve the budget question in December 1983, Thatcher told reporters that the Community might have to wait until it actually run out of money before showing willingness to reform its finances. Some people, she said often got down to dealing with their problems only when they neared the brink. Bull. EC 12-1983, p.7.
Until 1983 the French government had been resolutely opposed to the British demands. Yet the shift in France's EC policy in 1983 saw an increased willingness on part of Mitterrand to find a compromise solution to the budget dispute, which he saw as blocking the main objective of that new policy, the relaunch of the Community. Thus when the European Council failed to resolve the dispute at its meeting in Athens in December 1983, Mitterrand personally took on the task of finding a solution. The British Prime Minister initially refused to give ground and even threatened to withhold British payments to the Community. Yet in the end Thatcher did compromise. Thus when the EC leaders finally reached agreement on a settlement to the dispute over the budget at the June 1984 meeting of the European Council at Fontainebleau, Thatcher obtained neither a permanent solution to the problem of the British overcontribution to the Community budget nor a fundamental reform of the CAP. She had, however, further confirmed the suspicions of both Kohl and Mitterrand that Thatcher's vision of the EC differed quite markedly from their own and thus helped to bring them closer together.

Many commentators have attributed this backdown on the part of Thatcher to the realisation that the other members had lost all patience with the UK and were now prepared to proceed with their plans to relaunch the Community without the UK if need be. According to Peterson, the increased importance of the EC to the UK had made the threat of exclusion a much more effective means of forcing the UK to compromise than in the past.

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109 The CAP had been part of the bargain between France and West Germany that formed the basis for the establishment of the EC in 1957. (See Pinder 1991, pp.76-78). It had been a mechanism to redistribute some of the gains that West German industry had derived as a result of its access to a larger market to countries with large powerful agricultural sectors such as France.

110 Mitterrand 1986, pp.262-63.


112 The Economist 7 July 1984, pp.11-12.

113 Both Mitterrand and Kohl had expressed their opposition to the British request for a permanent rebate mechanism. Lurking behind such a request, they believed, was the British desire to replace the contractual obligations and solidarity of the original treaty by the law of 'fair returns', thereby reducing the Community to a mere free trade area. See Mitterrand 1986, pp.73, 285; Kohl 1984, p.323.

114 The threat to exclude the UK from a more integrated Community had already been raised by Mitterrand in 1982 when, reacting to an attempt by the UK to veto proposed EC farm price increases, he questioned whether the UK had any future role in the Community. See The Economist 22 May 1982, p.76. In the first half of 1984 both Kohl and Mitterrand repeatedly hinted that they were willing to form a new Community without the UK. In a speech in February 1984 the West German Chancellor (1984, p.323) declared that he was about to make new proposals for political integration and that these proposals would 'test who was ready to accompany us on this path and who is not'. In a remark clearly directed at the UK, he emphasised that the pace of integration should not be determined by the most reluctant member. In a speech to the European Parliament, Mitterrand (1986, pp.295-96) declared that a new approach to integration - a Europe of several speeds, a Europe of variable geometry - was now essential to allow for its expansion to new fields such as health, education, justice and security. He saw the need for a new treaty to achieve this and raised the possibility of an intergovernmental conference of interested member states.

115 Peterson 1992, p.155. For a similar argument, see Taylor 1989, pp.3, 6; Hoffmann 1989, p.34. The unilateralist approach of the Reagan Administration to both foreign and economic policies in the early 1980s had cast doubts on the utility of its 'special relationship' with the
After the settlement of the budget dispute Mitterrand and Kohl continued to use the threat of exclusion to get the British government to agree to increased political integration. The determination to proceed without the UK if necessary culminated in the majority vote at the meeting of the European Council in Milan in June 1985 - the first ever majority vote taken at such a meeting - to hold an intergovernmental conference to draw up a new treaty. Seven member states had decided to hold the conference despite opposition from the UK, Denmark and Greece, who feared that such a conference would result in further losses of national sovereignty. The UK had failed to prevent other member states from linking the establishment of the single integrated market and the strengthening of the EPC - both of which it was in favour of - to institutional reform. Yet once again the UK, when faced with the threat of exclusion from any new arrangement, backed down and agreed to participate in the conference. The end result was the Single European Act, which though not a new treaty did make revisions to the existing treaties and formally bound member states to qualified majority decision-making for most matters relative to the completion of the internal market.

US. At the same time the UK's dependence on trade with Western Europe had increased considerably and by 1986 trade with the other EC members accounted for over 50% of total UK trade. West Germany was replacing the US as the UK's most important trading partner. It was becoming increasingly clear that the UK's economic future was tied to that of the EC as a whole. The UK was particularly enthusiastic about the European Political Cooperation procedure which it saw as crucial to maintaining British influence in the world. According to Pfaltzgraff (1968, p.5), concern about the decline in Britain's influence in the world had been one of the principal reasons why the UK had sought to join the EC in the 1960s. Another had been a similar concern about its poor economic performance. Membership of the EC, it was believed, could solve both these problems. See also Taylor 1989, p.8.

In his report to the West German Bundestag on the Fontainebleau meeting Kohl (1984, p.457) reiterated his idea for a two-speed Europe.

See also Chapter Four, pp.136-37. For a more detailed account of the Milan European Council and the subsequent Luxembourg Intergovernmental Conference see Volle 1988, pp.203-209; Lequesne 1989, pp.154-55.

Taylor 1989, p.8. As was pointed out in Chapter Four (pp.140-43), the SEA was as much the result of aspirations for broader change as of the desire to ensure the rapid completion of the internal market. Indeed, the proposals for broader change, particularly those calling for institutional reform, must be considered as an important factor in the success of the internal market initiative. For a discussion of these broader proposals, see Chapter Four, pp.129-35.

According to Taylor (1989, p.10), the UK, in agreeing to participate in the intergovernmental conference, obtained from the other members the concession that there be no new treaty. Garrett (1992, pp.546-47) argued that the UK along with the other EC members was forced to accept the preferences of France and West Germany regarding decision-making because of the greater economic bargaining power that these two countries enjoyed in the EC. The UK, he maintained, feared that should France and West Germany go it alone British firms would be placed at a disadvantage relative to French and German firms. While the access of French and German firms to each other's national market would be based on the principle of mutual recognition of standards, British firms would have to adapt their products to meet both French and German standards. As participants in the single integrated market, however, the British would have some say in determining the rules that were to govern that market. Garrett also attributed some role to domestic factors in the British decision to concede to Franco-German demands on the question of decision-making. Within the ruling Conservative Party, many did not share Thatcher's hard line attitude on the EC and this weakened Thatcher's bargaining power. The Conservative Party was divided between the anti-Europeans of the Conservative European Reform Group and the pro-Europeans of the Jubilee Group. See The Economist 31 Mar. 1984, p.62. (Similar divisions also existed within the bureaucracy with the Foreign Office on the whole more pro-European and hence more willing to compromise on the budget issue, and the more budget conscious Treasury). Thus in the dispute over the size of the British EC budget rebate in late 1983 and early 1984 pressure from the Conservative...
**Conclusion**

From the discussion in Chapters Four and Five it is clear that the completion of the internal market and the Single European Act were the result of a number of inter-related factors. These factors fall into two groups: longer term factors encouraging further integration that were also present when the EC was first established; and more recent factors. In Chapter Four we saw that there were three main longer term factors: the desire to put an end to inter-state rivalry in Europe, particularly that between France and Germany; the desire to reverse the decline in European influence in world affairs that had become especially noticeable after WWII; and the desire - particularly strong among smaller European states - to enhance their economic and political security by increasing their influence over the policy decisions of their more powerful regional neighbours.

However, it was also clear that even the longer term factors had been modified by some more recent developments, particularly those of an economic nature. The resolve of France and West Germany to preserve and deepen European political unity was strengthened despite or even because of British opposition. As a result of the growing inter-regional economic rivalry between the EC, Japan and the US, the desire to increase European influence in world affairs became stronger. But the emphasis in the late 1970s and early 1980s was somewhat less on the need to enhance Western Europe's bargaining power in relation to the USSR and the US and more on the need to increase its negotiating position on economic matters *vis-à-vis* the US and Japan both bilaterally and in multilateral fora such as the GATT. The desire of the smaller states to constrain the power of the dominant regional powers, France and West Germany, continued to be a factor in the moves for deeper institutionalised regional economic and political integration in Europe, largely because of increasing German economic hegemony and domination of the EC agenda by the Franco-German axis.

In chapter Five nine major new factors driving the push to the SIM were identified. These were: the desire to revive the stagnating national economies within the EC; the desire to do something about the decline in the international competitiveness of EC firms and the relatively low level of investment activity in the Community compared to that in the US and Japan; the fear that unless something was done to stop it the Common Market would fall apart; the shift by member states to more market-driven economic policies; the *cassis de Dijon* decision of the European Court of Justice; the decision to strengthen the Community's commercial instrument; the linking of the internal market initiative to the adoption of common policies in investment and innovation; the linking of the internal market initiative to proposals for institutional reform; and last, but by no means least, the fear on the part of the UK that, if it continued to thwart the desire of France and West

backbenches had forced Thatcher to withdraw her threat to withhold part or all of Britain's monthly payments to the Community. Thatcher had made the threat in response to the decision of the EP to block payment of the 1983 British rebate until a solution was found to the EC budget impasse. Conservative MPs had feared that Thatcher's threat if carried out would put Britain in breach of its treaty obligations and see it condemned by the European Court of Justice. See *The Economist* 25 Feb. 1984, p.48.
Germany for institutional reform, it could find itself excluded once again from an inner core of more closely integrated EC member states.

The factors identified in both Chapters Four and Five as having contributed to the decision to complete the EC internal market confirm the five general propositions listed at the end of Chapter Three concerning the reasons for the emergence or re-emergence of institutionalised regional economic integration as a way of structuring international relations in the 1980s.120

The 'retreat and defend' proposition that the re-emergence of institutionalised regional economic integration is a response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US, was confirmed by several of the factors identified in the EC case study. One of these factors, the fear that unless something was done to stop it, the Common Market would fall apart, was particularly supportive of the sub-proposition (derived from the work of Triffin and Cooper) that trade liberalisation at the global level is becoming harder to achieve as a result of the increase in the number of members whose agreement is required and the increasing importance of non-tariff barriers (NTBs). Thus the inability of the GATT to stop the proliferation of NTBs together with the threat that these posed to the common market, which constitutes the very basis of the EC, increased the incentive for EC member states to establish the single integrated market.

Another factor that could be seen as confirming the 'retreat and defend' proposition was the linking of the completion of the internal market to the strengthening of the Community's commercial instrument. Of particular significance here was the argument that this reinforcement of the Community's commercial instrument was necessary to give the EC similar powers to those of the US President under Section 301. In addition, both the refusal of some member states to forgo their powers to protect their firms by restricting the access of foreign goods to their national markets unless the EC was given

120 These propositions in brief are:

• The 'retreat and defend' proposition that the re-emergence of institutionalised regional economic integration is a response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US.
• the 'advance and compete' proposition that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security in relation to members and non-members of the alliance or more particularly to boost their competitive position in the global economy.
• the 'rivals all' proposition that institutionalised regional economic integration is the result of a defensive interaction first among rival capitalists, but also among rival states. In the first place a move to regionalism occurs because increasing competition drives firms into regional arrangements. In the second case, states, seeing the prospect of their rivals advantaged, move to construct their own economic spheres of influence.
• the 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence.
• the 'ideas and learning' proposition that the re-emergence of institutionalised regional economic integration is the result of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism.
similar powers, and the argument advanced by the Commission that differential treatment of Community and non-Community products was inherent in the very nature of the Community, also provide support for the orthodox view that regionalism is the result of the desire by states and vested interests within those states to escape the discipline of the liberal international trading order and increase their protection against outsiders.

Most of the twelve factors identified above for the EC case study confirmed the 'advance and compete' proposition that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security in relation to members and non-members of the alliance or more particularly to boost their competitive position in the global economy. This general proposition was confirmed by all three of the longer term factors identified in Chapter Four. France and West Germany clearly saw institutionalised regional economic integration as a way to enhance their own economic and political security by reducing the risk of interstate conflict between themselves while the potential regional hegemon West Germany also believed that its membership of a regional economic and political arrangement would reassure other states in the region that it would not use its power to subjugate them. All the West European states were convinced that institutionalised regional integration in general would enhance their economic and political security by reversing the decline in the influence of Europe in international affairs. The smaller states also saw institutionalised regional integration as a means of constraining the economic and political power of the dominant regional economic powers, France and West Germany, by preventing them from making singly or together decisions that were detrimental to the interests of the smaller states.

The 'advance and compete' proposition was also confirmed by all but one of the nine new factors identified in this chapter. The EC member states felt that the establishment of the SIM would arrest the fragmentation of the EC internal market thereby restoring business and investor confidence and removing the threat of a return to interstate rivalry and renewed political and economic instability. They clearly believed that the SIM would enhance their economic and political security and boost their competitive position in the global economy by reviving their stagnating national economies, increasing the size of the home market and the economies of scale of EC firms, and making the EC a more attractive destination for both foreign and domestic investment. Member states such as France that considered new technologies to be an important source of economic growth and economic and military power and a significant factor in the international competitiveness of firms had realised that their own national markets and investment capabilities were no longer sufficient for them to undertake the development of such technology. These states now believed that the establishment of the SIM in conjunction with the adoption of common industrial policies was essential for the development of these technologies.

The 'advance and compete' proposition was also confirmed by the decision to strengthen the Community's commercial instrument. Member states such as France and
Italy feared that the establishment of a SIM without the strengthening of the commercial instrument would leave their firms vulnerable to the unfair trading practices of their foreign rivals and reduce the ability of the EC states to counter protectionist actions by other non-regional states. Finally, both the British willingness to compromise of the budget dispute and its decision to support albeit reluctantly the institutional changes that the other Member States believed were crucial to the success of the SIM also confirm the 'advance and compete' proposition. The UK was concerned that if it continued to thwart the desire of France and West Germany for institutional reform it could find itself excluded once again from an inner core of more closely integrated EC member states and its own economic and political influence both within and outside the EC would be considerable reduced.

The factors identified in the EC case study also supports the 'rivals all' proposition that institutionalised regional economic integration is a defensive interaction among rival capitalists and rival states, such that both firms and states come to see their welfare from a regional rather than a purely national perspective and there is a strengthening of regional identity and consciousness. From the case study it is clear that inter-regional rivalry and competition are at least as powerful motives for regionalism as either the undermining of the global trading system or the advancement of national interests. Thus the decision to establish the Single Integrated Market was the result of the growing perception by both regional and national political elites within the EC that such a market was vital if European firms were to be able to compete on an equal footing with their US and Japanese counterparts. They believed that the greater economies of scale and/or increased protection that such a market would afford European firms would increase their competitive advantage over their adversaries from other regions. Increasingly national interests were being seen as inseparable from the regional interest. This perception by political elites was also shared by European industrialists as the formation of the European Roundtable shows.

However, there is considerable disagreement among scholars concerning whether large European enterprises were instrumental in winning the support of member states for the internal market initiative. Thus Sharp sees the common polices as bringing together firms which then were to play a key role in the push for the SIM. Other scholars have rejected Sharp's argument and have attributed the success of the SIM to the action of

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121 Sharp 1990, p.101. According to Margaret Sharp (1990, p.117), developments in technology led to the US and Japanese technological challenge and europessimism, which led in turn to the Commission's European strategic programme for research and development in information technology (ESPRIT). ESPRIT restored the confidence of European firms and encouraged them to work together. They then realised that it was in their common interest to complete internal market and promoted moves to do so. See also Story (1990, p.46) who argued that the Roundtable of European Industrialists was the principal ally of the Commission in its efforts to relaunch the Community. This argument is also made by Sandholtz and Zysman (1989, pp.113-14, 116).
national political elites and/or the European Commission. Since these issues are part of the much broader discussion of whether or not the SEA validates neofunctional theory that occurs later in the conclusion to this chapter there is no need to pursue them any further here. Nevertheless, it would appear from this case study that the political elites were the prime movers in the push for the Single Integrated Market, and not the business elites.

Three of the twelve factors identified in the EC case study confirm the 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence. This appeared to be the case with member states such as France in both the push to strengthen the EC's commercial instrument and moves to establish common EC policies to promote innovation and investment. It was also argued in this chapter that the failure of the attempt at a Keynesian inspired reflation of the French economy - which led France to adopt economic policies that were more in line with those of the other EC member states - only served to underline the fact that this policy and other policies such as industrial policy and social policy had to be applied Community-wide if they were to be successful.

Nevertheless, this was definitely not a view of regionalism that was shared by the Thatcher government. For Thatcher, the Single Integrated Market was more an opportunity to entrench deregulation at home and thus limit the ability of future British governments to re-regulate, and to force other EC governments to adopt similar policies to her own. It would, she believed, bring the EC closer to her vision of the Community as a collection of largely politically independent states compelled by the discipline of the single integrated market to compete with each other in order to provide the most attractive environment for business. That vision was more in accordance with that of Hayek and Olson than with that of Philip and Erhard.

More generally the different governments of EC member states no doubt saw the Single Integrated Market as a means of boosting domestic economic growth and thus of increasing their chances of re-election.

The 'ideas and learning' proposition was also confirmed by many of the factors identified in the EC case study. In Chapter Four all three of the longer term factors identified in the EC case study confirm the 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence. This appeared to be the case with member states such as France in both the push to strengthen the EC's commercial instrument and moves to establish common EC policies to promote innovation and investment. It was also argued in this chapter that the failure of the attempt at a Keynesian inspired reflation of the French economy - which led France to adopt economic policies that were more in line with those of the other EC member states - only served to underline the fact that this policy and other policies such as industrial policy and social policy had to be applied Community-wide if they were to be successful.

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122 Thus Moravcsik (1991, p.65) has argued that the internal market initiative was not the result of pressure exerted by transnational business. According to Moravcsik, transnational business only became involved in the SIM initiative after 1985. See also Cameron (1992, pp.49-50) who has argued that, although some large firms were strong advocates of the internal market, it is uncertain as to whether this advocacy actually had an influence on the decision to complete the internal market. While Sandholtz and Zysman (1989, pp.99, 127-28) list industrial elites as one of the three elites - the other two being governments and Community institutions, particularly the EC Commission, they (p.117) are unsure as to whether the European business community was a cause or merely a consequence of efforts on the part of the Commission to complete the internal market.

123 See Chapter Two, pp.39-43.
supported the general proposition that the re-emergence of institutionalised regional economic integration is the result of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism. The most important cognitive change identified here concerned the original belief that the national interest can be best safeguarded by the unflinching defence of national sovereignty. In all three of the longer term factors identified in Chapter Four there appears to have been a realisation on the part of certain states - France and West Germany, the larger West European states, and the smaller states such as Belgium and the Netherlands - that their national interests could in some cases be better assured by the surrender of some of their national sovereignty. In the 1960s, however, France under De Gaulle reverted to the more traditional conception of national interest and refused any further surrender of national sovereignty. It was not until the early 1980s that France, once again, with Mitterrand at its helm - and only after a serious crisis - concluded that greater European economic and political integration was in its longer term interest.

A considerable number of the new factors identified in this chapter also supported the 'ideas and learning' proposition. Four cognitive changes were found to have played an important role in the success of the internal market initiative. The first was the increasing awareness on the part of certain states of the link between economic strength and political power. Whereas in the immediate post-war period the concern had been to find a means to counter the overwhelming military power of the Soviet Union and to a lesser extent of the US, in the late 1970s and 1980s the nature of that concern had changed. As a result of economic stagnation and the decline in the competitiveness of its leading industries in relation to their US and Japanese counterparts, it was feared that Europe was in danger of losing its economic basis for the pursuit of a strong foreign policy. Economic prosperity and industrial competitiveness were seen much more than in the past as vital to the maintenance and expansion of Europe's influence in international politics.

The significance of this changed perception concerning the importance of economic strength was reinforced by a second cognitive change concerning the size of the economic space that is required to support an internationally competitive and innovative industrial structure. We saw in this chapter that the failure of separate national programmes to halt the decline in the international competitiveness of European firms had convinced EC member states of the need to implement such programmes at the EC-level. The ideas of integration economists on the benefits of the greater economies of scale and increased competition that would flow from regional economic integration were also important in bringing about this cognitive change.

The third cognitive change to play an important role in the consolidation of institutionalised regional economic integration in the EC concerned the attitude of policymakers to government intervention in the economy. We saw in Chapter Three that in the early 1980s as a result of the empirical observations and theoretical advances of international trade theorists there had been a shift from a conception of comparative advantage where natural endowments and market forces are the determining factors and
state intervention is seen as counter-productive to a conception of comparative advantage where government intervention can be used to create competitive advantage in certain industries. This new theoretical and empirical evidence in support of the argument that certain types of government intervention can enhance the competitive advantage of particular industries, together with the two preceding instances of cognitive change - the growing awareness of the link between economic strength and political influence, and the realisation of the importance of market size in determining economic success - further increased support among policymakers both at a national level and within the Commission for the establishment of common policies in innovation and investment. It may also have played a role in convincing the member states of the need to reinforce the Community's commercial instrument. The argument that some non-member states, particularly Japan, through a combination of government intervention and the protection afforded by non-tariff barriers, were able to enhance the comparative advantage of their own firms at the expense of EC firms was particularly important in this respect.

Of the EC member states, France was perhaps the most affected by this change. It was the most enthusiastic supporter of the proposals for common policies in innovation and investment and for the strengthening of the Community's commercial instrument, and this enthusiasm no doubt played an important part in overcoming its traditional hostility to majority decision-making in the Council of Ministers. Yet as we have seen in this chapter other member states were no less affected. Both Kohl and Thatcher, who, unlike Mitterrand, were the heads of governments that might be considered to be ideologically opposed to this form of government intervention in the economy and to increased protectionism, moved closer to the French position. While this shift in position by the UK, West Germany and the Netherlands on these questions may have been in part the result of inter-state bargaining, it was also no doubt due to some change in the attitudes of policymakers.

The fourth and final cognitive change to have played a role in the success of the internal market initiative also concerned the attitude of policymakers to government intervention in the economy. Whereas the previous cognitive change saw policymakers adopt a more favourable attitude towards certain specific kinds of government intervention that often sought to accelerate market forces, this other cognitive change took the form of a much broader shift away from government intervention towards deregulation.\textsuperscript{124} In this chapter we saw how the success of the internal market initiative was also the result of a shift in the dominant paradigm of domestic economic policy from Keynesian regulation to the deregulation of neo-liberal economics. Thus the failure of traditional Keynesian policies to overcome the economic crisis and the subsequent shift by governments to more neo-liberal economic policies saw the arguments of those who favoured a larger role for market forces and less government regulation as a means of increasing productivity and economic competitiveness reinforce the arguments of those who advocated increased

\textsuperscript{124} As a result it was often presented as government intervention that seeks to accelerate the action of market forces.
regional economic integration as a means to those same objectives. In this chapter we found that while the shift from Keynesian regulation to neo-liberal deregulation was particularly important in explaining British endorsement of the internal market initiative, it was also played a part in making the other member states, particularly France, more favourably disposed towards the initiative. British support for the single integrated market initiative was clearly a consequence of the Conservative government's commitment to the ideas and principles of neo-liberal economics and of its desire to see those ideas embraced by the Community as a whole. The British endorsement of the internal market initiative represents a radical departure from its more usual behaviour pattern of rejecting proposals that further institutionalised regional economic integration in the EC and thus provides confirmation of the sub-proposition that as a result of this reduced emphasis on state intervention in the market, states are more inclined to accept the loss of certain instruments of economic sovereignty in order to realise the goals of economic ideology and hence less resistant to institutionalised regional economic integration than in the past.

Some of the factors identified in Chapters Four and Five could also be seen to confirm another of the sub-propositions of the 'ideas and learning' general proposition, namely that institutionalised regional economic integration is the result of the adoption by policymakers of certain ideas favourable to regionalism due to the lobbying and influence of epistemic communities and/or existing regional institutions. Our analysis of these factors highlighted the important part played by certain Community institutions - the EC Commission, the European Court of Justice and the European Parliament - in the push for the internal market. This has led some scholars to argue that these Community institutions were also an important factor in the success of the internal market initiative. Certain scholars have even seen the role played by these institutions in the internal market initiative as proof that the single integrated market was at least in part the consequence of the neofunctional logic and that therefore neofunctionalism was still valid as an explanation of the integration process. This view is of course contested, particularly by those who continue to support the intergovernmental perspective on the EC. But the debate is further complicated by the fact that scholars have interpreted neofunctionalism in different ways and as a result the arguments of one group of scholars who reject neofunctionalism as an explanation of the internal market initiative are nonetheless seen by another scholar as validating neofunctional theory.

Thus Sandholtz and Zysman reject the neofunctional explanation of European integration because it cannot explain the discontinuous nature of that process or the preference of the member states for nationalist options rather than more integration in the 1960s and 1970s. The completion of the internal market and the Single European Act, they argue, were the product of 'elite bargains formulated in response to international

125 Sandholtz and Zysman 1989, p.99. Sandholtz and Zysman (pp.99, 127-28) attributed the success of the internal market initiative to the action of three elites: the Community institutions and in particular the EC Commission; industrial elites; and governments, but maintained that neofunctionalism cannot explain the revival of the Community through the SEA.
structural change and the Commission’s policy entrepreneurship.\textsuperscript{126} This explanation is firmly rejected by Moravcsik. Governments, he argues, not institutions and European MNCs brought about the completion of the internal market. The proposals of the European Parliament had been rejected and its participation in the intergovernmental conference severely curtailed by the member states, European business elites had only become involved after the internal market proposal had been adopted, and there was already general acceptance of the proposal by member states before the Delors Commission had begun its mandate.\textsuperscript{127} Moreover, according to Moravcsik, Delors’s choice of options for relaunching the Community was determined by what he believed was acceptable to the member states.\textsuperscript{128}

Employing a different definition of neofunctionalism to Sandholtz and Zysman, Moravcsik finds their explanation to be 'compatible with neofunctionalism in all but a few particulars.'\textsuperscript{129} Their explanation, he argues, conforms to a variant of neofunctionalism, which he calls supranational institutionalism, that sees integration as resulting from the actions of regional institutions, transnational business interest groups, and key institutional leaders.\textsuperscript{130} Moravcsik contrasts this approach to his own which he calls intergovernmental institutionalism. According to Moravcsik, the three elements of intergovernmental institutionalism - intergovernmentalism, lowest common denominator bargaining, and the protection of sovereignty - offer a better explanation not only of the push towards the internal market but of the process of European integration since its very beginning.\textsuperscript{131}

\textsuperscript{126} Sandholtz and Zysman 1989, p.97. There is general agreement among the various scholars and political actors involved that the completion of the internal market and the SEA were not the result of mass political pressure but of the action of elites (Hoffmann 1989, p.35; Sandholtz and Zysman 1989, pp.97, 127). Indeed, according to West German Foreign Minister Genscher (1982, p.116), part of the impetus for the desire to revitalise the EC in the early 1980s came from the fear that the EC was losing the support of its citizens. Even after the signing of the SEA, Delors (1988, p.272) was critical of the lack of involvement by ordinary people in the construction of Europe which he described as 'a monument of abstruseness ....... familiar only to some specialists or interest groups'. What the scholars disagree about is which particular elites were important in the success of the internal market initiative. See below.

\textsuperscript{127} Moravcsik 1991, pp.64-66.

\textsuperscript{128} This argument was further developed by Garrett (1992, pp.549-59) who maintained that both the proposals of the Commission and the decisions European Court of Justice are based on what these two institutions consider the most powerful member states are likely to find acceptable. Both Garrett and Moravcsik agreed that a modified realist approach provides the best explanation for the success the internal market initiative and that the SEA is therefore best understood in terms of intergovernmental bargaining. But while Moravcsik (1991, p.63-64) considered the final result of that bargaining to reflect largely the preferences of the UK, Garrett (1992, p.546) believed that result to be more in line with the preferences of France and West Germany.

\textsuperscript{129} Moravcsik 1991, p.45; p.77, fn.17. Moravcsik's definition - which he freely admitted is that of only one variant of neofunctionalism - is based on a description of neofunctionalism by Haas as a process in which a central institution successfully demonstrates the need for further integration if previously agreed to goals are to be attained, and in which business and labour from the different member states come together to formulate common policy. See Moravcsik 1991, pp.45-46; p.78, fn.18.

\textsuperscript{130} Moravcsik 1991, pp.64-67.

\textsuperscript{131} Moravcsik 1991, pp.67-69.
Other scholars such as Cameron and Keohane and Hoffmann argue that both the neofunctionalist and realist perspectives are necessary to fully account for the SEA. Keohane and Hoffmann contend that while the neofunctional concept of spillover does not adequately explain the decisions of the Milan Summit or the SEA, the theory of spillover has not been disproved, only its applicability has become more restricted. The SEA, they argue, is best explained by the convergence of the preferences of the major European governments, pressures from the world political economy, and to a lesser degree, spillover from the expansion of Community membership and in particular the fear that an increase in membership would make it more difficult to complete the internal market.

While the neofunctionalists may have been right in their prediction that further steps towards regional integration will be the result of the desire to protect and extend existing benefits of regional economic interdependence, they failed to correctly identify the process by which these steps would come about. Contrary to neofunctionalist predictions the state political elites were generally more keen than the general population or economic elites to embrace further regional integration. State elites in Europe were on the whole concerned that the spillover process had halted. They believed that the existing level of regional economic functionalism in the EC was inadequate to ensure the international competitiveness of European firms and therefore had to be encouraged through state intervention. The SIM it would seem was not the result of automatic spillover or of a shift in political loyalties from the national to the supranational entity but of changed external and internal circumstances which forced states to see increased regional integration as the best way to achieve their separate national interests.

In the light of the preceding discussion we can conclude then that the success of the internal market initiative and the SEA was due to a number of interrelated factors. An

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132 Cameron (1992) argued that both the actions of the EC institutions and the inter-state bargaining that took place in the European Council were important.

133 Keohane and Hoffmann 1991, pp.19-20. Keohane and Hoffmann also saw another aspect of neofunctional theory - that regional economic integration would result in the transfer of authority from the member states to a supranational entity - as needing some qualification. According to Keohane and Hoffmann (1991, pp.7-18), while the EU member states have surrendered their authority to make decisions in certain areas, that authority has not been transferred to a supranational body but to an interstate body (the EC Council of Ministers), where it is exercised jointly by the states concerned. This practice, which they described as the ‘pooling’ of sovereignty, is a qualified form of supranational decision-making without supranational institutions. The EU, they argued, is an anomaly in terms of traditional state-centric theory since it cannot be adequately described as either an international regime/organisation or a federation of states. Its constituent members have surrendered their right to make unilateral decisions on some issues including external trade but not as is the case in a federation on other foreign policy issues and defence.

134 Keohane and Hoffmann 1991, pp.23-25. On the question of the validity of neofunctionalism, Keohane and Hoffmann (1991, pp.19-20) maintained that some integration is still attributable to the spillover that results from an initial intergovernmental bargain. Yet they argued that spillover is limited in time and scope and new governmental bargains are necessary to keep up the integration momentum. Unlike Cameron, and Keohane and Hoffmann, Kastendiek (1992, p.82) rejected any attempt to explain the success of the internal market initiative by neofunctionalism. But he and other scholars such as Pinder (1989, p.104) and Taylor (1989, pp.23-24) concurred with Cameron (1992, p.25), Keohane and Hoffmann (1991, p.26) that the Maastricht Treaty and in particular the EMU component were the result of spillover from the SEA.
examination of these factors reveals that although the EC case study provides some support for each of the five general propositions identified at the end of Chapter Three, two of these - the 'advance and compete' and the 'ideas and learning' propositions - must be given much greater weight in any explanation of the success of the internal market initiative. Thus if we are to go by the findings of the EC case study the moves towards greater institutionalised regional economic integration in the 1980s were principally the result both of the desire of states to enhance their economic and political security in relation to members and non-members of the regional economic grouping, or more particularly to boost their competitive position in the global economy, and of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism. Indeed, there would appear to be some kind of dynamic relationship between these two, in which the one reinforces the other.

Nonetheless, it is still not clear whether these findings are generalisable to the resurgence of institutionalised economic regional integration in both North America and the Asia Pacific in the 1980s, or whether they are limited to the EC case study. In the remaining two case studies we will attempt to illuminate this question further.
CHAPTER SIX
INSTITUTIONALISED REGIONAL ECONOMIC INTEGRATION IN NORTH AMERICA IN THE 1980S AND EARLY 1990S:
THE CANADA-US FREE TRADE AGREEMENT

Introduction

Chapters Six and Seven examine two instances of institutionalised regional economic integration in the 1980s and early 1990s in North America: the bilateral free trade agreement (FTA) between Canada and the US; and the extension of that agreement to include Mexico. Chapter Six examines the factors that led to the signing of free trade agreement between Canada and the US in 1989 while Chapter Seven looks at the factors behind both the decision by the US and Mexican governments to negotiate a free trade agreement and the subsequent decision by Canada to join them in the trilateral arrangement known as NAFTA. In both chapters these factors are examined country by country.

As in Chapters Four and Five each of the factors identified as having contributed to the decision to establish the Canada-US FTA and NAFTA is examined to see whether it confirms one or more of the five main propositions that were derived from our review of the theoretical literature in Chapters Two and Three. At the end of both chapters an attempt is then made to establish the relative importance of each of these propositions in accounting for the emergence of institutionalised regional economic regionalism in North America in the 1980s and early 1990s.

Both chapters will also attempt to understand why there occurred such a dramatic reversal in the attitude of the Canadian and Mexican governments to the issue of institutionalised economic integration in North America. It should be remembered that only in May 1980 Mexican President José López Portillo and Canadian Prime Minister Pierre Trudeau in a Joint Statement issued in Ottawa had declared trilateral economic cooperation to be not in the best interests of their countries.¹ This initial hostility by both the Canadian and Mexican governments to the idea of institutionalised regional economic integration in North America serves to illustrate dramatically the different conceptions of the link between political integration and economic integration in North America and in Western Europe. In Western Europe from the very beginning the perceived link between the two had encouraged some states to embrace economic integration and led others to oppose it. In North America, however, this linkage had always been an obstacle to institutionalised regional economic integration. Indeed, as we shall see in this chapter, it was only when the Canadian and Mexican governments came under intense economic, geopolitical and ideological pressure that they were able to subordinate the desire to

¹ Weintraub 1984, p.183.
preserve their political sovereignty and independence to their desire for economic security and development.

The Canada-US Free Trade Agreement

On September 26 1985 Canadian Prime Minister Mulroney announced to the House of Commons that he had informed President Reagan of Canada's wish to negotiate the broadest possible trade agreement with the US. On December 10 1985 Reagan formally

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2 Doern and Tomlin 1991, p.30; Leyton-Brown 1986, p.183; Hart 1990a, pp.8-9. For an account of the steps leading to the final decision by Mulroney to request a free trade agreement with the US, see Doern and Tomlin 1991, pp.15-69. Canada was the demandeur, at least officially. However, the significance of this is not clear. The 1984 Trade and Tariff Act had extended coverage of fast-track procedures to bilateral agreements, but had also specified that a bilateral agreement would only be negotiated under fast-track if it had been formally requested by the other country. (See Doern and Tomlin 1991, p.161; and Destler 1992, p.99). The US government was also aware that Free Trade with the US was a sensitive political issue in Canada and that Canadians might reject any such agreement should it be seen as coming from the Americans. Of course this did not stop the US government from encouraging the other partner to make such a request. In the mid 1970s Congress had inserted a provision in US trade law that authorised the President to explore the possibility of free trade with Canada. (See Royal Commission On Economic Union and Development Prospects for Canada 1985a, p.376). Governor Reagan in his campaign for Republican nomination in 1976 had already called for the establishment of a North American economic community. (See Symms 1986, p.130). In the early 1980s there were plenty of signs that the US would not look unfavourably at a Canadian request for a FTA. The 1979 US Trade Agreements Act asked the President to report to Congress by August 1981 on the possibility of agreements with countries of the northern portion of the Western Hemisphere (External Affairs Canada 1983, p.209). The Canadian Senate Standing Committee on Foreign Affairs had advanced the idea of a comprehensive and preferential free-trade agreement with Canada in its 1982 report on Canada's trade relations with the United States. The US Trade Representative Brock is said to have proposed a comprehensive agreement both to Canadian business representatives and to Canadian government officials in response to their requests for a series of sectoral agreements with the US. (Doern and Tomlin 1991, pp.48, 67). Mulroney's announcement followed the release on September 5 1985 of the report of the Royal Commission on Economic Union and Development Prospects for Canada, and, twelve days later, the report by the US Trade Representative and the Canadian Trade Minister. Both reports recommended that Canada and the United States negotiate a comprehensive bilateral trade agreement. The Royal Commission had been established in November 1982 by the Liberal government of Pierre Trudeau 'to inquire into and report upon the long-term potential, prospects and challenges facing the Canadian federation and its respective regions, as well as the implications that such prospects and challenges have for Canada's economic and governmental institutions and for the management of Canada's economic affairs.' (Royal Commission on Economic Union and Development Prospects for Canada 1985a, p.v). The Commission was chaired by Donald Macdonald, a former Liberal minister, and is sometimes referred to as the Macdonald Commission.

The Trudeau Liberal government had established the Royal Commission on the Economic Union and Development Prospects for Canada in response to the severe economic recession that was affecting Canada at that time and to the opposition from the provinces to its highly interventionist economic strategy that sought to broaden Canada's industrial base and increase Canadian control of its energy resources. The Western provinces in particular had been angered by what they saw as an attempt by the Federal government to increase its powers at their expense and, according to Doern and Tomlin (1991, p.53), the Liberal Party had originally hoped that the Royal Commission would provide the necessary intellectual backing for its claim that federal government had to be given greater control of economic policymaking if Canada was to meet the challenges of growing global economic interdependence. The Liberal Party had appointed as president of the Commission Donald Macdonald, who when he had been Liberal Energy Minister had overseen the implementation of his government's highly interventionist energy policies. Yet, contrary to the expectations of the previous Liberal government, during the course of the Commission's enquiries, Macdonald's views were radically altered (see below) and in November 1984 almost a year
requested the House of Representatives Ways and Means Committee and the Senate Finance Committee to grant him the authority to negotiate a free trade agreement with Canada under the so-called 'fast-track' provisions of US trade law.\(^3\) The committees acceded to the President's request and negotiations began on May 21, 1986.\(^4\) They were not completed until December 10, 1987.\(^5\) On January 2, 1988, Mulroney and Reagan formally signed the agreement which was approved by the US House of Representatives on August 9 and by the US Senate on September 19. In Canada the agreement was approved by the House of Commons in August 1988 but the Liberal dominated Senate delayed passing the legislation and an election was fought largely on the issue of free trade.\(^6\) With the Conservatives\(^7\) returned to office, the Liberal dominated Senate passed the implementing legislation. The agreement took effect on January 1, 1989.

The agreement itself can be divided into three parts: Chapters 3 to 13 dealing with the liberalisation of trade in goods; Chapters 14 to 17 liberalising trade in services; and Chapters 18 and 19 which institutionalise the relationship by establishing procedures for dispute settlement by binational panels.\(^8\)

Under the agreement, the US and Canada committed themselves to eliminate over a period of ten years all tariff and some non-tariff barriers to trade and to establish rules of origin, often of 50% value added.\(^9\) The sectoral free trade agreement that already existed before the Commission's report was made public, he publicly announced his support for a free trade agreement with the US. See Doern and Tomlin 1991, p.24.

\(^3\) Leyton-Brown 1986, p.183; Doern and Tomlin 1991, pp.35-36; Hart 1990a, pp.10-12. The fast-track procedures were part of the Trade Act of 1974. They were introduced to enable foreign governments to negotiate reductions in non-tariff barriers with the US in full confidence that any agreement they reached would not be amended by the US Congress. The President must first gain the approval of the relevant congressional committees to negotiate an agreement under the fast-track procedures. Once that approval has been obtained and an agreement has been reached, the President submits to Congress a bill implementing the agreement. Congress then has 90 legislative days to either accept or reject - it cannot amend - the bill in question. Fast-track procedures are only granted by Congress for a limited period (usually of two years) and should that period expire before the completion of negotiations or before the statutory 90 legislative days required by Congress are up, then the President must ask Congress for a renewal of fast-track. For an account of the history of fast-track, see Destler 1992, pp.71-77. The 1984 Trade and Tariff Act extended coverage of fast-track procedures to bilateral agreements.

\(^4\) Doern and Tomlin 1991, pp.43. The Senate Finance Committee almost rejected the President's request. See below, this chapter, fn.113.

\(^5\) For an extensive account of the negotiations, see Hart 1990a; Doern and Tomlin 1991, pp.103-201.

\(^6\) For a detailed account of the election, see Hart 1990a, pp.28-39; Doern and Tomlin 1991, pp.205-42.

\(^7\) The terms Conservatives and Conservative Party are commonly used in Canada as a shorthand for the Progressive Conservative Party. It was formed in 1942 when the Progressive Party merged with the Conservative Party. The Conservative Party and its traditional rival the Liberal Party have dominated Canadian political scene since Canada attained Dominion status in 1867. In the early years the Conservative Party was staunchly pro-British and anti-American and supported protectionist measures to promote the development of Canadian industry, while the Liberals were pro-free trade and supported reciprocal free trade with the United States. By the 1980s the positions of the two parties regarding free trade had been reversed with the Conservative Party advocating a free trade agreement with the US and the Liberal Party opposing such an agreement. See Delury (ed.) 1983, pp.152-55.

\(^8\) For a detailed examination of the contents of the Agreement, see McCrae and Steger 1988; Hart 1990a, pp.25-28; and Doern and Tomlin 1991, pp.70-99.

\(^9\) According to Hufbauer and Schott (1992, pp.156-63), the rules of origin established under the Agreement require that an imported good undergo substantial transformation in the area
for the auto industry or Auto Pact was subsumed under the broader agreement with some minor changes. Thus Canada retained safeguards designed to favour production in Canada but agreed to phase out duty remission programmes. But as a result of the concern by North American producers about an increase in investment by third party auto companies in Canada to take advantage of the duty-free entry of parts from non-US and Canadian sources into Canada, under the agreement Pact membership is restricted to current members. In the energy sector Canada gained more secure access to US energy markets in return for Canadian guarantees about reliability of supply, particularly in times of short supply. Of particular importance to Canada was the agreement by both parties to exempt the other from safeguard actions against import surges under GATT Article XIX unless it can be shown that the other is the substantial source of injury. Even then imports of the good in question cannot be reduced below a certain level. Trade in agriculture was also liberalised but to a much lesser extent than trade in manufactures. All covered by the FTA in order to qualify for preferential treatment. Substantial transformation is considered to have occurred when a good has been transformed to such an extent that a change in its tariff classification is warranted and/or 50% of the value of the originating materials plus the direct cost of processing is US, Canadian, or a combination of both. Ronald Wonnacott 1991b. Murray Smith 1988b, pp.26-27; Paul Wonnacott 1988, pp.104-108. The renegotiation of the Auto Pact was demanded by US auto parts manufacturers who saw it as unfairly favouring Canadian parts and car production to the detriment of US manufacturing and jobs. According to Linda Hoffman, Vice President of Government Affairs and Trade for the Automotive Parts and Accessories Association (1989, p.100), Pact manufacturers were required ‘to produce one car in Canada for each car sold there and to create 60 cents’ worth of Canadian cars and parts for each dollar’s worth of vehicles sold there’ (the so-called Canadian safeguards) in order to be able to import cars and parts duty-free from anywhere in the world. ‘(I)t is possible to envision cars built in Canada without a dime’s worth of US content.’ According to both Deputy Chief Canadian Trade Negotiator Ritchie and Canadian Minister for International Trade Carney (House of Commons Standing Committee on External Affairs and International Trade 1987, p.15), although the rule of origin for the car industry remained at 50%, changes in the calculation of the content requirement effectively increased the amount of Canadian and US sourced parts to about 70% on the old formula, thereby encouraging Japanese and Korean car makers to source more from Canadian manufacturers. According to US Trade Representative Yeutter (1988, pp.70-71), the US was willing to accede to industry demands for a 60% rule of origin but would not agree to the conditions that the Canadians attached to their acceptance of a higher percentage. According to Christopher Bates, in his testimony before the Senate Finance Committee on behalf of the Motor and Equipment Manufacturers Association (1989b, pp.71-74), a 60% rule ‘would encourage a more rapid increase in purchases from US part suppliers by Japanese, Korea and other third-country vehicle producers; foster more procurement by traditional North American vehicle producers from US and Canadian rather than third-country parts manufacturers; and partially offset existing incentives to increase use of third-country components, such as foreign-free trade zones, the GSP (Generalised System of Preferences) programme, tariff provisions 806/807, and multilateral duty-free sourcing privileges which Auto Pact members in Canada will retain indefinitely under the terms of the FTA.’ Hart 1992, p.11. Section 201 of the US Trade Act of 1974 authorises the President to impose temporary restrictions on imports that were ‘a substantial cause of injury, or the threat thereof’ to US producers. Under Article XIX of the GATT such restrictions were to be non-discriminatory and to be imposed on all imports of the good or goods in question, irrespective of their country of origin. See Destler 1992, pp.54,435. Morici 1991a, p.66. This effectively satisfies one of the Canadian objectives in requesting an FTA: to insulate Canadian exports to the US from the effects of sideswiping in blanket safeguard actions and thus restore the confidence of producers and investors that goods produced in Canada will enjoy unimpaired access to the US market.
tariff and some non-tariff barriers were removed but some of the most important non-tariff barriers such as price support mechanisms remain.\textsuperscript{15}

As for trade in services, both countries agreed that any future laws and regulations must grant companies of the other country national treatment. Yet the agreement fell short of the full national treatment that the members of the EC accord to each other.\textsuperscript{16} In financial services the US gained exemption from various Canadian restrictions on market share, asset share and capital expansion of foreign companies but further liberalisation of access in this area was prevented when the US was unable because of domestic legislation to meet the Canadian condition that such access should be reciprocal.\textsuperscript{17} In investment, with the exception of certain sensitive industries, both countries agreed to extend national treatment to the subsidiaries of the other.\textsuperscript{18} The agreement also eased restrictions on the entry and relocation of business travellers but falls far short of the freedom of movement of people of the EC treaties. The agreement failed to increase protection for US intellectual property.\textsuperscript{19} Government procurement markets were opened only slightly more than that required under the GATT Government Procurement Code.\textsuperscript{20}

Chapters 18 and 19 of the agreement were perhaps the most important from the Canadian perspective since by establishing joint institutions and a binational dispute settlement mechanism they effectively made Canadian access to the US market more secure.\textsuperscript{21} As a result of the inability of Canada and the US to agree on a subsidy code

\begin{itemize}
\item \textsuperscript{15} Hart 1991, p.96.
\item \textsuperscript{16} Schott and Murray Smith 1988, p.150. The EC treaties allow greater mobility of capital and labour.
\item \textsuperscript{17} Schott and Murray Smith 1988, p.144; Hart 1992, p.14. The US is prevented from providing reciprocal access by domestic legislation which maintains strict barriers between commercial and investment banking (the Glass-Steagall restrictions), and which forbids interstate branch banking (the McFadden Act). These prohibitions were also the source of tension between the US and the EC over EC moves to make access by non-member country firms to the deregulated EC financial market conditional on the granting of reciprocal access to EC firms in their home countries. See Chapter Seven, pp.255-56.
\item \textsuperscript{18} Morici 1991a, p.67. The exemption of the Canada's cultural industries from this and other provisions had been recommended by the Royal Commission on the Economic Union and Development Prospects for Canada (1985a, p.358) to take into account Canadian political sensitivities about the loss of social, political and cultural independence and cultural identity. The restrictions on foreign investment in other industries were made less onerous. Thus, while major take overs are still subject to review, there is to be no review of indirect acquisitions or new plants and the threshold for review of direct acquisitions is raised from $5 million Canadian to $150 million and still barred or restricted in transportation, energy, communications.
\item \textsuperscript{19} Hart 1992, p.15. According to Hart, this was because the US refused to accept Canadian conditions for an end to Canada's compulsory licensing of pharmaceuticals.
\item \textsuperscript{20} Hart 1991, p.97. According to Doern and Tomlin (1991, pp.84-86), the Canadians were eager to gain access to the huge US government procurement market and the US was largely responsible for the lack of significant progress on the matter.
\item \textsuperscript{21} According to the Royal Commission on the Economic Union and Development Prospects for Canada (1985a, p.318), 'Canada's need for dependable market access suggests that an effective intergovernmental body should be established to administer the agreement, and that a legally binding process should be designed for resolving disputes over the proper interpretation of its obligations.' The Commission was also concerned about ensuring that the provisions of the agreement take precedence over any state statute that legislated trade barriers and that they constrain federal legislation. According to the Commission, the best way to ensure this would be through a formal treaty but this would require ratification by the Senate and thus would render the agreement liable to amendment by that body. Alternatively, the agreement could be enacted by Congress under the fast track procedure. The Commission
delineating acceptable and unacceptable practices, Canada failed to gain exemption from US contingent protection or trade remedies. Instead the agreement established a binational judicial review panel to review domestic decisions regarding contingent protection action.

Factors contributing to Canada's decision to request an FTA with the US

This section will analyse the main factors that led to the Canadian decision to request a free trade agreement with the US. Securing and enhancing Canadian access to foreign

believed that, although this would be less secure legally, it would ensure that the agreement was passed by the US Congress without amendment.

The agreement in fact established two dispute settlement mechanisms: one relating to trade remedies, and the other to all other disputes under the FTA. See Horlick, Oliver and Steger 1988, p.65.

Hart (1989, p.11) identified three components of US contingent protection or trade remedies: the countervailing duty law, the anti-dumping duty law, and the escape clause action. For an account of the evolution of US trade remedies since the 1970s, see Destler 1992, pp.139-72; Hart 1989, pp.11-16. The refusal of the US to exempt Canada from its trade remedy laws and thus assure Canada of secure access to the US market had almost led to the abandonment of the negotiations in September 1987. The talks were saved when both parties accepted a compromise proposal by the Chair of the Trade Subcommittee of the US House Ways and Means Committee, Sam Gibbons. Gibbons had proposed that an agreement on subsidies and trade remedies not be part of the present agreement but be resolved in subsequent negotiations; and that instead a binational dispute settlement mechanism be established. See Doern and Tomlin 1991, pp.178-80. According to Murray Smith (1988b, p.48), only the EC has succeeded in outlawing the use by its members of countervailing duties against fellow members. He attributed the failure of the US and Canada to do likewise to their reluctance to establish supranational bodies similar to those in the EC that would be needed to discipline their use.

According to US Trade Representative Yeutter in testimony before Congress (1988, p.97), the US rejected the trade off between the disciplining of Canadian subsidies and the waiving of US ability to impose countervailing duties and anti-dumping duties on Canadian exports as it felt that Canada was not willing to go far enough. Murray Smith (1988b, pp.45-46) attributes this reluctance on the part of Canada to the concern that even the minimum code acceptable to Congress would raise fears among Canadians about the loss of national sovereignty and therefore jeopardise the whole agreement.

Nevertheless, although Canada failed to gain exemption from US trade remedies, the likelihood of Canadian access to the US market being inadvertently impaired as the result of any future tightening of US trade remedy laws has been diminished. Under the agreement Canada must now be named if changes in US anti-dumping and countervailing duty laws are to apply to it. The agreement also established work programmes to continue negotiations aimed at the adoption within periods of five to seven years of common rules governing subsidies, government procurement practices and trade remedies. See Murray Smith 1988b, p.45; and Yeutter 1988, p.72.

According to Stone (1988, p.99), although the agreement provides for a choice between binding arbitration panels and advisory panels to resolve disputes, the decision of neither of these panels is in fact binding on the two countries.

The significance of the establishment of such panels did not escape Gordon Ritchie (1988, pp.16-17), Canada's Deputy Chief Trade Negotiator during the negotiations. According to Ritchie, this is the first time that 'US law and its interpretation by US authorities will be subject to review by an international, impartial panel.'

The decision by the Mulroney Conservative government to request a free trade agreement with the US sparked considerable controversy within Canada and it was the focus of the 1988 national election. Consequently a considerable amount has been written on the subject. These writings were often understandably highly polemical in nature and largely concerned with the consequences of the agreement for Canada, and in particular the question of whether the agreement was in the best interests of Canada. These works do examine the possible motives of the Canadian government in seeking such an agreement. See for example Doern and Tomlin 1991; McQuaig 1991; Hart 1992. This account draws on the debates in this literature, but takes a somewhat more disinterested stance on the value issues.
markets had been a key objective of Canada's international trade policy since at least the 1930s. What is significant and must be explained here is the dramatic shift from the trade policy of the 1970s and early 1980s that deliberately sought to reduce Canada's dependence on the US market and enhance its access to non-US markets such as the EC and Japan to a policy that strove to secure and enhance access to the US market. The decision by the Canadian government to make Canadian access to the US market the major objective of its foreign trade policy and its endorsement of a Canada-US free trade agreement as the best vehicle to achieve that goal was itself the consequence of various interrelated and mutually reinforcing factors: the desire to restructure the Canadian economy and to enhance the international competitiveness of Canadian firms; the failure of Canada to diversify its exports markets and growing disillusionment with the GATT; and the rise of protectionism in the US. It was also, as has been already noted, seen by the newly elected Conservative government as an extension of its domestic economic strategy aimed at reducing government involvement in the economy, and as a means to ensure that no future government could revert to the economic nationalism of the past. In other words, it was a direct consequence of the adoption of economic rationalism and neo-liberal economics as the new economic orthodoxy by policymakers. Other factors also examined...
in this section are historical factors; party politics and provincial and regional rivalries; and the influence of economic studies and of new ideas concerning economic development and international trade.

*The weight of history in the Canadian decision*

The idea of free trade with US or - as it is often called - continentalism, did not suddenly emerge in the 1980s. It has a long history pre-dating the Canadian Confederation beginning with the signing of a reciprocal free trade treaty with the US in 1854. Indeed, one of the motivations for the establishment of the Canadian Confederation in 1867 had been the need to create a larger market as a result of the loss of preferential access to the British market and the US decision to abrogate the Reciprocity Treaty in 1866. The National Policy of 1879, which used protectionism as a tool to develop an indigenous manufacturing sector and thus reduce Canadian migration to the US, came only after the US had rebuffed Canadian requests for the renewal of the Reciprocity Treaty.

Whereas the Reciprocity Treaty had fallen foul of US protectionism, subsequent attempts at free trade came unstuck as a result of Canadian protectionism and nationalism. The success of the National Policy, in creating a strong sense of Canadian national identity (or at least one strong enough to fear absorption by the US) and a manufacturing base dependent on protection and thus fearful of the effects of free trade, was responsible for a strong anti-free trade constituency. Yet the question of free trade

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26 For a detailed account of that history, see Granatstein 1985.
28 Stairs and Winham 1985, pp.1-2; Stairs 1987, p.3. The National Policy was introduced by the then Conservative Prime Minister John A. Macdonald. There has been some debate between proponents and opponents of the Canada-US FTA over how one should interpret Canada's past trading policies and whether the FTA is in line with or a departure from past policies. In its 1983 Review of Canadian Trade policy External Affairs Canada (1983, pp.212-13) had argued that 'continentalism runs counter to the drift of Canadian history - from the National Policy to the Third Option.' Thus Murray Smith (1988b, p.38) saw the adoption of the National Policy less as an attempt to build a separate Canadian national identity and more as the result of the failure of attempts to negotiate another reciprocity treaty with the US. Stairs (1987, p.3) argued that the National Policy was originally intended by Macdonald to put pressure on the US and force them to reconsider their opposition to free trade with Canada. This view is also shared by Hart (1989, p.2) who claimed that the search for stable and preferred access to the US market has been 'one of the most enduring themes in Canadian trade policy.' Nevertheless, it is clear that the desire to preserve Canada's political independence and distinct cultural identity became the main justification for both the National Policy and Trudeau's third option and one of the principal obstacles to a comprehensive free trade agreement with the US.
29 Murray Smith 1988b, p.38.
30 See Winham 1989, p.40; Stairs 1987, p.3. According to the Royal Commission on Economic Union and Development Prospects for Canada (1985a, p.354), '(m)otives of protection aside, the concerns of Canadians who have traditionally opposed free trade with the United States have been founded on the premise, whether explicit or not, that among the basic determinants of our political, social and cultural habits and values are the prevailing patterns of economic exchange.' This idea is closely related to that of the integration theorists, see Chapter Two, pp.47-53. One irony in all this is that the US and Canadian positions on free trade reversed over time. In 1911 the governing Liberal Party, having successfully negotiated a free trade agreement with the US, was defeated by the Conservatives in an election fought on the issue of free trade and the agreement lapsed. See Stairs 1987, p.3; Hart 1989, p.3. In 1948 concern over the implications of free trade with the United States for Canadian
with the US refused to go away. In 1965 the threat of US protectionist measures against Canadian car exports to the US market led to the signing of the Auto Pact, a free trade agreement limited to the auto sector.\textsuperscript{31} In the early 1970s rising US protectionism again raised the question of Canada's trading relations with the US.\textsuperscript{32} The Trudeau liberal government rejected both the maintenance of the status quo (First Option) and a comprehensive free trade agreement with the US (Second Option). Instead it chose a policy based on reducing market dependence on the US through a combination of market diversification and the consolidation of the internal market (Third Option).\textsuperscript{33}

Since the adoption of what is in fact the Second Option by the Mulroney Conservative government in 1985 can be understood largely as a reaction to and a rejection of the Third Option and the reasoning behind it, some further discussion, necessarily brief, of the Third option is warranted here. The Third Option as it had been envisaged in 1972 by Canada's Secretary of State for External Affairs Mitchell Sharp had an international and a domestic component. The Third Option called for the diversification of Canadian export markets with the aim of reducing Canada's dependence on the US market and hence its acute vulnerability to unilateral changes in US trade policy. Domestically the policy was used to justify greater government involvement in the economy. It called for the development of a balanced and efficient economy by a deliberate comprehensive and long term strategy aimed at recasting economic structures and broadening the spectrum of Canada's export markets. The government would use the policy instruments at its disposal - fiscal policy, monetary policy, tariffs, foreign investment regulations, government procurement, rules of competition, science policy - to foster entrepreneurial activity in general and the development of Canadian multinationals capable of competing in world markets.\textsuperscript{34}

\textsuperscript{31} Paul Wonnacott 1988, pp.103-104. According to Paul Wonnacott, the Auto Pact was sparked by a countervailing duty suit by the US against Canada's duty remission programme.

\textsuperscript{32} This was the result of the failure of Nixon to grant Canada an exemption to the 10% surcharge that the US had put on all imports into the US in 1971.

\textsuperscript{33} The three options as outlined by the then Secretary of State for External Affairs Mitchell Sharp (1972, p.1), were: (1) 'Canada can seek to maintain more less its present relationship with the United States with a minimum of policy adjustments'; (2) 'Canada can move deliberately toward closer economic integration with the US'; (3) 'Canada can pursue a comprehensive long-term strategy to develop and strengthen the Canadian economy and other aspects of its national life and in the process reduce the present Canadian vulnerability.'

\textsuperscript{34} This deliberate fostering of Canadian multinationals is similar to the promotion by some European countries, particularly France, of national champions. See Chapter Five, pp.155-57. Thus competitiveness was seen to be more a function of the size of the enterprise than the size of the market. Key elements in the Canadian strategy were the Foreign Investment Review Agency (FIRA), established in 1973 to vet foreign take-overs of existing businesses and the establishment of new foreign owned businesses, and the National Energy Policy (NEP), introduced in 1980 'to promote increased national participation, ownership and control in the domestic petroleum industry and to ensure a more equitable distribution of wealth arising from energy development.' According to External Affairs Canada (1983, p.43), the
It is also important to understand the factors that led the Liberal government of the time to adopt this Third Option strategy in the 1970s as changes in these factors were also important considerations in the Mulroney Conservative government's decision to abandon it in the early 1980s. The first such factor was the growing perception that the US was now taking a more narrow, short term view of its national interests, particularly in relation to its trade policy, and that support for protectionist policies among business and in Congress was increasing.\(^{35}\) A second factor had been the increasing drift toward continentalism under the existing policies and a heightened awareness of the threats such a drift might pose to Canada's distinct political, social and cultural identity and to its future as an industrial nation.\(^{36}\) There were fears that free trade with the US would lead to the de-industrialisation of Canada and its overspecialisation in the resource sector.\(^{37}\) Such fears were based on contemporary theories of economic development and international trade and concepts such as poles of development and natural comparative advantage.\(^{38}\) A third factor was the growing confidence in the ability of Canada to be more self-reliant in terms of both its economic and cultural development.\(^{39}\) The trading position of Canada, it was argued, had improved, its economy was maturing and it had reduced its dependency on foreign capital inflows to finance its development. Given its relatively high per capita income, its domestic market provided the economies of scale necessary for many less complex and less capital intensive industries to be internationally competitive.\(^{40}\) A fourth factor was the prospect of a new GATT Round beginning in 1973 and of enhanced access to the growing markets in Europe and Asia.\(^{41}\)

As we can see from the arguments outlined above in support of the Third Option, there was considerable opposition within Canada to a free trade agreement with the US. Although there has always been some support for such an agreement with the US, that

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35 Sharp 1972, pp.6, 10. According to Sharp (pp.10-11), this was the result of persistent US balance of payment difficulties and trade deficits, the desire of the US administration to restore the economic strength and vitality of the US, and a strong disposition in Congress and elsewhere to believe that the US had not been tough enough in the past in economic and trade negotiations. Canada had been made particularly aware of its vulnerability with regard to the US by the decision of US President Nixon on August 15 1971 to impose a 10% surcharge on all imports into the US as a means of forcing other countries to agree to changes in international trading and monetary arrangements. See Sharp 1972, p.7. For a definition of the term 'vulnerability', see Chapter Three, p.61, fn.1. This term was employed by some scholars of international relations in the 1970s in an attempt to give an economic dimension to the power relations among states. See Chapter Three, pp.62-63.

36 Sharp 1972, p.11. Sharp stressed the increased awareness of Canadians of the distinctness of Canada and of their willingness to accept a lower standard of living if need be to preserve it. These objections to an FTA with the US were also raised in the 1983 review of Canada's trade policy by External Affairs Canada (pp.210-11).

37 See, for example, Myrdal 1957; and Hirschman 1958. These theories also provided the theoretical underpinnings for Mexico's strategy of import substitution industrialisation and economic nationalism. See Chapter Seven, pp.235-36.

38 Sharp 1972, pp.5-6, 17.

39 Sharp 1972, p.17.

40 Sharp 1972, p.17.

41 Sharp 1972, p.17.
support was never enough to ensure its implementation. The failure of past attempts, if anything, could be said to have made Canadian policymakers more wary about free trade with the US. Any free trade agreement would have to overcome the combined opposition of Canadian manufacturing interests, who feared the loss of a protected domestic market, and of Canadian nationalists, who saw free trade as threatening Canada's distinct political, social and cultural identity. There were also doubts in the minds of Canadian policymakers about the long term political commitment of the US to such an arrangement.

Thus, although the idea of free trade with the US did not originate in the 1980s, it is clear from the preceding discussion that it was given new impetus by the particular circumstances of the early 1980s. It is to these circumstances that we now turn in the rest of this section.

Restructuring the Canadian economy and enhancing international competitiveness

We have already seen that part of the rationale for the Third Option had been the desire to reduce Canada's vulnerability to violent shifts in the world demand for commodities. There was a growing realisation that in the long term Canada could no longer depend on its natural resources to ensure its prosperity, a realisation that was reinforced by the dramatic drop in commodity prices during the 1982 recession and the increased competition Canadian exports faced from third world countries desperate to earn foreign currency to repay their debts. For both the Liberal governments of the 1970s and early 1980s and the Conservative government that followed, the solution was to restructure the economy so as to increase the amount of higher value added and more technologically intensive production. The Canadian reaction to the events of the early 1980s clearly

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42 Winham 1989, p.40. Although the Royal Commission on Economic Union and Development Prospects for Canada (1985a, p.303) endorsed the idea of a free trade agreement with the US, it still emphasised the need to preserve Canadian national autonomy with regard to social, economic and defence policies. However, the Commission (pp.352-53) dismissed the arguments that economic integration would inevitably lead to political integration or at least loss of distinctness, citing in particular the failure of the EC to achieve political integration as an example. It argued that 'Canadians are perfectly capable of mentally separating our trading activities in the North American market-place from other aspects of our national way of life': The Commission (pp.356-57, 365) believed that the free trade agreement would increase Canada's international bargaining position and strengthen national unity by ending the divisive debate over protectionist policies, while the economic gains derived from the agreement would reduce the general level of disaffection within Canadian society.

43 There had been proposals in the 1960s for a Canada-US FTA by economists such as Wonnacott and Wonnacott (1967) and by the Canadian-American Committee (1965). A similar proposal was made in 1978 by the Canadian Senate Standing Committee on Foreign Affairs.

44 According to Wilkinson (1985, pp.165-66) there has been a significant decline in Canada's comparative advantage in resource-based products as a result of the discovery of new deposits in other countries, of technological advances that have improved the competitiveness of other suppliers, and of the substitution of some resources by others. This point was also emphasised in the new Conservative government's 1985 green paper on foreign policy, Competitiveness and Security: Directions for Canada's International Relations (External Affairs Canada, p.19). In the paper the government declared that, because of the global oversupply of many raw materials, 'our "traditional" comparative advantage in natural resources can no longer be counted on to ensure our prosperity to the extent it once could be' and that Canada was becoming increasingly more reliant on manufactured exports.

45 The growing support of officials in External for Free Trade did not represent so much a break in Canada's economic strategy as a change in the means adopted to achieve it. In the late
parallels that of EC member states at the same time (see Chapter Five, pp.142-46) and, as we shall see, the reaction is repeated at the same time among the countries that were to form APEC.

While the Liberal governments of the 1970s and the Mulroney Conservative government shared the view that to be successful these new industries must be internationally competitive, the Liberals believed that the economies of scale afforded by the Canadian domestic market were adequate for many industries to become internationally efficient. By the early 1980s, however, there was growing concern that the earlier Liberal strategy was not working. The Liberal government adopted a more favourable attitude to closer economic relations with the US and undertook to negotiate sectoral free trade agreements with the US. At the same time economic considerations,
and in particular the need to enhance the international competitiveness of Canadian firms, were becoming more important than political considerations in the determination of Canada's trade policy.\(^49\) Canadian industrialists were also becoming more aware of the importance of greater economies of scale and increased specialisation to maintaining and enhancing their international competitiveness.\(^50\) They believed that for most industries the Canadian market was too small to provide the necessary economies of scale and that what was required was free and secure access to the much larger American market.\(^51\)

Thus even before the election of Mulroney in 1984 Canada was already shifting its trade policy strategy away from a multilateral focus aimed at diversifying its export markets to a bilateral focus aimed at securing and enhancing its access to the US market.\(^52\) Exploratory talks on sectoral free trade were begun in 1984.\(^53\) But such negotiations were fraught with inherent difficulties.\(^54\) Given these difficulties, the US sectoral free trade agreements with the US covering defence production and the auto industry. See above this chapter, p.190, fn.31. According to the report, sectoral agreements would not only further the rationalisation of production and enhance the efficiency of national industrial structures, they would also provide a solution to the problem facing both Canada and the US of how to meet the competition from third countries and to slow down the exodus of production facilities from North America.'

\(^49\) According to External Affairs Canada (1983, p.201), the decision of Trudeau in 1982 to transfer responsibility for trade to the Department of External Affairs indicated that the government's first foreign policy objective was the pursuit of growth through trade.

\(^50\) Finlayson 1985, p.31. A similar realisation was also occurring in Australia in the 1980s and was to play an important part in the push for trade liberalisation in that country. See Chapter 8, pp.297-99.

\(^51\) According to Doern and Tomlin (1991, p.49), by 1982 the Canadian Manufacturers' Association had become convinced of the need to become more competitive through preferred access to the US market. There is an obvious link here between increasing Canada's competitiveness and reinforcing its preferential access to the US market. The Royal Commission (1985a, p.326) argued that an FTA, by establishing preferences for Canadian goods in the US market, would further promote Canada's relative advantage over third countries. This had already been evident in the case put by External Affairs in 1983 (pp.206-207) in support of sectoral free trade with the US. External Affairs had expressed concern at the erosion of Canadian preferential access to the US market in automotive products, through the increasing resort by US producers to third country sourcing, and defence equipment components, through the extension by the US of the longstanding arrangements for production sharing that it had with Canada to other allies. Hart (1989, p.28) warned of the danger that Canadian business might come to see the FTA as a preferential rather than a free trade agreement and thus be unwilling to share the privileged access that it has gained to the US market with others.

\(^52\) Tomlin and Molot 1985, p.11. The continuity of Canada's foreign policy despite the change of government in 1984 is also stressed by Molot and Tomlin (1986, p.3). Kirton (1985, p.16) maintained that Canada's decision to seek a bilateral free trade agreement with the US did not in fact represent a break with the past but was the logical consequence of the decision of Trudeau in 1968 that henceforth the aim of Canada's foreign policy should be to further national interests rather than international ones.

\(^53\) Michael Smith 1984, p.17.

\(^54\) These difficulties were outlined by the Royal Commission On Economic Union and Development Prospects for Canada (1985a, pp.304-05). First, such agreements contravene Article XXIV of GATT. Under this article only free trade agreements which liberalise substantially all trade between participating countries are permitted. Any agreement that does not fulfil this requirement would require two-thirds of GATT signatories to approve the granting of a waiver and the Commission doubted that such a waiver could be obtained for any new sectoral arrangements between the US and Canada in the difficult circumstances of the mid-1980s. The US would be particularly reluctant to be seen to be violating the fundamental principles the GATT at a time when it was trying to get a new round of multilateral talks off the ground. Second, it would be difficult to justify a situation in which some sectors enjoyed exemption from US contingent protection but not others. Third,
preference for comprehensive free trade and the lack of interest shown by US business in the sectoral proposal, little progress was made.\textsuperscript{55}

The new Conservative government was also concerned by Canada's declining international competitiveness.\textsuperscript{56} This was made evident by Mulroney at the March 1985 summit with US President Reagan. Both leaders argued that it was necessary to establish a climate of greater predictability and confidence in US-Canadian relations so that Canadians and Americans could 'plan, invest, grow, and compete more effectively with one

sectoral approach would limit the ability of the negotiators to make the trade-offs necessary to ensure broad political support for the final result.

For a summary of the arguments for and against both sectoral free trade agreements and a comprehensive bilateral free trade agreement between the US and Canada, see Wilkinson 1985, pp.170-83. For the position of the US administration, see the article by Deputy US Trade Representative Michael Smith 1984.

Doern and Tomlin 1991, p.22. According to an official from External Affairs Canada, Michael Hart (1990, p.6), 'the initiative was dead in the water by the summer of 1984.' Hufbauer and Samet (1985, pp.198-99) argued that the main motivation of the Office of the United States Trade Representative in a sectoral agreement with Canada was the desire to increase the pressure on both Europe and Japan to agree to a new round of multilateral trade negotiations.

In his economic statement, \textit{A New Direction for Canada: An Agenda for Economic Renewal}, issued in November 1984 not long after the election of the Mulroney government in September 1984, the new Finance Minister, Michael Wilson, had already signaled that the matter of trade relations with the US would be a major, if not the major preoccupation of the new government and would play a key role in the government's strategy for achieving economic renewal. (See Doern and Tomlin 1991, p.23; Tomlin and Molot 1985, p.12, Hart 1990a, p.7). The matter was also the subject of a discussion paper released in January 1985 by Canada's Minister for Trade, James Kelleher, entitled \textit{How to Secure and Enhance Access to Export Markets}. (Leyton-Brown 1986, pp.181-82). The discussion paper identified four options to secure and enhance Canadian access to the US market: the status quo; sectoral arrangements; a comprehensive bilateral trade agreement (bilateral free trade); and a bilateral framework agreement to lay down guide lines for the improvement and expansion of bilateral trade relations and to establish an institutional framework for the settlement of trade disputes. According to Leyton-Brown, the report appeared to favour a bilateral free trade agreement.

A government green paper, \textit{Competitiveness and Security}, published in May 1985 by External Affairs Canada, confirmed that the new government's first priority was to maintain and enhance Canada's international competitiveness. The paper (p.31) listed Canada's vital objectives as security of export market access and enhancement of international competitiveness. It (p.18) argued that because of its dependence on trade Canada could only be economically secure if it was internationally competitive. It (p.24) went on to argue that a less internationally competitive economy would reduce Canada's political influence in the world by curtailing its ability to provide military and economic assistance to other countries. The paper (pp.19-20) pointed to the growing importance of manufactures as a percentage of total Canadian exports between 1970 and 1982 but expressed concern at the decline in Canada's share of manufactured exports to other market economies. It saw this as evidence of the decline of international competitiveness, a decline which it attributed to lower productivity growth and lower expenditure on R\&D and fewer R\&D scientists and engineers as a percentage of total population compared to other OECD economies. The paper (pp.31-32) maintained that one way to enhance Canada's international competitiveness was by securing and enhancing trade with the US. It found that, of the four options outlined in the Kelleher discussion paper, that of a comprehensive trade agreement was more likely to secure and enhance Canadian access to the US market. For a detailed discussion of the contents of the green paper, see Molot and Tomlin 1986, pp.11-18. In response to the External Affairs green paper a Special Joint Committee of the Senate and House of Commons was established to examine Canada's international relations. (Leyton-Brown 1986, pp.182-83). In its interim report released in August 1985, the Committee recommended that Canada begin immediate trade discussions with the US on resolving problems in the bilateral relationship but argued nevertheless that it was too early to negotiate a comprehensive bilateral free trade agreement.
another and in the global market. With the aim of securing and facilitating bilateral trade and investment flows they committed their governments to reducing and eliminating the barriers to bilateral trade and instructed their respective trade ministers to report within six months on ways to do this.

In its report the Macdonald Commission also stressed the need for Canada to move away from its dependence on resources, to improve the competitiveness of its manufacturing and service industries and to shift to higher valued added production. According to the Commission the best way of ensuring the competitiveness of Canadian industry was to expose it to competition from the US and the best way to do this was to enter into a comprehensive free trade agreement with the US.


58 Royal Commission On Economic Union and Development Prospects for Canada 1985b, p.3. The Commission argued that Canadian industry would have to increase its productivity if it was to meet the challenge from Japan and the NIES. See Morici 1991a, p.38; Doern and Tomlin 1991, p.290. But it considered the Canadian market to be too small for Canadian industry to achieve the economies of scale that would stimulate greater productivity and efficiency. See Royal Commission On Economic Union and Development Prospects for Canada 1985a, p.269. In a study commissioned by the Macdonald Royal Commission, Baldwin and Gorecki (1985) demonstrated that productivity was lower in Canada than in the US because of the smaller economies of scale available to Canadian producers. The Commission also drew on the arguments of Markussen (1985), Harris (1985) and Ronald Wonnacott (1985) concerning the importance of larger markets for increasing competitiveness. The Commission (1985a, p.375) also argued that the domestic market was no longer sufficient to ensure economic growth. According to Hill and Whalley (1985, p.44), it is for this reason that bilateral liberalisation which increases Canada's access to other markets is to be preferred to unilateral liberalisation which does not. It also found that in view of the difficulties in getting the Uruguay Round going, GATT, which Canada had traditionally relied on to secure and enhance its export markets, would not be the best avenue to increase Canada's economic competitiveness. See Royal Commission On Economic Union and Development Prospects for Canada 1985b, pp.9-10. The Macdonald Commission stressed both the unlikelihood of a speedy conclusion to the future Round of GATT negotiations and the inability of Canada to influence either the agenda or the results of such negotiations. The option of pursuing freer trade through multilateral negotiations is discussed in detail in Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.279-96. The growing disillusionment in Canada with the GATT is discussed below.

The Commission (1985a, pp.270-73) also rejected two other options: a return to the National Policy, and the status quo. It argued that a return to National Policy even if combined with some sort of industrial targeting would not provide a lasting solution to Canada's problems as it sought to protect Canada from the very exposure to foreign competition that the Commission believed was essential to increasing competitiveness, and assumed the ability to pick winners. In fact the Commission (1985a, p.60), reflecting the general trend at the time away from state intervention, saw free trade as the main instrument of industrial policy. The Commission also dismissed the option of maintaining the status quo, arguing that this would result in an incremental drift toward protectionism and managed trade under the pretext of fair trade and could lead very quickly to 'calls for a planned economy.'

59 Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.60, 325, 375. The Commission (p.325) drew a parallel between its findings and those of the 1961 Royal Commission on the Automotive Industry with the Canada. The 1961 Commission had concluded that the chronic underproductivity of the automotive industry was largely attributable to low-volume production. According to the Commission, the findings of the 1961 Commission provided the theoretical basis for the 1965 Auto Pact, which introduced free trade between the US and Canada in the automotive sector. This resulted in the rationalisation of the industry, longer production runs, increased specialisation and a significant increase in investment in Canada by US multinationals. As a result Canadian auto exports increased twelve-fold between 1965 and 1981. According to the Commission, a comprehensive free trade agreement would have a similar positive effect on the rest of Canada's manufacturing industries.
The failure of Canada to diversify its exports markets and growing disillusionment with the GATT

At the same time that questions were being asked about one of the underlying assumptions of the Third Option strategy - the ability of the Canadian market to give Canadian industry the economies of scale it needed to become internationally competitive, doubts were also being expressed about another key assumption, namely that Canada could decrease its dependence on the US market and hence its vulnerability to growing US protectionism by increasing its exports to markets other than the US. By 1983 it was clear that Canada had failed to achieve significant increases in its exports to other markets. By 1985 it was also apparent that the strategy of reducing Canadian dependence on the US market had failed. The US share of Canadian exports had grown from 64% in 1971 to over 76% in 1984.

External Affairs Canada attributed both the failure of Canada to reduce its dependence on the US and more importantly to increase the elaborately transformed manufactures component of its exports to the restrictive trade practices of the EC and Japan. It found that both restricted imports of Canadian manufactures and processed materials while facilitating imports of unprocessed materials. It also saw little prospect for any change in this situation.

It was thus becoming increasingly apparent that if Canada was to increase its international competitiveness in manufactures through enhanced access to a larger market, that market would have to be the US. Indeed the 1985 Macdonald Commission argued that it was only by first consolidating ties with US that Canada could achieve greater

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60 According to External Affairs Canada (1983, pp.214, 218), Canadian exports to the UK had declined from 9% of total Canadian exports in 1968 to less than 5% in 1981 while over the same period Canadian exports to the EC had increased only slightly from 7% to 8%. Canadian exports to Japan had increased from just under 5% in 1968 to 7% in 1973, only to fall to just over 5% in 1981. Exports to the NICs had remained at just under 3%, while those to the OPEC countries had risen sharply from under 1% in 1968 to about 3% in 1975 but had not risen any further. According to the Macdonald Commission (1985a, pp.249-50) the 1976 Framework Agreement with EC, a key element of the Third Option strategy, had failed to increase Canadian access to the EC.

61 Canadian exports to the US had previously tended to fluctuate depending on the economic cycle. They accounted for over 70% of total exports in 1969, 64% in 1971, 70% in 1978, and 63% in 1980. The US in 1981 took 66% of Canadian exports and supplied 69% of Canadian imports, while Canada took only 17% of US exports and supplied 18% of its imports. In 1984 the US took over 76% of Canadian exports and provided 72% of its imports while Canada accounted for only 19% of US trade. See External Affairs Canada 1983, p.203-204; 1985, p.31.

62 External Affairs Canada 1983, pp.214-16, 219-221. Hart (1990a, p.4), an official in the Department of External Affairs and a member of the team that prepared and negotiated the free trade agreement with the US, attributed the failure of the Third Option to the more inward-looking nature of Japanese and European markets compared to the US market. According to Hart (1989, p.6), the EC and Japan practised a discriminatory tariff system that encourages resources imports and discouraged manufacturing imports.

63 The EC, it argued, gave priority to resolving its own internal problems and and to its trading relations with the rest of Europe and the Mediterranean Basin. With the impending accession of Spain and Portugal to the EC, Canada would find it difficult just maintaining its existing access rights. Given Japan's leadership in innovative and competitive manufacturing, External Affairs Canada also saw little opportunity for Canada to increase the proportion of manufacturing goods in its exports to that country.
market diversification - the goal of the Third Option - since by becoming more competitive in North America Canada would become more competitive world-wide.64

The failure of Canada to increase its exports of manufacturing goods to the EC and Japan was seen as symptomatic of the changes taking place in world trading arrangements.65 The 1983 External Affairs discussion paper noted the development and enlargement of regional trading blocs, a development that had resulted in the undermining of the existing multilateral trading system and of the principle of MFN and led to its replacement by trilateral order based on the EC, the US and Japan.66 The paper expressed concern at the increasing proportion of world trade that was taking place within these regional blocs and at the fact that Canada did not belong to one.67

The failure of Canada to diversify its market access had also cast doubts on the utility of GATT.68 There was a growing debate within the Department of External Affairs and among scholars over whether bilateralism or multilateralism was the most appropriate means for Canada to realise its key objectives of security of export market access and enhancement of international competitiveness.69 The Macdonald Report with its

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64 Royal Commission On Economic Union and Development Prospects for Canada 1985a, p.71.
66 External Affairs 1983, pp.197-98. According to the paper, less than 50% of world trade was now being conducted on a MFN basis. There are some interesting parallels between the analysis of Canada's position in the international trading system here and that of Australia's position by the Australian Department of Foreign Affairs. See below Chapter 8, pp.288-92, 295-99.
67 This point was also taken up by the Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.245, 324. The Commission expressed its concern at the growing trend towards regionalism and the fact that Canada - together with Australia and New Zealand - was one of the few major industrial countries that did not have unrestricted access to a market of over 100 million. It argued that this doubly disadvantaged Canada. First it placed Canada with its smaller domestic market at competitive disadvantage vis-à-vis Japan, the US and the EC. Second, because international trade negotiations were increasingly concerned with access to these larger markets, they tended to be trilateral in nature, thereby reducing Canada's ability to influence the final outcome.

This concern about the growing regionalisation of world trade was shared by some sections of Canadian business and Finlayson (1985, p.31), who was Director of Research for the Business Council on National Issues at the time, identified the rise of regional trading blocs as one of the factors that led business to advocate a FTA with the US. According to Finlayson, the other factors were the increased dependence of Canadian industry on the US market; rising US protectionism; the need for greater economies of scale and increased specialisation to increase international competitiveness.

68 According to Sharp (1972, p.17), the chances of success of the Third Option would be enhanced by 'a basically multilateral environment, in which trade is governed by the most-favoured-nation principle' and by the prospect of a new round of multilateral trade negotiations in 1973. However, according to Hart (1989, p.6), the Tokyo Round saw Canada obtain 'only meagre gains in improved access to Japan and the EC.'

69 Winham 1988, p.49; Hart 1990b, p.45; Curtis 1985a, p.182. There was also disagreement over whether the norm of Canadian trade policy since confederation had been multilateralism or bilateralism. See Winham 1988, pp.47-52; Hart 1990a, p.5; 1989, pp.6-9; Doern and Tomlin 1991, p.46. Much of the debate centred on whether bilateralism and multilateralism were mutually incompatible and whether Canada's decision to seek a comprehensive free trade agreement with the US would further undermine the multilateral trading system. Thus Winham (1988, p.51) and others argued that Canada's embrace of bilateralism did not mean that it had abandoned GATT principles, it was just that Canada's trade was bilateral not multilateral and hence required a bilateral approach. Hart (1990a, p.6), an official in External Affairs, argued that Canadian and US awareness of the limitations of GATT in the past had led to bilateral agreements such as the Auto Pact and the defence production sharing
recommendation that Canada seek a free trade agreement with the US saw the victory of the bilateralists over the multilateralists.70

The bilateralists presented three kinds of arguments in support of their claim that GATT was no longer the only or even the most appropriate vehicle for trade liberalisation. One set stressed more general problems with GATT. Another emphasised the problem posed by the distinctly bilateral nature of Canada's trade. A final argument addressed problems that Canada shared with other middle and small economic powers in view of the tripolarisation of the multilateral trading system.

The general problems with the GATT have been alluded to earlier and include the negative impact that the large increase in GATT membership and the increasingly divergent views of its members as to the nature and purpose of GATT were having on both the pace and outcome of the negotiations to liberalise trade, the proliferation of non-tariff barriers, and an increasing tendency among GATT members to settle disagreements bilaterally, outside of GATT and to disregard GATT panel recommendations.71 The bilateralists also argued that as a result of the increasingly tripolar nature of multilateral trade negotiations, the GATT was not the best place for small and middle economic powers such as Canada to liberalise trade. In a system where deals are struck first between the major suppliers, that is, the US, Japan and the EC, the bargaining power of Canada and other medium and small economic powers was considerably reduced.72 The US, it was argued, was unlikely to make specific concessions to Canada because under MFN it would also have to grant those concessions to the EC and Japan without necessarily

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70 Winham 1988, p.49; Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.31-32; 294-96. The Royal Commission argued that GATT 'should no longer be seen as an exclusive and sufficient forum for trade liberalisation' and that 'it would be naive for Canada to put all its eggs in the multilateral basket.' The Commission characterised the international economic order as one in which the relative influence of states is determined by their economic strength and where states are constantly striving to increase their competitive advantage by means of domestic policy, changes in the rules governing international trade, the formation of FTAs and the use of NTBs. It (p.32) argued that Canada should pursue its own interests through unilateral and bilateral as well as multilateral initiatives. The report cited the UK as an example of where failure to maintain competitiveness had seen a reduction in living standards relative to other EC members. Yet the Royal Commission (1985a, p.303) also stressed that the FTA should be pursued in parallel to, and not in place of, multilateral liberalisation. The FTA, it argued, should not undermine GATT and must conform to Article XXIV of GATT. See also the Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.31-32.

71 For a more detailed discussion of the general problems of GATT, see above Chapter Three (pp.83-94) and the Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.273--96; and Hart 1989, pp.6-9. The Commission (p.284) noted the change in the US attitude to GATT, in particular its growing reluctance to sacrifice its economic interests to political and security interests, and its perception of itself as a free trader and a victim of the unfair practices of others. The Commission (p.286) also argued that the EC was not interested in strengthening GATT and that it perceived the US proposal for a new round as a threat to own internal policies.

72 Royal Commission 1985a, p.294; Winham 1988, p.50. According to the Royal Commission (1985a, p.283), the GATT favours the more powerful members which can afford to take action that may adversely affect a smaller country, secure in the knowledge that retaliation is unlikely.' It cited as an example of this the decision by Canada not to insist on its rights in terms of the access of its goods to the EC market for fear of repercussions in other areas.
receiving anything in return from these two entities. With Canada accounting for only 20% of US trade from the US point of view the gains of gaining greater access to the Canadian market would not offset the costs. A bilateral free trade agreement would resolve this problem.

The obverse of this situation was also a problem. Canada was also wary of making concessions to the US in order to improve its access to its largest export market because it knew that under MFN these concessions would have to be extended to other countries without these countries giving anything in return. However, since the US market accounted for over 70% of Canadian exports, it had little choice but to do so. As a result its ability to force the EC and Japan to increase Canadian access to their markets was considerably reduced.

Another argument was more concerned with the failure of the GATT to provide the necessary incentives for middle and small economic powers such as Canada to reduce their barriers to foreign competition. Both Hart and Winham have maintained that in negotiations in which the trade-offs are between the main players, under MFN smaller players such as Canada can benefit from the concessions that the larger players make to each other without having to make concessions themselves. From a mercantilist perspective such countries would be seen to have made gains at the the expense of the larger players, but according to these scholars, in reality they have lost since by maintaining their protectionist barriers, they are allowing their firms to remain inefficient and uncompetitive internationally. This argument reflected a view that was gaining currency in the early 1980s that the best way to increase the productivity, efficiency and

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73 The Royal Commission (p.294) argued that, even if the new round of multilateral negotiations were to be successfully completed, there was no guarantee that Canada would obtain a better and more secure access to the US market. It cited the example of the Tokyo Round, where the US was unwilling to accept the Canadian offer to liberalise its market for petrochemicals if the US did likewise because the US did not want to have to open its market to Japan and the EC. According to the Royal Commission (1985a, p.274), since the US market was already more open than that of Japan and the EC, it was unlikely to want to open it further without reciprocation from Japan and the EC.

74 Hart 1989, p.22.

75 However, following the establishment of CUSFTA it was expected that this would change and in 1989 Hart (1989, p.9), an External Affairs official, declared that with Canadian-US trade issues now dealt with by the FTA, the EC and Japan 'for the first time will have to pay in real coin for any improvements in access to the Canadian market.' A similar argument is made by Murray Smith (1988a, p.92). As a result of Canada's difficulties in increasing its exports to the EC and Japan, there was a growing identification on the part of External Affairs with the US position concerning fair trade and reciprocity, particularly in relation to Japan. This was already evident in 1983 (External Affairs Canada, pp.218-22) when in a discussion paper Japan was described as a relatively closed economy where free trade is inhibited not by tariffs but by the way business is organised, by consumer preferences, and by the close collaboration between business, labour and government. According to the Royal Commission On Economic Union and Development Prospects for Canada (1985a, p.253-54), 'US concerns are not dissimilar to those of Canada'. However, both the Commission and External Affairs expressed concern that Japan may be forced to accommodate the US (and the EC) in ways detrimental to Canada. These fears were not dissimilar to those of Australia. See below Chapter Eight, pp.288-92.

international competitiveness of domestic firms was to expose them to foreign competition.\textsuperscript{77}

The rise of protectionism in the US

Another significant contributing factor to the decision by the Mulroney government to seek a FTA with the US was the growing concern among political leaders and government officials and within the business community about rising US protectionism.\textsuperscript{78} At the same time that awareness was growing of need for enhanced access to the US market, existing access was once again being threatened in the early 1980s by the increasing resort of the US Congress to contingent protection.\textsuperscript{79} Underlying this upsurge in protectionism was an even more alarming tendency on the part of Congress to employ in its assessment of its trading relations with other countries a much narrower definition of the concept of reciprocity than that generally accepted internationally and one which could have serious implications for the principle of MFN.\textsuperscript{80} The asymmetrical nature of the US-Canada trading relationship limited Canada’s ability to constrain US protectionism through tit for tat retaliation. The lack of US concern about the effects of protectionist measures on

\textsuperscript{77} It is also similar to the argument of Olson concerning the protectionist role of stable coalitions of interest groups in the declining economic growth of certain countries. See Chapter Two, p.41.

\textsuperscript{78} The Trudeau government had also expressed concern at the rising protectionist tide in the US but, as we have already seen, had sought between 1983 and 1984 to secure access to the US market through the negotiation of sectoral free trade agreements rather than a comprehensive free trade agreement. See above this chapter, pp.193-95.

\textsuperscript{79} Winham 1988, pp.45-46; Murray Smith 1988a, pp.100-101; Tomlin and Molot 1985, p.9; Clarkson 1985, pp.150-54. According to a document of the US International Trade Commission (House, US Congress 1986, pp.14-16), between 1980 and 1986 there were some 21 escape clause actions, 16 unfair practices in import trade, 13 countervailing duty and 17 anti-dumping investigations involving Canada before the US International Trade Commission. Some of these actions were principally aimed at other trading partners, but because duties were applied across the board, they also hurt Canadian exporters (a phenomenon known as ‘side-swiping’). Others such as those concerning softwood lumber were aimed principally at Canada. In December 1982 Congress had threatened to pass a bill that would abrogate the 1965 Auto Pact and restrict Canadian exports to the US market, thereby threatening the very existence of the Canadian auto industry. The Royal Commission (1985a, pp.302-303) saw the growing insecurity regarding Canadian access to the US market as due to fragmented decision-making power in the US regarding trade policy and to the different legal mechanisms that facilitate the access of US producers to contingent protection. Hart (1989, p.13) identified three ways in which US has become more protectionist: through increased product-specific legislation or administrative action; through the greater resort by industry to trade remedy law and through the greater willingness on the part of the US Administration to interpret this law in a way that favours protectionism; through the extension of government procurement restrictions by Congress. According to Hart (1989, p.22) the FTA ‘institutionalises for Canada the liberal, outward looking trade policy that reigned in the United States until the early 1970s’ and ‘restores security and predictability of Canadian access to the US market ... by creating a formidable institutional and statutory shield against either legislated or administrative US protectionism.’ For an account of the specific circumstances that produced the growing protectionist sentiment in the US, see Destler 1992; Hart 1989, pp.9-16; and Murray Smith 1988a, pp.70-79.

\textsuperscript{80} External Affairs Canada 1983, pp.208-09; Hill and Whalley 1985, pp.49-50. According to the Royal Commission (1985a, p.324), there had been a change in thinking in the US regarding the aggressive use of trade policy instruments to gain more reciprocal access to markets.
Canada meant that Canada was often the innocent victim of measures aimed at the EC or Japan, a phenomenon known as 'side-swiping'.

Many scholars have seen the change of attitude on the part of business to the proposal for free trade with the US as having contributed to a similar change of attitude by the ruling Conservative Party, a party which had been traditionally opposed to free trade with the US. By 1984 the two most important business organisations, the Business Council on National Issues (the BCNI) and the Canadian Manufacturers' Association (the CMA) had endorsed the idea of a comprehensive free trade agreement with the US. According to US Deputy Secretary of Energy, William Martin (1989, p.35), Mulroney had expressed concern during his March 1985 Summit with Reagan at calls in Congress for a 10% surcharge on all US imports. The proposal was aimed principally at imports from Japan and Korea but would have hurt Canada the most. The 1985 External Affairs discussion paper Competitiveness and Security (p.30) argued that, given Canada's dependence on the US market for its exports and the rising tide of protectionism in the US, it was imperative to secure and enhance Canada's access to the US market. While many downplayed this rise in US protectionism, seeing it as the result of temporary factors such as the 1982 recession, the worsening US trade deficit and the more aggressive style of the Reagan presidency, for others it represented a longer term trend in US trade policy. According to the 1983 External Affairs review of Canada's foreign policy (p.207), the protectionist upsurge reflected the loss by the US of its economic preeminence and the growing importance of exports as a source of domestic growth in the US. These factors, it maintained, would 'inform American trade policymaking towards Canada throughout the decade and beyond, regardless of the Administration in office.' Hart (1989, p.9), an External Affairs official at the time, argued that far from being a temporary aberration from the established US pattern of trade liberalisation since the 1930s, taken from a longer historical perspective the aberration of protectionism might in fact be the norm - a return to the much longer term US tradition of protection that dates back to the late 18th century - and the established pattern of trade liberalisation an aberration. Hart (1989, pp.9-10) attributed the liberal aberration of the post WWII period to two factors: the loss of protectionist policy credibility due to the 1930 Smoot-Hawley Tariff Act and the subsequent cession by Congress to the President of authority for the trade policy; and the dominant position of the US at end of WWII. There were also fears that US contingent protection would increase if the US was to experience another downturn similar to that of 1981. See Hill and Whalley 1985, pp.49-50; Winham 1988, p.52.

Finlayson 1985, p.31; Doern and Tomlin 1991, p.46. Even Mulroney had made clear his opposition to free trade with the US during his 1983 campaign to become leader of Conservative Party. See Hart 1990a, p.39. According to Kirton (1985, p.22), Mulroney's own experience outside politics, as the manager of a Canadian subsidiary of a US multinational that exported ore to the US, had made him aware of the importance of trade relations with the US. In an economic statement issued not long after the election of the new Conservative government, the new Finance Minister Michael Wilson mentioned the need for his government to consider the various private sector proposals for bilateral free trade. Kelleher, the new Minister for International Trade, also undertook extensive consultations throughout Canada to gauge public attitudes towards bilateral free trade. See Hart 1990a, p.7. According to Doern and Tomlin (1991, pp.54-55), the shift in business attitudes towards an FTA was also an important factor in the decision by the head of the Royal Commission on the Economic Union and Development Prospects for Canada, Donald Macdonald, to endorse the FTA option. Macdonald, a former Liberal cabinet minister, who had previously supported the Third Option, had been influenced in his decision by the testimonies of businesses from across Canada that they could compete with US firms without the protection of tariffs.

Doern and Tomlin 1991, pp.46-50; McAuiga 1991, p.126. Although rising protectionism in the US was an important factor motivating this change in attitude on the part of business, it was not the only factor. Finlayson (1985) lists four factors: increasing dependence on the US market; rising US protectionism; the rise of regional trading blocks; and the need for the larger economies of scale that secure access to a larger market would provide. Doern and Tomlin (1991, p.47) give three: opposition to the Liberal Party's interventionist policies; the 1982 recession; and fear of increased US protectionism. According to Murray Smith (1988b, p.43), manufacturers in Ontario and Quebec had been forced to become more internationally competitive by the cuts in tariffs from successive GATT Rounds. The number of Canadian manufacturers exporting to the US market had increased dramatically and their confidence about their ability to compete had also risen. According to Doern and Tomlin (1991, p.49), the percentage of CMA members exporting to the US had increased from 15% to 40%. They
Yet External Affairs officials and the government were not just concerned by the immediate effects that protection would have on Canadian exports to the US market. They were also worried about the longer term effects the threat of US protectionism would have on their plans to restructure the economy and increase the international competitiveness of Canadian industry. These plans could only be realised if foreign companies and financial institutions were willing to invest in new production, technology and human resources in Canada. Given the small size of the Canadian market and its inability to provide the necessary economies of scale for many industries, that investment would not be forthcoming if there was uncertainty about Canadian access to the US market. A comprehensive FTA with the US would eliminate that uncertainty. Investors would be more willing to invest in Canada and less inclined to invest in the US instead.

The rise of economic rationalism / neo-conservatism

According to Hart, an External Affairs official and member of the Canadian team that negotiated the FTA, the most important, though least publicised, motive for the agreement 'was to effect domestic economic reform by eliminating, at least for trade with the United States, the last vestiges of the National Policy and constrain the more subtle new instruments of protection.' The FTA was thus a consequence of the Conservative government's domestic economic programme of privatisation and deregulation, and was seen by the government as a means of hastening the implementation of that programme.

As we have seen earlier in the case of the EC and more widely, the early 1980s had seen the return to vogue of economic liberalism, particularly in the US under Reagan and Great Britain under Margaret Thatcher. This economic doctrine, also known as neo-conservatism, was heavily influenced in North America by the ideas of Friedman and the...
Chicago School and monetarism.\textsuperscript{90} The problems of low growth and high inflation or stagflation were seen as the result of excessive government intervention in the economy. The theory emphasised the need to free up market forces, arguing that the market was the best judge of where scarce resources should be allocated. As such it called for privatisation and deregulation.\textsuperscript{91}

The new Conservative Prime Minister, Mulroney, and his finance Minister Wilson were staunch supporters of economic rationalism and deregulation.\textsuperscript{92} Their conviction that the government role in the economy had to be reduced was also partly a reaction to the economic nationalism of the previous Liberal governments.\textsuperscript{93} For the Conservatives free trade was a logical consequence of deregulation.\textsuperscript{94} Indeed for many in the government, the bureaucracy and in the business community the most important reason for supporting the FTA with the US was that it would lock in the reforms and prevent a future government

\textsuperscript{90} For the link between the rise of economic rationalism and regionalism, see Chapter Two, p.42.

\textsuperscript{91} The influence that this new economic doctrine had on economic thinking in Canada generally can be seen in the report of the Macdonald Royal Commission (1985a, pp.60-66). The report was critical of the general shift of power away from markets to governments that had occurred in the industrialised countries since the depression. It rejected the overdependence of citizens and private economic actors on the state and called for a significant change in direction. The role of governments, the Commission argued, was 'not to retard competitive market forces, but to complement them by positive adjustment measures.' It recommended decreased state intervention and increased reliance on market forces and saw a free trade agreement with the US as the best way to do this. The Commission (1985a, pp.60, p.269) declared free trade to be the main instrument of its industrial policy. It rejected the previous strategy of deliberate government action to strengthen and establish an industrial base in Canada and instead advocated 'allowing greater play to free-market forces in determining the direction of our economic development.'

\textsuperscript{92} According to Hart (1991, p.2), 'the philosophical orientation of the federal government since 1984 has been to reduce the role of government in the economy.' Mulroney's support for more market-oriented economic policies was apparent at his March 1985 summit with Reagan in Quebec City, when the two leaders declared that 'an improved and more secure climate for bilateral trade relations will encourage market forces to achieve a more rational and competitive production of goods and services.' They also called for the preparation of a report within 6 months by their respective trade ministers on how this could be achieved. See Department of State Bulletin 1985, p.8; Hart 1990a, p.8.

\textsuperscript{93} One of their first steps on coming to government was to change the FIRA to Investment Canada and make its principal task that of attracting foreign investment to Canada. See Tomlin and Molot 1985, p.12; Schott and Murray Smith 1988, p.147; Doern and Tomlin 1991, p.31. This was followed in March 1985 by the dismantling of the NEP as a result of the substantial deregulation of the oil and gas industry under the Western Accord. Economic nationalism in the energy field had been a response to the oil crisis of 1979. According to Doern and Tomlin 1991, p.17, the New Energy Policy had been established by the Liberal government in 1980 to ensure the supply of low cost oil to Central Canada. However, oil and other raw material producers in Western Canada saw the NEP as a constraint on their growth, and the Prairie provinces as an infringement of their right to control their natural resources and a diversion of money to Canada's inefficient manufacturing base in the central provinces of Ontario and Quebec. Hence their support of the Conservative government's policy of deregulation and its logical extension - free trade, both of which, they believed, would reduce government intervention in the market. See below this chapter, pp.205-06.

\textsuperscript{94} The Conservative government may also have seen the FTA as a means by which it could force the provinces to deregulate in areas which, under the division of powers in the Canadian federal system, were outside the jurisdiction of the federal government. The Royal Commission (1985a, p.364) was also conscious that an FTA could have such an effect. It maintained that a FTA 'would require the provinces to give up some of their latitude in the use of public policies that made use of NTBs.' According to the Commission, in the longer term an FTA could 'reduce the power of the provinces in relation to that of the federal government and of the market.' For a similar argument by Hayek, see Chapter Two, pp.39-42.
from returning to economic nationalism. The parallels again with the European experience are clear.

*Party politics and provincial and regional rivalries*

Party politics and provincial and regional rivalries within Canada also played a role in the decision by the Mulroney government to seek an FTA with the US. Mulroney was quick to realise that an FTA could be used to his party's electoral advantage in several ways. First, it answered the early criticisms of his government - that it lacked clear policy direction - by providing it with a definite strategy for the economic future of Canada, a strategy which was clearly different from that of past liberal governments. Second, it would divide the Liberal opposition on free trade and thus pave the way for a second term in government for the Conservative Party. Finally, Mulroney saw the FTA as a chance to get business on side and to build a political base in Quebec and consolidate his existing base in the Western Provinces. It could, he believed, enable the Conservative Party to displace the Liberals as the natural party of government federally.

The support by Quebec and the Western Provinces for an FTA with the US was largely a reaction to the deliberate attempt by previous Liberal governments to increase the powers of the central government at the expense of the provinces. They saw the FTA as a way to limit the power of the central government, particularly over their economic development. Because of their reliance on world markets, the Western and Atlantic

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97 Doern and Tomlin 1991, p.35.
98 Doern and Tomlin 1991, pp.24, 29, 57. The Macdonald Royal Commission - set up by a Liberal Government and headed by a former Liberal Cabinet Minister - had come out clearly in favour of an FTA. Already in November 1984, almost a year before the official release of the Commission's final report and not long after the election of the Conservative government, Macdonald had announced that he favoured a free trade agreement with the US as the best way to overcome Canada's economic problems. Doern and Tomlin 1991, p.24. According to Doern and Tomlin (1991, pp.54-55), Macdonald's support for free trade can be attributed to three factors: a visit to Sweden where he was impressed by the ability of Swedish manufacturing industries to compete successfully without the protection of tariffs in the larger European market; the testimonies of businesses from across Canada that they could compete without the protection of tariffs in the larger US market; and the arguments of Canadian economists who were supporters of free trade and had been appointed as advisers to the commission that the main economic problem facing Canada was lack of access to a larger market.
100 It is interesting to note here that in Australia a deregulating Labor party actually became the 'natural' party of government until its defeat in 1996.
101 Seven out of the ten premiers supported the agreement, including two of the four liberal premiers: Quebec and New Brunswick. Manitoba, Prince Edward Island and Ontario were opposed. See Murray Smith 1988b, p.57; and Doern and Tomlin 1991, p.149. For an explanation of how the provinces could obstruct the implementation of the agreement, see Murray Smith 1988b, pp.56-57.
102 Doern and Tomlin 1991, p.302. As we have already seen (fn.93), support in Alberta for an FTA with the US had been galvanised by the introduction in 1980 of the NEP by the Trudeau Liberal government and its government saw the FTA as a means of ensuring that the Federal government could never again revert to nationalist energy policies. It would also ensure that the US could not limit their access to the lucrative US energy market. See Doern and Tomlin 1991, p.80. Alberta's Premier Lougheed, a strong free trader, is said to have played an important role in convincing fellow Progressive Conservative Party member Mulroney of the need for a free trade agreement with the US. See Doern and Tomlin 1991, pp.50-52, 127.
Provinces, were traditionally pro-free trade.\textsuperscript{103} Quebec, like Ontario, had traditionally been opposed to any free trade agreement with the US. Yet the Quebec provincial government supported Mulroney's FTA proposal and in March 1986 rejected a proposal by the Ontario government that both governments should negotiate as a bloc with Ottawa on the question of free trade.\textsuperscript{104}

\textit{The influence of economic studies showing the gains from Free Trade Agreements and the changes in ideas about economic development and international trade}

As we have seen in Chapter Two, many studies undertaken in the 1950s and 1960s had shown that in the medium and long term economic integration would boost economic growth, increase employment, and enhance international competitiveness. At the time, however, with Canada already experiencing economic growth, the government paid little attention to such studies. But in the early 1980s the situation had changed as governments and policymakers searched for policy solutions to high unemployment, low or negative growth and declining competitiveness,\textsuperscript{105}

\textsuperscript{103} External Affairs Canada 1983, pp.15-16, 206; Royal Commission On Economic Union and Development Prospects for Canada 1985a, pp.330-31; Hamilton and Whalley 1985, p.295. According to Shearer (1985, pp.332-33), the differing attitudes of the Provinces to freer trade can be explained by the pattern of trade in manufactures. Whereas for both the Atlantic and Western regions world markets are more important than the markets of other regions, the reverse is true for the Central region. The Western and Atlantic provinces have traditionally seen central Canada, that is, Ontario and Quebec as using the protective tariff to force the rest of Canada to buy from them rather than from less expensive foreign suppliers. But the Macdonald Commission (1985a, p.61, 331) argued that the question of an FTA with the US should no longer prove divisive as it had in the past and should in fact reduce regional divisions. It maintained that given the high mobility of factors of production between regions the benefits would be spread throughout the country and that all regions would benefit from the protection a free trade agreement would give against US contingent protection.

\textsuperscript{104} According to Doern and Tomlin (1991, p.140), the attitude of the Quebec provincial government changed from one of neutrality under the \textit{Parti Quebecois} governments in 1985 to one of strong support by the Liberal government in 1986. Had the Quebec government accepted the Ontario invitation, Doern and Tomlin (p.143) argued, the free trade initiative would not have succeeded. (For an explanation of the opposition of the Ontario Liberal government to FTA, see Doern and Tomlin, pp.143-47). This change of attitude occurred for several reasons. Because of its growing hydro-electricity exports to US, Quebec had come to share the desire of the Western Provinces to limit the ability of the federal government to control the development of its natural resources and for secure access to the lucrative US energy market. The more favourable attitude of Canadian manufacturing firms generally to an FTA, already mentioned as a key factor in the decision of the Mulroney government to seek an FTA, was also true of Quebec firms and could have made successive provincial governments more willing to support an FTA. See above, pp.202-03. According to External Affairs Canada (1983, pp.12-13), approximately 60% of Quebec's exports go to US. At the same time the support of Quebec for the free trade agreement could also have flowed from a more general desire of Quebecers for greater autonomy from the federal government and even independence. Pro-independence Quebecers no doubt saw it as a way of increasing their province’s economic independence and hopefully its political independence too. By securing Quebec's economic ties with the US, the FTA could be used to refute the powerful argument that Quebec would suffer economically if were to become independent.

\textsuperscript{105} Ron Wonnacott (1985) and Harris and Cox (1983) estimated the gains in manufacturing at between 7 and 10\%. These gains are largely the result of greater economies of scale,
Economists - often the authors of such studies - also played a role in getting a Free Trade Agreement with the US on the government agenda. Through their publications, their submissions to government inquiries, and their membership on consultative panels they were able to make business, government ministers and officials aware of the benefits of economic integration.106 Hart, a member of the External Affairs team that negotiated the FTA, used the findings of these studies regarding the beneficial effects that an FTA would have on the Canadian economy to argue the case for the FTA.107

The apparent success of the EC, EFTA and the Auto Pact in boosting growth and employment seemed to confirm the findings of these economic studies and the validity of a major tenet of free trade theory, namely, that larger markets are the key to increased growth and competitiveness.108 At the same time the success of these regional trading arrangements seriously undermined one of the longstanding arguments against them, namely that they would lead to a rationalisation of economic activity in the larger market on the basis of comparative advantage and in accordance with the observed pattern of economic development known as poles of development.109 The Auto Pact and the increased specialisation, and the effects of increased competition such as an increased tendency to invest in new technologies and greater efficiency. See Chapter Two, pp.34-36.

106 The decision of the Macdonald Royal Commission (1985a, pp.327-330) to call for an FTA with the US was also heavily influenced by the studies and by the arguments of certain economists. The studies referred to in the report included those undertaken by economists on behalf of the Commission, some of which were published in volume 11 of the Commission's extensive research programme, under the title of *Canada-United States Free Trade* (Whalley 1985). The Commission also discussed the findings of earlier studies, such as Young (1957); Ronald and Paul Wonnacott (1967); Shearer, Young and Munro (1971); Williams (1978); Dauphin (1978); Harris and Cox (1983); Harris (1985). According to Doern and Tomlin (1991, pp.54-55), the arguments of Canadian economists who were supporters of free trade and had been appointed as advisers to the Commission played a key role in persuading the head of the Royal Commission, Donald Macdonald, that the main economic problem facing Canada was lack of access to a larger market.

The Commission made it quite clear in its report that its case for an FTA was based, at least in part, on these studies. According to the Commission (1985a, pp.327-330), these studies confirm the view that 'in the long run, Canada would benefit substantially from bilateral free trade with the United States, particularly from access to the expanded unrestricted market and from economies of scale.' The Commission goes on to state that 'among Canadian economists (this view) now seems a mainstream opinion. The consistency in the intellectual debate over the last 30 years has impressed us in our deliberations, and we therefore base our case, in part, on these studies.' According to the Commission (1985a, p.327), '(t)hese studies have helped convince us that there is a high probability that Canada would experience significant gains from free trade with the United States.' These gains, it argued, are even greater than those outlined in the studies, which have concentrated on only the gains from reduced barriers to US-Canada trade. The Commission identified other important gains in terms of improved security of access and the enhancement of Canada's multilateral negotiating abilities.

107 Hart 1989, pp.22-24. Like some of the authors of the studies themselves, Hart also pointed out that such studies tend to underestimate these benefits because of the inability of the econometric models on which they are based to capture the dynamic gains of economic integration. See Chapter Two, pp.32-33, 34-36.


109 The theoretical underpinnings for this were provided by Myrdal (1957) and Hirschman (1958). According to Myrdal (p.13), '(t)hat there is a tendency inherent in the free play of market forces to create regional inequalities, and that this tendency becomes the more dominant the poorer a country is, are two of the most important laws of economic underdevelopment and development under laissez-faire.' Opponents of a Canada-US FTA had claimed that it would result in the de-industrialisation of Canada and an overspecialisation in the resource sector. This argument was used against an FTA with the US in 1983 by External Affairs Canada in its review of Canada's trade policy. (External Affairs Canada 1983, pp.210-13). But the
experiences of the EC and EFTA showed that rather than resulting in the disappearance of whole industries in some member countries, regional trading arrangements would see an expansion of intra-industry specialisation.110

Factors contributing to the US decision to sign an FTA with Canada

When we looked at the EC and Canada, the US was the voice off stage being interpreted through European and Canadian eyes. In this section the US speaks for itself, and as we shall see, this casts a different conception of the US role in both the CUSFTA and the EC SIM.

At the March 1985 Reagan-Mulroney Summit the leaders of the two countries had asked their trade ministers to report back to within 6 months on ways to reduce and eliminate the barriers to Canada-US trade. In his report to President Reagan US Trade Representative Clayton Yeutter identified the broad US objective as the elimination of the significant Canadian barriers to the export of US goods and services. These barriers were high Canadian tariffs; federal and provincial NTBs; specific barriers to the export of US services; obstacles to US investment; and government subsidies.111 The further objective of the protection of US intellectual property rights was added later.112

Yet these Canadian specific objectives were soon to be overshadowed by more general objectives of US trade policy, objectives that were often concerned with strengthening the US negotiating position both bilaterally and multilaterally with countries other than Canada.113 Thus in 1988 US Treasury Secretary Baker, in his testimony before the Senate

success of the Auto Pact, Canada's own experiment in sectoral free trade, in increasing the importance of manufactures as a proportion of Canada's exports from 8% in 1960 to 42% in 1989, appeared to refute that argument. See Hart 1989, pp.5-6.

Murray Smith 1988b, p.51. As a result there would be less dislocation of jobs and thus lower adjustment costs than had originally been feared. This shift in thinking with regard to the effects of economic integration is reflected in the report of the Macdonald Royal Commission. (1985a, pp.347-49). According to the Commission, those that argue that an FTA would result in de-industrialisation and overspecialisation have failed to take into account changes in the theory of comparative advantage that stress intra-industry specialisation rather than inter-industry specialisation and have not taken into account the creation of new businesses to take advantage of the larger, more dynamic market. The negative effects of a US-Canada Free Trade agreement, it concluded, would be considerably less in the case of bilateral liberalisation than in unilateral liberalisation. As for the more traditional argument concerning Canadian political independence, the Commission (1985a, pp.305-307) argued that Canadian political independence would be not as diminished by an FTA as it would be by either a Common Market or a Customs Union and that any detrimental effects that an FTA might have would be more than offset by other effects of the FTA that would enhance Canada’s political independence. See above this chapter, fn.30.


111 Thus in his testimony before the US House Committee on Foreign Affairs, Peter Murphy (1987, pp.4-5, 9-10, 12-13), Special Negotiator for US/Canada Affairs in the Office of the US Trade Representative, listed six areas of special interest that the US would pursue during the negotiations. See also Murray Smith 1988a, pp.78-79. According to both Yeutter (1986a, p.29) and Murphy (1987, p.4-5), these areas of interest were decided on after extensive consultation with 44 private sector advisory committees.

According to Doern and Tomlin 1991, pp.105-106, part of the reason for this greater emphasis on the wider benefits of a Canada-US FTA was the low priority accorded to the US-Canada trade relationship by business, Congress and the US administration. The President almost failed to get approval from the US Senate Finance Committee to negotiate the FTA with Canada under the 'fast-track' provisions of US trade law. Senator Heinz (1986, p.32) wanted
Finance Committee, gave three reasons why in the broader context the FTA was in the US national interest. First the FTA would strengthen commitment to free trade both in the US and abroad. Second it would break new ground for trade liberalisation in services, investment and technology. Finally, the Canada-US FTA would set a new course in trade policy, one which aimed to promote liberalisation on regional and bilateral fronts as well as on the multilateral front. 114

From the above it can be seen that there were two kinds of factors that led to the US decision to sign an FTA with Canada. The first set of factors discussed below are those relating to broader US concerns which can be traced back to the rising US trade deficit and to declining weight of the US in the world economy. They include: the rising protectionist sentiment in the US and the US Administration's efforts to contain it; the growing disillusionment with GATT and the search for alternatives to it; the desire of the US to increase the pressure on other countries to speed up the Uruguay round; the desire to reform GATT so that it is more amenable to US trading interests; and the desire to boost US international competitiveness and thus reduce domestic protectionist pressure.

The second set of factors discussed below relate to specific US concerns regarding its trade with Canada. These are the result of the more favourable attitude of the Canadian government to market oriented reforms and the ensuing US desire to lock in these reforms and extend them.

114 This new policy, Baker (1989, pp.50-51; 1988, p.9) argued would reassure those countries that support an open world economy and reduce the domestic pressure for a more negative, unilateral trade policy. According to Baker, ‘(i)f activity on one frontier of trade negotiation slows, we may be able to maintain momentum and achieve solutions worthy of imitation through other agreements.’ Similarly one of the three reasons given by US Under Secretary for Economic Affairs in the State Department, Allen Wallis (1989, p.10), in testimony before the US House Committee on Foreign Affairs in 1988, for why the Senate should ratify the US-Canada FTA was that the FTA would support broader efforts at achieving trade liberalisation in Uruguay Round. The other two were to strengthen an important strategic relationship and to reap the benefits of free trade.
Factors relating to broader US concerns

The desire of the US Administration to contain rising domestic protectionist sentiment and growing disillusionment with GATT

An important factor in the decision of the US to enter into an FTA with Canada was the desire of the US administration to contain rising domestic protectionism. The idea of using an FTA to contain rising protectionism rather than relying solely on the GATT would have been anathema to past US administrations but now in the face of the growing disillusionment of US business and Congress with the GATT such an idea was much more acceptable.

As a result of persistent and worsening US trade deficits - the US merchandise trade balance had been in deficit every year since 1976 - the US Congress was coming under increasing pressure from both business and organised labour for greater protection from foreign competitors. In 1985, just when the US and Canada were investigating the possibility of an FTA, the situation had considerably worsened. For the first time, according to Destler, it seemed that the system that Congress had established to insulate itself from protectionist pressures might collapse. By December 1985 there were more than 300 pieces of protectionist legislation before Congress. The Administration was under increasing pressure to act. In the past the Administration had responded to an upsurge in protectionist sentiment by embarking on new round of GATT. In engaging

115 The rise of neo-isolationist and protectionist forces in the US was already apparent in the mid seventies. See Patrick 1975, pp.5-6.

116 Destler 1986, pp.96-97. Under the US Constitution, Congress has the power to regulate external commerce. But, according to Destler (1986, pp.97-98), since the protectionist debacle of the 1930 Smoot-Hawley Tariff Act, it had sought by various means to limit its susceptibility to protectionist pressure by voluntarily limiting its authority in this area. Under the Reciprocal Trade Agreements Act of 1934 and subsequent agreements it had authorised US presidents to negotiate with other countries the reciprocal reduction of barriers to trade. It established rules setting out the conditions under which industries would qualify for import relief and required the International Trade Commission or the Commerce Department to determine the eligibility of those industries that had requested it. It had pressured the Administration into preventing the formation of powerful protectionist coalitions by granting certain industries special protection in the form of VERs. Finally, it had established within the White House the position of US Trade Representative and entrusted it with the task of balancing domestic and international interests in the management of US trade policy.

117 Wallis 1985a, p.54. According to Destler (1992, pp.122-24), the increase in protectionist legislation was not only a reaction to the unprecedented US trade deficit of over $100 billion and a further rise in the value of the US dollar, it was also an attempt by Congress to express its anger at Reagan's neglect of US international trading interests, and to force him to take action to rectify the situation and thus take the heat off Congress. The statement by Wallis (p.36) in December 1985 expressing the Administration's determination to resist this 'retreat into a "Fortress America" ' suggests that the actions of Congress were having the desired effect.

118 In September 1985 the pressure on the administration to take action had become so great that for the first time since Section 301 had been passed in 1974 the President ordered the Office of the US Trade Representative to initiate investigations of its own into the practices of any country deemed to have reduced the sales of competitive US exports. In the past the Office had acted only on petitions from industry. See Destler 1992, p.126; 124-24; Wallis 1986, p.35; and Bhagwati and Patrick 1990. This was a prelude to the provision of the 1988 Trade Act, known as Super 301, which required the US Trade Representative to identify by 31 May 1989 priority foreign countries against which retaliatory action was to be taken. See Destler 1992, p.132.

119 Destler 1992, pp.17-18, 54. Destler saw this as part of bicycle theory of trade liberalisation according to which the momentum for trade liberalisation had to be maintained otherwise, like a bicycle, the liberal trade system would fall over.
in a new round the Administration had been able to use the promise of increased access to export markets to build up a pro-free trade coalition of US businesses to counter the protectionist lobby in Congress.\(^{120}\) The strategy had been successful in the 1970s when the Tokyo Round had been used to contain the protectionist pressure on Congress and US Trade Representative Brock had hoped for a similar success when he proposed a new round of multilateral trade negotiations in the early 1980s.\(^{121}\)

But two factors, one relating to a change in the domestic attitude towards GATT and the other concerned with the increased difficulty in inaugurating and completing a new round of multilateral negotiations, made the employment of this strategy much more difficult in the 1980s. Americans had become less supportive of the GATT process. The trade and federal budget deficits had eroded the coalition for freer, more open trade.\(^{122}\) Those still in favour of freer trade had come to see GATT as part of the problem rather than the solution. Many Americans were critical of GATT for failing to guarantee the US reciprocal access to the markets of other countries.\(^{123}\) They no longer believed that GATT could solve their country’s trade problems and were calling for unilateral action to reduce the deficit and ensure bilateral reciprocity in the form of quota programs and surcharges.\(^{124}\)

The various theoretical challenges that were being made to the liberal trade orthodoxy at the time both reflected and further contributed to the erosion of elite support within the US for liberal trade.\(^{125}\) New developments in international trade theory concerning

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\(^{120}\) Schott 1988, p.3; Destler 1986, pp.100-105; 1992, pp.17-18. It would also enable the Administration to argue that to increase trade barriers during such negotiations would be counter productive as it would strengthen the arguments of those opposed to free trade in other countries and thus reduce the likelihood of opening foreign markets to US goods. Destler (1992, pp.237-38) identified three purposes of international negotiations: to bring export interests into the political process to counter protectionist interests, to provide a rationale for resisting protection; and to reinforce the position of the central trade broker/negotiator, that is, the Administration.

\(^{121}\) Destler 1986, p.100; 1992, p.238; Macdonald Royal Commission 1985a, p.290.

\(^{122}\) See a statement to this effect by Douglas McMinn, Assistant Under Secretary for Economic and Business Affairs (1986, p.32).

\(^{123}\) Yeutter 1986b, pp.43-44. The US Administration was very much aware of this criticism and of the dangers it posed to the continued support of the US for the liberal international trading system. In his address before the US Chamber of Commerce in September 1986, US Trade Representative Clayton Yeutter declared that ‘(m)any Americans look at our $150,000 million trade deficit and at the growing use of subsidies, non-tariff barriers, and other GATT-illegal practices throughout the world and wonder why we are still a signatory to the GATT.’ For similar arguments concerning the growing perception by Americans of the inadequacies of GATT and its role in undermining the strategy of using multilateral trade negotiations to contain protectionism, see Destler 1992, p.54, Morici 1991a, p.5; and Schott 1988, p.3; 1989, pp.4, 7-8. One particular criticism concerned the progressive undermining of principle of non-discrimination through the establishment of the EC, the granting of preferential treatment to developing countries and the widespread recourse to VERs and OMAs.

\(^{124}\) The US Council of Economic Advisors in its 1985 Annual Report saw the FTA as providing a means of channelling this desire for reciprocal access in a way that further liberalised trade. According to the Report, ‘the possibility of FTA negotiations ... offers the US and others the option of using a free-trade instrument, rather than protectionism, as a lever against protectionist countries.’ Quoted in Murray Smith 1988a, p.91.

\(^{125}\) Destler 1992, pp.182-83. These challenges and their effect on American support for the multilateral trading system are discussed in Chapter Three, pp.90-93. Thus in an address given in 1987 to the Conference on International Trade, US Deputy Secretary of State John Whitehead referred to the debate that was ‘raging in Congress and elsewhere in the US - as to whether free trade is still a relevant guiding principle in today's world.’
imperfect competition, the dynamic nature of comparative advantage, the cultural and social preconditions for free trade questioned the legitimacy of free trade. There was a growing tendency to redefine free trade as fair trade. Many argued that free trade was not possible with Japan and advocated instead a form of managed trade based on market share requirements.

Even among those who still supported multilateral trade liberalisation there was a feeling that the GATT was outdated and that unless it changed it would become obsolete. Yet attempts by the US administration to overcome the growing disaffection in the US with GATT and to build up a new coalition for free trade had only made it even more difficult to get agreement on a new round of multilateral trade negotiations. Thus US insistence that non-tariff barriers be included on the agenda and that any new agreement should extend the coverage of GATT to trade in agriculture, services, intellectual property and investment not only increased the reluctance of other countries to agree to a new round at this time but also made reaching an acceptable conclusion to the round a much more difficult and drawn out process.

The increased difficulty in inaugurating and completing a new round of multilateral negotiations had also lessened the utility of the GATT to the US administration as a means of containing growing protectionism at home. GATT rounds were becoming harder to get started and were taking longer to complete. This was due to a number of factors. A larger and more varied membership meant that there was more scope to disagree and that it was therefore harder to arrive at a consensus. The growing

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126 There was a marked increase in the use of arguments based on reciprocity and fair trade to justify protectionist measures. See for example the statement made by Senator Heinz in 1986 before the Senate Finance Committee. For US Under Secretary for Economic Affairs, W. Allen Wallis (1985b, p.41), "(w)hen individuals, industries, or even whole sectors perceive their economic interests to be threatened they often rationalise a course of action that has, over and over again proven to be a failure: protectionism. "We believe in free trade," they say, "but it must be fair trade." "Fair trade" is not defined, but implicitly it means trade in which we win." This point was also made by the US Assistant Secretary for Economic and Business Affairs Douglas McMinn (1987, p.58). He criticised those who 'seem to be engaged in an effort to convince themselves that taking away the President's discretion in trade, making retaliation mandatory, subsidising exports, and the like are not protectionist (actions) in and of themselves but, rather, will help us move to "fair trade" or level the playing field'.' According to McMinn, 'too often, the unspoken definition of fairness is "our industry always wins ".'

127 An example of this was the commitment made by the Japanese in 1986 to increase the US producers' share of the Japanese semiconductor chip market to 20 percent within five years. See Destler 1992, pp.127-29. See also Morici 1991a, p.7

128 Schott 1989, p.7; Murray Smith 1988a, p.81. Those Americans that were still outward looking, Yeutter (1986b, pp.43-44) maintained, were 'losing faith in the ability of existing rules and institutions to effectively address new issues that are of increasing importance in international commerce - services, investment, intellectual property protection and others'.

129 The new round of multilateral negotiations - the so-called Uruguay Round - was only inaugurated in September 1986. It was not completed until December 1993. According to Skelp (1986-1987, pp.64, 71), the US insistence on the inclusion of services delayed the start of the Uruguay Round by at least two years. In 1974 the US had already tried unsuccessfully to get services on the Tokyo Round agenda. Brock, who had been appointed US Trade Representative by Reagan in 1981, took a keen interest in trade in services. Between 1981 and 1983 he travelled the world in an effort to get trade in services, intellectual property and investment on new multilateral trade negotiations agenda. See McQuaig 1991, pp.48, 127.

130 Schott 1989, pp.7-8; Destler 1992, p.53.
resistance to previous tariff reductions by labour intensive industries in developed countries had made it politically difficult for these countries to pursue further liberalisation. Non-tariff barriers had replaced tariffs as the main obstacle to further liberalisation and hence would have to be a key issue in any new round of multilateral negotiations.\textsuperscript{131} These were less visible and their removal required the harmonisation of domestic policies and practices, something governments were extremely reluctant to agree to. The rise of new centres of economic power in Europe and Asia meant that the US was no longer able to dominate the international trade agenda as it had in the past. The gradual consolidation of the EC as an economic entity had created a new economic giant whose share of world trade already exceeded that of the US.\textsuperscript{132} The EC had become increasingly self-preoccupied. Its energy and resources were being diverted away from international trade talks and towards resolving problems associated with further economic and political union.

Given the declining credibility of GATT and the unlikelihood that a new GATT round would be launched in the near future, the US administration began looking for alternatives to GATT as a way of containing the rising protectionist sentiment in the US. It came to see bilateral agreements, and free trade agreements in particular, as one such alternative.\textsuperscript{133} It agreed to Canada's request for exploratory talks on the possibility of sectoral free trade agreements in 1982.\textsuperscript{134} The extension under the Trade and Tariff Act of 1984 of the fast-track procedures to cover bilateral agreements further facilitated the negotiation of such agreements.\textsuperscript{135} This made countries more willing to negotiate a bilateral agreement with the US Administration since it meant that any specific trade-offs contained in the agreement could not be modified later on by Congress. In 1985 the Administration concluded an FTA with Israel.\textsuperscript{136} That year US Secretary of State, Schultz, gave a clear indication of the Administration's intention to use FTAs as a means of containing growing protectionist pressures at home and increasing pressure on other countries to agree to a new GATT round.\textsuperscript{137}

\begin{enumerate}
\item Destler 1992, p.53.
\item In 1989 the EC accounted for 16.2% of world imports and 15% of world exports, while the US accounted for 15.6% of world imports and 12% of world exports. Japan accounted for 7% of world imports and 9.1% of world exports. See Commission of the European Communities 1991, p.7.
\item The US had been particularly disappointed by the failure of the 1982 GATT Ministerial Talks to reach agreement on the launch of a new round of multilateral trade negotiations. See Murray Smith 1988b, p.41; Schott 1989, p.4. According to Schott, this failure led US Trade Representative Brock to pursue bilateral talks with Israel and Canada.
\item Wilkinson 1985, p.168
\item Destler 1992, p.99.
\item Schott 1989, pp.5-6. According to Schott, Israel sought an FTA with the US because it feared that the push within Congress to reform the US General System of Preferences, if successful, would reduce the preferential access that it and other developing countries enjoyed to the US market.
\item Schultz 1985, pp.28, 30. US Secretary of Treasury Baker (1988, p.9; 1989, pp.13-14, 50-51), in his testimony before the Senate Finance Committee in support of the Canada-US FTA, also endorsed the use of FTAs as a means of containing domestic protectionist pressures. According to Baker, the Canada-US FTA would demonstrate that a bilateral free trade area was a viable option, that trade liberalisation was still possible and that the US would benefit from it. The FTA, he maintained, was part of determined government action 'to re-invigorate
Thus the US administration had come to see bilateral free trade arrangements as a means of fending off protectionism and fostering multilateralism, though this was not how US trade policy was perceived in the capitals of continental Europe. For them, this US move represented a definite departure from the attitude immediately after WWII when bilateral and plurilateral/regional free trade agreements had been opposed on the grounds that they were a dangerous form of protectionism.\footnote{138} The attempt by the Administration to build a domestic coalition in support of bilateral free trade agreements proved successful and led to the emergence of a third force in the struggle over the future direction of US trade policy.\footnote{139} The multilateralists and the unilateralists/protectionists were now joined by the bilateralists/regionalists who promoted the negotiation of bilateral or regional free trade agreements. This third force was, however, ambiguous in nature. While the Administration saw it principally as a way of defending the multilateral system and boosting support for a new GATT round, others had already written off that system and saw bilateral and regional agreements as the best way to further the ideal of free trade. Still others came to see a North American Free Trade Area as the best way to defend their natural North American market from foreign competitors.\footnote{140}

\footnote{138}{See Chapter Two for the theoretical debate concerning preferential and multilateral trading arrangements, pp.28-39. The US had, however, supported the establishment of the EC principally for military and strategic reasons but also because it believed that regional trade liberalisation would be a step towards trade liberalisation at an international level.}

\footnote{139}{Hart 1990b, pp.54-55.}

\footnote{140}{This tendency is already evident in the Canada-US FTA in the demands by textile and apparel industries and car manufacturers for strict rules of origin and tighter local content rules. It is more in evidence, however, in similar demands from these firms in the negotiations over the NAFTA. See Chapter 7, pp.232-34, and fn.88.}
The desire of the US to increase the pressure on other countries to speed up the Uruguay Round

The adoption of the FTA strategy, however, did not mean that the US had abandoned the push for a new round of multilateral trade negotiations. On the contrary, the US administration clearly saw FTAs as a means of increasing the pressure on other countries to undertake further trade liberalisation on a multilateral basis. It would, it believed, serve notice to other trading partners that if there was no further progress on multilateral trade liberalisation then the US could strike other bilateral deals.

Between 1985 when the US formally agreed to the Canadian proposal for an FTA and the ratification of the FTA by Congress in 1988 the US Administration continued to emphasise its willingness to pursue the FTA option should other nations choose not to strengthen the multilateral trading system. In the various hearings by Congress committees on the Canada-US FTA the Administration argued that ratification by Congress of the FTA would force other countries to take the US threat seriously.

141 Schott 1989, pp.11-12; Murray Smith 1988b, p.61. The Agreement itself lists as one of the objectives to 'lay the foundation for further bilateral and multilateral cooperation.' See 'Summary of the Agreement', a document provided by the Office of the US Trade Representative as part of its testimony before the Senate Finance Committee. (Senate, US Congress 1989a, p.160). According to Samet and Hufbauer (1985, pp.198-99), the change of attitude towards FTAs was already apparent in 1982. They argued that the US Trade Representative's interest in sectoral agreements with Canada at the time can be explained in part by the desire to increase the pressure on Europe and Japan to agree to a new round of multilateral talks.

142 Thus in 1985 US Trade Representative Brock argued that FTAs could be used to demonstrate to 'those countries which seem to have chosen a different path for the moment' the benefits of freer trade. Cited in the Royal Commission 1985a, p.376. Brock's successor Clayton Yeutter expressed a similar opinion. See Yeutter 1987a, p.198. President Reagan, in a statement issued to mark the signing of the Agreement into law, also stressed the important international implications of the agreement. It would, he maintained, encourage supporters of free trade throughout the world by demonstrating that governments can remove trade barriers even in the face of protectionist pressures.' See 'Statement by the President', a document provided by the Office of the US Trade Representative, as part of its testimony before the Senate Finance Committee. (Senate, US Congress 1989a, p.155). For US Secretary of State George Schultz FTAs would not only provide an example for others to follow, they would also increase the pressure on other countries to agree to expand trade on a global basis by demonstrating that the US could successfully pursue other options should the multilateral option fail. According to Schultz (1985, p.30), FTAs need not result in a splintering of the multilateral system and could be used instead to stimulate trade and strengthen that system. The US Council of Economic Advisers in its 1986 Annual Report saw the Canada-US FTA as performing the same liberalising role as the 1935 Canada-US bilateral agreement which became a catalyst for broader international cooperation. Cited in Murray Smith 1988a, p.91.

143 This was made quite clear by US Trade Representative Yeutter on a number of occasions. In 1986 Yeutter (1986b, pp.43-44) declared that 'if other nations are not truly interested in strengthening the multilateral trading system, the US will have no choice but to defend its interests bilaterally and plurilaterally, and we will do so vigorously. The GATT as we know it today would disappear, to be replaced, we hope by institutions that would better accommodate the world's commercial needs.' In 1988 Treasury Secretary James Baker in testimony before the House Ways and Means committee also endorsed this course of action. Baker (1988, p.9) declared that 'if all nations are not ready (for trade liberalisation), we will begin with those that are and we will build on that success.'

144 This is clearly shown in testimony given by US Trade Representative Yeutter in 1988 before the House Committee on Foreign Affairs. According to Yeutter (1989, p.98), the FTA 'certainly indicates that we can achieve success bilaterally, and that we are prepared to pursue these basic objectives on a bilateral basis should that prove essential.' In testimony given in 1988 before the House Committee on Ways and Means US Trade Representative Yeutter (1988, p.13) expressed his conviction that the US strategy was working. He referred
To some extent the US decision to proceed with the Canada-US FTA grew out of the perception by the US Administration that the EC was giving priority to the liberalisation of trade within its own bloc over multilateral trade liberalisation. By demonstrating that it too could form a bloc it may have hoped to deter the Europeans from establishing a 'fortress Europe'.

The desire to reform GATT so that it is more amenable to US trading interests, and the CUSFTA as a model of comprehensiveness for GATT

Both the US administration and the US service industry clearly saw the Canada-US FTA as setting an example and providing models for a future GATT agreement and for other bilateral agreements on intellectual property, investment and services. In 1984 the services sector had finally succeeded in having services placed on a par with trade in goods as a priority in future trade negotiations. But in the face of opposition from third world countries to the inclusion of trade in services in the GATT the service lobby had

to the 'deep and abiding interest' shown by representatives of other governments at international meetings in the Canada-US FTA:

Some of that is because they feel left out and wonder if they cannot join the party. Some of it is concern, by some of our major trading partners, that we are developing a very powerful economic bloc here in North America that may be an enormous competitor to them. I think it is a rather welcome sight to see some of our trading partners squirm a bit in the context of that development.

- Schott 1989, p.12. However, the fear that EC 92 might see greater restrictions on the access of US exporters to the EC only became commonplace among US businesses, the Congress and the Administration in 1988 after the Canada-US FTA negotiations had been concluded. As such these fears were to play a more significant role in the push for NAFTA and will therefore be discussed in more detail in Chapter Seven. See pp.255-56.

- US Trade Representative Yeutter (1986a, p.31) clearly stated this to be one of the objectives of the FTA in his testimony before the Senate Finance Committee. See also Yeutter 1986b, p.43; 1987a, pp.199-200; 1989, pp.88-89, 93. A statement to this effect was also made in 1986 by Peter Murphy (1987, p.12), Special Negotiator for US/Canada Affairs in the Office of the US Trade Representative, in testimony before the House Committee on Foreign Affairs. According to Murphy (1987, p.6), 'if in the context of the US-Canada agreement we can set a high enough claim, that in essence, will be the envy of those in the multilateral system, then they might see the advantage of working toward such a system.' Hart (1989, pp.1-2; 1990, p.27), an External Affairs official who was part of the Canadian negotiating team, also stressed the importance of the FTA in setting precedents for future global agreements but also in 'launching the bilateral negotiating agenda of the future'. Hart considered that the governments of Australia and New Zealand, in incorporating service provisions into their bilateral free trade agreement (CER), were following the US-Canadian lead. Other scholars also saw the desire of the US to use the FTA as a model for future GATT agreements on services as a significant factor in the US decision to enter into an FTA with Canada. See for example Wilkinson 1985, p.180; Murray Smith 1988a, p.94.

- The Trade and Tariff Act of 1984 also authorised the President to retaliate under section 301 of the 1974 Trade Act against any country that did not give equal treatment to US service providers, specifically mentioned services in the authority it gave the President to negotiate free trade agreements with Israel and Canada, and allowed for the establishment of a new agency to monitor trade in services. See McQuaig 1991, p.54; Wilkinson 1985, pp.179-80; Murray Smith 1988a, pp.90-92. In the 1980s Robinson, the head of American Express and of the influential international trade committee of the US Business Roundtable, used his position on the top private sector Advisory Committee for Trade Negotiations to the US Trade Representative to push for the inclusion of free trade in services in the next round of GATT negotiations. (McQuaig 1991, p.48; Skelp 1986-1987, p.71). Robinson also played a role in keeping the momentum of the Canada-US FTA going. He formed coalitions of service and other industries to ensure it was approved by the Senate and intervened at the highest level following the last minute suspension of official negotiations to get the two sides talking again. See McQuaig 1991, p.149, 156.
also come to see bilateral agreements as both an alternative and as setting useful liberalising precedents for the Uruguay Round. 148

The Administration had two reasons for wanting to extend the GATT to these new areas. First, as we have already seen earlier, the old free trade coalition had collapsed and the Administration believed that it could be replaced by a new coalition for trade liberalisation composed of service and other industries who were concerned about getting these issues on GATT agenda. 149 Second, the Administration believed that extending the GATT to these new areas would help solve the chronic US balance of payments problems and halt the decline in US competitiveness. Services were the fastest growing sector of US economy and world trade in services was growing rapidly. 150 But the US was prevented from using its comparative advantage in services to offset its declining comparative advantage in manufactures by the protectionist policies of other countries. 151

The desire to boost US international competitiveness and thus reduce domestic protectionist pressure

We have already seen in this chapter and in Chapter Five how concern by governments in Canada and in Europe about the declining international competitiveness of their firms had helped convince them of the need for institutionalised regional economic integration. The same was also true in the US. In the early 1980s there was growing recognition in business circles, in the Congress and in the Administration of the importance of international competitiveness. 152 Concern about the chronic US trade deficit led Reagan to establish the Commission on Industrial Competitiveness in June 1983 to review the means

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148 According to the Executive Vice-President of American Express, Harry Freeman (1987, p.143), other countries, fearful that the US and Canada might continue to go it alone, could be goaded into following the example of Canada and US. As well as putting pressure on other countries to liberalise, Freeman (1987, p.140) saw the FTA as increasing the pressure for the deregulation of the services sector in the US. He argued that the push for reciprocal rights by Canada and other countries could be instrumental in having the 'increasingly outmoded and ineffective' Glass-Steagall Act rescinded.

149 According to the 1985 report of US Advisory Committee on Trade Negotiations, support by US business for new multilateral trade negotiations was conditional on bringing new areas under the GATT. See Aho and Levinson 1987, p.147. Given that US gains in manufacturing from the FTA were likely to be small, it was clear that the main support for the FTA would have to come from the service sector. Hence the importance that the Administration placed on services during the negotiations. See Wilkinson 1985, p.180.

150 Yeutter 1986b, p.44.

151 The US saw its comparative advantage as now lying in new areas such as services. See Skelp 1986-1987, p.76; Doern and Tomlin 1991, p.67. Some, such as Amex Executive Vice-President Harry Freeman (1987, p.138), were fearful that if trade in services was not liberalised soon the US would lose its competitive edge in services to other countries such as Japan. Others, such as the President's Commission on Industrial Competitiveness (1985, p.276), argued that the protection of intellectual property rights under GATT was essential if US competitiveness were to be preserved.

152 See for example McMinn 1987; Wallis 1985a; Olmer 1985; President's Commission on Industrial Competitiveness 1985. It is significant that Michael E Porter chaired the Strategy Group of the Commission. US Under Secretary for Economic Affairs Wallis (1985b, p.44) argued that protectionism is not the answer to US problems as it only undermines the international competitiveness of US firms by denying them 'access to the highest quality and lowest cost products available in the world market.'
of increasing long-term competitiveness of American industries, and particularly that of high technology industries, in both domestic and foreign markets.\textsuperscript{153}

In business circles, the Congress and the Administration there was a growing perception that FTAs could be used to boost the competitiveness of US firms both in domestic and overseas markets.\textsuperscript{154} It was argued that by removing the barriers to trade and investment between Canada and the US, the FTA would result in a more efficient allocation of resources.\textsuperscript{155} Again it was argued as in Europe and Canada that, by affording firms the opportunity of greater economies of scale and of increased specialisation, the larger market would raise the productivity and efficiency of firms while lowering the cost and increasing the quality of the goods that they produced.\textsuperscript{156} US goods would thus become more competitive both at home and abroad, resulting in increased sales and a

\textsuperscript{153} President's Commission on Industrial Competitiveness 1985, p.ix. Among the recommendations of the Commission (pp.220, 276) was the recommendation 'that the US pursue plurilateral agreements that could serve as a basis for multilateral GATT negotiations in order to extend coverage and to increase developing country commitment to the multilateral trading system.' In his report entitled \textit{US Manufacturing at a Crossroads: Surviving and Prospering in a More Competitive Global Economy}, US Under Secretary for International Trade Lionel Olmer (1985, p.3) wrote of the growing US competitiveness problem. He warned of the tougher competition US manufacturers were likely to face from the Japanese and the NIEs and of the challenge from a revitalised Europe - a mirror image of the fear expressed at the same time in Europe, and of course, as we shall see later by Japan. Olmer (1985, pp.vii-viii) particularly stressed the importance of new technology in enabling companies to 'leapfrog their competitors and capture (or recapture) important growth markets almost overnight.' One of his recommendations was that the US should 'accelerate actions to minimise the impediments to the mobility of capital, know-how, and labour'. According to US Under Secretary for Economic Affairs Wallis (1986, p.35), one of the key objectives of Reagan's trade programme was to stimulate the innovation needed to maintain a technological edge over the adversaries of the US. Wallis argued that open markets and competition would help keep the US strong, free and prosperous. Fostering and promoting America's ability to compete became a key objective of the Reagan Administration and in his State of the Union Address on January 27 1987, Reagan outlined a broad initiative to enhance US competitiveness. See Yeutter 1987b, p.25.

\textsuperscript{154} According to Reagan (1987a, p.1), the FTA would strengthen the competitive ability of the US in world markets. Trowbridge (1989, p.170), President of the National Association of Manufacturers, saw a definite link between the FTA and US competitiveness. The FTA, he argued, was 'perhaps a more important opportunity for the United States than any previous agreement or possible agreement because trade and trade competitiveness are more important to us today than they have been at any other time.'

\textsuperscript{155} According to the Vice-President of the National Association of Manufacturers, Lawrence Fox (1986, pp.95-96, 102-103), the FTA would redirect resources to the most productive industries and boost US productivity and exports by increasing the efficiency and competitiveness of US companies.

\textsuperscript{156} According to Louis Laun (1989, p.19-20), Assistant Secretary for International Economic Affairs in the Department of Commerce, Canada would increase the US local market by 10% or, in the words of Amex Executive Vice-President Freeman (1989a, pp.88-89), the equivalent of another California. For US Trade Representative Clayton Yeutter (1986a, p.29; 1987a, p.197), an important benefit of the FTA was the larger economies of scale that would boost the international competitiveness of both the US and Canada. The rationalisation of production that would occur, Yeutter (1988, p.14; 1989, pp.91-93) argued, would enable the US to meet the competitive challenge. According to Yeutter, the EC, the Australia-New Zealand CER and the US-Israel FTA were examples of how the FTA would lead to increased economic growth and productivity and thus make the US and Canada 'a more formidable force in international commerce'. According to Freeman (1989a, pp.88-89), the larger markets and greater economies of scale of the FTA would increase the competitiveness of US products in world markets, boost employment opportunities, lower the prices and increase the quality of goods, and result in higher growth rates and a more efficient allocation of resources. See also similar arguments by US Treasury Secretary Baker (1988, p.9; 1989, pp.13, 49); the US Under Secretary for Economic Affairs, Wallis (1989, p.11), and Deputy US Trade Representative Holmer 1989, p.30.
reduction in the trade deficit. More jobs would be created and protectionist pressures would be contained. 157

As can be seen from the preceding discussion concerning the role of the FTA in enhancing US international competitiveness, the positive effects that economists were claiming the FTA would have on the the US economy were also those that the Reagan administration had wanted to achieve with its supply-side economic policies. 158 This compatibility of the FTA with the Administration's broader economic policies could explain the readiness with which it took on board the FTA proposal. Thus Reagan, like Thatcher and Mulroney, saw the proposal for regional free trade as a means of achieving his government's wider economic policy objectives. 159

**Factors relating specifically to US-Canada trade**

So far we have seen how the US decision to accept the Canadian offer to negotiate an FTA can be explained by the perception of the US administration that a Canada-US FTA would help achieve a number of broader US trade policy and domestic objectives. However, it is also clear that this decision was also the result of other factors relating to more specific concerns that the US had regarding its trade relationship with Canada. Thus the US saw the FTA as a way to lock in Canadian market-oriented reforms, to guarantee US access to Canadian energy resources, and to eliminate Canadian tariffs.

*Lock Canadian market-oriented reforms to ensure that there is no return to the economic nationalist policies of the past*

Since the early 1970s successive US administrations had been concerned by the economic nationalist policies of their northern neighbour. We have already seen earlier in this chapter the strong reaction of the Reagan administration, US business and Congress to the attempts by the Trudeau Liberal government to increase Canadian control of its oil industry and to restrict foreign investment. 160 The 1981 crisis had made the US administration more aware of the need to manage in a more systematic manner its

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157 Murray Smith 1988a, pp.74; Schott 1988, p.3.
158 According to Laun (1989, pp.16-18), the FTA would allow investment to move unimpeded across the US-Canada border, resulting in a more efficient use of resources and in the increased competitiveness of US firms in domestic and foreign markets. This increased efficiency, he argued, would also boost returns on investment and thus increase the funds available for both R&D and investment, 'on which future commercial success and employment depends.' For a description of the positive effects of economic integration, see Chapter Two, pp.31-39. The process described by Laun in the preceding footnote is very similar to Cecchini's 'virtuous circle' of EC 92, 'where greater competition stimulates European innovation and innovation in turn stimulates European competitiveness.' See Chapter Five, fn.32. These effects are similar to those that supply-siders claim their economic policies will have. See Chapter Five, fn.43.

159 The EC Commission drew on the arguments of supply-side economics to support its case for the completion of the internal market. See Chapter Five, p.151. For the role of supply-side economics and monetarism in the decision by Thatcher to support EC 92, see Chapter Five, pp.163-64. For economic rationalism as a factor in the decision by Mulroney to propose an FTA to the US, see this chapter, pp.203-04.

160 See above, this chapter, fn.47.
relationship with Canada. The Reagan Administration saw the election of the Conservative Mulroney government as an opportunity to recreate 'the special relationship' that had once existed between Canada and the US. For the US Administration a free trade agreement with Canada would ensure that this temporary alignment of Canadian economic policy with that of the US would become permanent and that the economic reforms undertaken by the Mulroney government could not be undone by any subsequent Canadian government. The Administration was particularly concerned that should this opportunity be missed another might not present itself for a long time. This echoes Thatcher's interest in locking in the EC states to neo-liberal economic policies.

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161 Clarkson 1985, p.150; Murray Smith 1988b, p.42. Thus in 1982 US Secretary of State, George Schultz, instituted quarterly meetings with his Canadian counterpart. This desire on the part of the Reagan Administration to put its relations with Canada on a firmer footing also explains, at least in part, the accession by the US Administration to the request by the Liberal government for exploratory talks on the possibility of sectoral free trade. See this chapter above, pp.193-94.


163 See, for example, the statement by President Reagan (Senate, US Congress 1989, p.155) on signing the US-Canada Free Trade Agreement, in which he maintained that 'the agreement firmly establishes that the trade environment between the two countries will be based in the future on the principle of free and open trade.' See also Deputy US Trade Representative Alan Holmer (1989, p.27), who, in his testimony in favour of the FTA, declared that 'basically what we have here is protection that the Canadians will not go back to the restrictive policies of the 1970s.' According to US Under Secretary for Economic Affairs, W. Allen Wallis (1989, p.13), the FTA would consolidate the current free market environment on both sides of border. The Executive Vice-President of American Express, Harry Freeman (1989a, p.89), in his testimony before the US Congress, argued that the FTA would provide 'a long term guarantee that our services will continue to get equal treatment and unrestricted access to the Canadian market.'

164 See statements to this effect by US Secretary of the Treasury Baker (1988, pp.8-9; 1989, p.49) and US Trade Representative Yeutter 1988, p.15.

165 See Chapter Five, pp.163-65. In this context, given the extent of US investment in Canada, both the Administration and US business were particularly keen to ensure that the recent liberalisation by the Mulroney government of the regulations governing foreign direct investment in Canada were firmly entrenched and further extended. According to the head of the US negotiating team, Peter Murphy (1987, p.12), one of the key US objectives in the negotiations was to produce a Canadian policy environment as open to direct inflows of foreign investment as that of US. Murphy (pp.10-13) listed the other priority areas of concern as high Canadian tariffs, the non-tariff barriers maintained by the national and provincial governments, trade in services, intellectual property, and government assistance. Various US officials and business leaders have also stressed the importance of achieving a free trade environment in Canada for US investment. According to US Trade Representative Clayton Yeutter (1988, p.14), 'the agreement reduces the screening of US investment in Canada, and moves Canada towards a more open, market-oriented investment environment.' US Assistant Secretary for International Economic Affairs in the Department of Commerce, Louis Laun (1989, pp.21,23) argued that the FTA 'will add to the predictability and stability that investors and business look for when assessing a market opportunity.' According to the Executive Vice-President of American Express, Harry Freeman (1989a, p.84), the FTA would do this by guaranteeing 'US investors against a return to restrictive Canadian policies of the past.' The President of the National Association of Manufacturers, Alexander Trowbridge (1989, p.173), also argued that investment had been a key area of concern for business. According to Trowbridge, business would not have approved an agreement that had not included a chapter on investment: 'US companies that operate in Canada would have found little merit in an agreement that took away the constraints of tariffs only to allow others to be added in the investment area.' He saw the agreement as establishing a formal link established between Canadian access to the US market and Canadian investment policies: 'once the agreement is in place, it will not be possible for a Canadian government to alter its investment policies vis-à-vis US companies without jeopardising the commercial advantages Canada receives under the agreement.'
Ensure access to Canadian energy resources

Another important factor was the desire by the US to secure its access to Canadian energy resources. This was related to the more general US concern about its increasing dependence on foreign countries for its oil supplies. With its own domestic oil production in decline and growing doubts regarding the reliability of supplies from the Middle East the US was seeking to obtain guaranteed access to Canadian, and - as we will see later in Chapter Seven - to Mexican oil. Under the agreement Canada gave up its right to impose export taxes and to set a higher price for oil and other energy resources exported to the US than that charged for the same resource in Canada, thus ensuring that the discriminatory pricing of the NEP could not be re-introduced. The agreement also ensured that in times of short supply Canada could not reduce the proportion of oil exported to total oil production. If exports to the US were curtailed then domestic consumption would in future have to be reduced by the same proportion. Others also argued that the energy provisions of the agreement would also help boost US international competitiveness by guaranteeing US manufacturers cheaper and more secure energy supplies.

Eliminate Canadian tariffs

Another factor in the decision by the US Administration to enter into a FTA with Canada was the need to do something - or at least be seen to be doing something - about the spiralling US trade deficit. The general role played by the US trade deficit in the US decision has already been discussed earlier in this section. However, because of the size of the trade deficit with Canada - over $24 billion in 1985 and thus higher on a per capita basis than the US deficit with Japan - the US felt the need to take concrete steps to reduce it. The FTA, it was argued, would boost US exports to Canada by removing Canadian tariffs on US goods, tariffs that on average were twice those of the US. According to

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166 The US doubts concerning the reliability of Middle Eastern suppliers arose from the oil price hikes of the 1970s, the boycott of the US by Arab producers as a result of the Arab-Israeli conflict, and the loss of one its key non-Arab sources of oil, namely Iran, following the overthrow of the Shah. According to US Deputy Secretary of Energy, William Martin (1989, p.35), the FTA would reduce US dependence on foreign oil suppliers, particularly those in the Persian Gulf.

167 The importance of the enhanced security of supply and the end to discriminatory pricing was emphasised by US officials in their testimony in support of the FTA before different Congress committees. See, for example, the testimonies of US Under Secretary F. Allen Wallis (1989, pp.7, 13), and US Assistant Secretary for International Economic Policy in the Department of Commerce, Louis Laun (1989, p.20). US Trade Representative Yeutter (1989, p.15) argued that the gains to the US from the energy provisions of the FTA are significant enough to make them the most important part of the agreement from the US point of view.


170 Yeutter 1986a, pp.30-31; Murphy 1987, pp.5, 10; Baker 1988, p.10; Trowbridge 1989, p.172. The elimination or reduction in Canadian tariffs was one of the objectives listed by Reagan in a letter to the Chairman of the Senate Finance Committee in 1986. According to Leyton-Brown (1987, pp.153-54, 156), among the other objectives listed were: comparable treatment for US and Canadian intellectual property rights; the resolution of current trade disputes in softwood lumber and agriculture; acceptance of the Agreement by the provinces; greater
the President of the National Association of Manufacturers, Alexander Trowbridge, the elimination of these tariffs would increase investment in the US and raise the efficiency and competitiveness of US production facilities.171

Conclusion

From the preceding examination of the factors that led to the establishment of the CUSFTA it is possible to draw several conclusions. First, as in the EC case study, it would appear that institutionalised regional economic integration here was the result of a number of inter-related and mutually reinforcing factors. Second, again as in the EC case study, these factors were not identical nor were they of equal significance for all of the countries involved. Third, although there are some factors common to both this case study and the EC case study, there are other factors present in the EC case study, such as the desire for political union and the historical factors, that are totally absent from the CUSFTA case study. Even where factors are common to EC and CUSFTA their weighting differs.

In this chapter I have shown that the Canadian decision to seek an FTA with the US was the result of five main factors: the perceived failure of the economic strategy of Liberal governments in the 1970s to reduce Canada's economic vulnerabilities in terms of its over dependence on commodity exports and its over reliance on the US market for its exports; the rise in protectionism in the US; the shift in the dominant economic paradigm from Keynesianism to economic liberalism; the continued decline in Canada's terms of trade and international competitiveness; and new evidence that purported to show that the benefits of FTAs in terms of increased economic growth and productivity outweighed the costs. As is apparent from this chapter these factors are closely interrelated and it is quite impossible to establish any clear hierarchy.

The continued decline in Canada's terms of trade and its international competitiveness made the need for an alternative economic strategy even more evident. The failure of the so-called 'third option' was instrumental in the Canadian government's embrace of bilateralism in several distinct ways. First, the failure served to undermine support in Canada for multilateralism and enabled proponents of bilateralism to present it as a better alternative. Thus the inability of Canada to increase its exports to markets other than US had further amplified doubts regarding the ability of the GATT and multilateral trade negotiations to solve Canada's economic problems and had given rise to a coincidence of views in the US and Canada particularly among academics and bureaucrats concerning the unfair trading practices of the EC and Japan. Other arguments were now being heard as to why GATT was no longer the most appropriate forum for Canada to negotiate trade

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liberalisation. Canada's failure to diversify its markets was, it was claimed, the result of the growing regionalisation of the world economy which had reduced the incentive of other countries to negotiate trade liberalisation in multilateral forums and had diminished Canada's bargaining power in what was an increasingly tripolar multilateral trading system. Given the overwhelmingly bilateral nature of Canada's trade, it was argued, it was more advantageous for Canada to negotiate specific trade issues with the US bilaterally than multilaterally. At the same time the decline in Canada's international competitiveness lent support to those who argued that multilateral trade negotiations in the past had worked to the advantage of domestic protectionist interests and were less effective than bilateral negotiations in increasing the efficiency and competitiveness of the Canadian economy.

Second, the growing asymmetrical dependence of Canadian firms on US market, one of principal consequences of the failure of the third option, also increased support in Canada for an FTA with the US. With protectionism on the rise in the US, some business interests and parts of the bureaucracy and the political elite saw the need for an arrangement that would safeguard Canadian access to the US market.

This significant shift in the perception of Canadian national interests so that they were seen to be consonant with and not inimical to an FTA with the US was reinforced by another shift, this time in the dominant economic paradigm. This shift from Keynesianism to economic liberalism had lessened Canada's fear of a loss of sovereignty and independence to US, which in the past had been a major obstacle to an FTA with the US. Associated with this shift and the push for an FTA with the US was the desire of certain interest groups to reduce the role of government in the economy, to prevent by way of an international agreement any future government from returning to the economic nationalist policies that characterised the third option, and, particularly on the part of some of the provinces of the Canadian Federation, to reduce the powers that the central government had taken on in the context of the third option and the Keynesian management of the national economy. There was thus an implicit coalition between those favouring these ideas in Canada and those favouring the same ideas in the US.

The shift in the dominant economic paradigm favoured the spread of FTAs in another way by giving rise to a policymaking environment that was more receptive than in the past to the arguments concerning the economic benefits of FTAs. There was a logical coherence between the basic conviction of economic liberals that a return to economic growth would require less government involvement in the economy and a greater reliance on market forces and the long standing arguments of economic integration economists that FTAs by eliminating the government regulation of trade between states would boost economic growth through increasing economies of scale and increasing competition between firms. A Canadian government with economic liberal inclinations was thus less likely to be deterred by the loss of economic sovereignty that would result from
membership of an FTA than its predecessors whose Keynesian style policies required extensive government regulation of the economy.172

Here it can be seen that these shifts in economic ideology and in perceptions of Canadian interests changed the balance of political forces to permit the FTA to go forward. A similar phenomenon (though different in substance) had occurred in the EC.

At the same time that governments were becoming more receptive to the arguments of regional integration economists, new evidence made the arguments themselves all the more persuasive. The apparent success of the EC and the Canada-US Autopact in promoting economic growth and the development of manufacturing in the relatively less developed members of these arrangements seemed to confirm the claims of economic integration theory concerning the benefits of regional economic integration. This success further weakened the rival arguments of certain development scholars that regional economic integration between countries of differing levels of development would actually result in the de-industrialisation of the less developed members. These arguments had provided a basis for the Third Option, which had ruled out closer economic integration with the US on the grounds that this would only result in the de-industrialisation of Canada and an overspecialisation of its economy in the resources sector.

As can be seen from the preceding brief overview, the factors involved in the Canadian decision to request an FTA with the US provide confirmation of the five propositions concerning the rise of regionalism in the 1980s that were identified at the end of Chapter Three.173

172 Keynesian inspired governments were also often more aligned with organised labour and hence more inclined to be suspicious of proposals that would entail less government control and greater control by business - both domestic and international - of the economy.

173 These propositions in brief are:

- The 'retreat and defend' proposition that the re-emergence of institutionalised regional economic integration is a response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US
- the 'advance and compete' proposition that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security in relation to members and non-members of the alliance or more particularly to boost their competitive position in the global economy.
- the 'rivals all' proposition that institutionalised regional economic integration is the result of a defensive interaction first among rival capitalists, but also among rival states. In the first place a move to regionalism occurs because increasing competition drives firms into regional arrangements. In the second case, states, seeing the prospect of their rivals advantaged, move to construct their own economic spheres of influence.
- the 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence.
- the 'ideas and learning' proposition that the re-emergence of institutionalised regional economic integration is the result of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism.
Canada's decision was definitely a response to the undermining of the liberal international trading regime and the associated rise of protectionism in the US (proposition one). The decision by Canada to abandon the GATT as the forum for the conduct of its trade relationship with the US in favour of a bilateral arrangement was the result of a change in Canada's perception of its relationship with the US and of the utility of GATT in the conduct of that relationship. It was also the consequence of a more general loss of confidence on the part of Canada in the GATT and in Canada's ability to realise its trading objectives through it.

Canada's decision also provides confirmation of proposition two, that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security, and more particularly to boost their competitive position in the global economy. As has been mentioned above, Canada's decision was motivated by a desire to safeguard the access of Canadian firms to the US market at a time when that access was being threatened by rising US protectionism. It was also motivated by the expectation that an FTA would enhance the international competitiveness of Canadian exports in the face of efforts by other countries to do likewise and that it would maintain and increase Canada's attractiveness as a destination for foreign investment needed to restructure and modernise the Canadian economy.

Other factors in the Canadian decision lend support to the third proposition, that institutionalised regional economic integration is a defensive reaction among rival capitalists (and rival states). Both the Canadian government and Canadian business were concerned at the rise of regional trading blocs. They wanted to offset the increased competitiveness that these blocs had given rival foreign firms through the greater economies of scale and increased specialisation that access to a larger market could bring and saw an FTA with the US as a way to do this. There was also a growing identity of interests between Canada and the US. The failure of Canada to increase its exports to Japan and the EC led Canada to share the US scepticism regarding the GATT and its inability to eliminate the unfair practices of Japan and the EC.

The Canadian decision would seem to provide some support for the fourth proposition that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence. We have already seen that the Canadian decision was in part a defensive reaction to the growing dependence of Canadian firms on the US market and the rising protectionist sentiment in the US. Thus the Canadian government saw the the FTA as a way to limit the ability of the US to employ trade remedies against goods said to have benefited from Canadian subsidy programmes. Nevertheless, the Canadian decision to request an FTA with the US was not motivated as was the case with some countries in the EC by a desire by the Canadian government to regain through the joint exercise of economic sovereignty with the US some of the ability to regulate the economy that it had lost as a result of increasing economic interdependence. On the contrary, the Canadian government saw the FTA as a way of giving up certain regulatory powers and of ensuring that no future Canadian government could regain them. In this respect the Mulroney
government's view of regionalism is more in accordance with that of Hayek and Olson than that of Philip and Erhard.\textsuperscript{174}

The decision by Canada to request an FTA also confirms the fifth proposition, that institutionalised regional economic integration is the result of cognitive change. There were three areas of cognitive change that were significant factors in the Canadian decision: the shift in economic ideology from Keynesianism to economic liberalism; learning from the Third Option experience; and the example of the EC and the Canada-US Autopact.

The US decision to agree to an FTA with Canada, like that of Canada, was the result of inter-related and mutually reinforcing factors. We have seen that these factors fall into two categories: the more general US trade concerns and the more specific US concerns regarding its trade with Canada. As far as the broader factors are concerned the US decision to agree to an FTA with Canada must be seen as a result of the change in the economic circumstances of the US, and in particular its worsening trade deficit, and a shift in the dominant economic paradigm from Keynesianism to economic liberalism. To the US Administration the FTA with Canada appeared as the best policy solution to several important problems that were the result of the burgeoning US trade deficit. These were the rise in protectionist sentiment in the US; the growing disillusionment in the US with the GATT and trade liberalisation at a multilateral level; and declining US international competitiveness. The Canada-specific factors were long standing concerns which had been given greater prominence by the Reagan Administration as a result of changes in the economic environment in both Washington and Ottawa. They were: the desire in the US to reduce the burgeoning US trade deficit by increasing access to one of its largest export markets; the desire to increase US energy security by ensuring US access to Canadian oil supplies in times of crisis; the desire of the US to lock in and extend market-oriented reforms in Canada.

From this brief overview of the factors behind the US decision to enter into an FTA with Canada, it is apparent that these factors also provide support for some of the five propositions concerning the rise of institutionalised regional economic integration. There can be no doubt that the US decision, like that of Canada, was a response by the US administration to the undermining of the liberal international trading regime and the associated rise of protectionism - particularly in the US itself. The US decision represented a tactical retreat from its tradition position of support for multilateralism and opposition to regionalism and a defence of US national interests in that context. In the US case, however, the FTA was not so much a defensive strategy aimed at guaranteeing access to its most important trading partners, as an aggressive strategy aimed at enhancing its access to these markets.

\textsuperscript{174} See Chapter Two, pp.39-44.
Our analysis of the factors behind the US decision also confirms the contradictory nature of this response to the undermining of the multilateral trading regime. On the one hand it supports those who have argued that the emergence of institutionalised regional economic integration in the 1980s was the result of efforts by the supporters of free trade to check the rise of protectionist forces domestically at a time when this can no longer be done by global liberalisation. The US administration clearly saw the promise of trade liberalisation through an FTA with Canada as an incentive to bring out those forces in favour of free trade. It also believed that an FTA would force other countries to negotiate within the framework of the GATT a substantial opening of their markets and thus help restore faith in the GATT inside the US. On the other hand, our analysis of the US factors supports - to a lesser degree here than in the NAFTA - those who argue that regionalism is the result of the desire by states and vested interests within those states to escape the discipline of the liberal international trading order and increase protection against outsiders. It could be argued that many in the US no longer felt that the GATT as it was then constituted was still in the US interest and saw the FTA with Canada as both an opportunity to force other countries to accept changes to the GATT, such the inclusion of services and agriculture, that would make it more in line with US interests and as an alternative to the GATT should other countries prove unamenable to those changes. Whether those changes were actually designed to ensure that the practices of the GATT once again accorded with the principles of free trade or whether the changes were simply to ensure that those practices reflected the shift in the comparative advantage of the US and thus accorded again with the US national interest, is a question of subjective judgement. It is nonetheless clear that some, particularly in the auto and textile and clothing industries saw the FTA as an opportunity to increase their protection from outsiders.

The US decision to enter into an FTA with Canada also confirms the second proposition, that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security, and more particularly to boost their competitive position in the global economy. From our analysis of the factors behind the US decision it is apparent that that decision was partly motivated by the desire to increase the international competitiveness of US firms. The US also saw the FTA with Canada as an opportunity to enhance its economic security, particularly in the energy and resources sector in the wake of the overthrow of the Shah and the second oil shock. Also through an FTA with Canada the US could lock in and further extend the economic reforms of the Mulroney government, ensuring that these reforms could not be undone by a future Canadian government, and enhancing US economic security.

The US acceptance of the Canadian request for an FTA supports the third proposition that institutionalised regional economic integration is a defensive reaction among rival capitalists and rival states. The US had become increasingly aware of the growing weight of the EC in international trade negotiations and of the ability of the EC to obstruct US initiatives. The US Administration clearly saw the FTA with Canada as a means of
increasing its bargaining power vis-à-vis the EC in any new GATT round. The spectre of a regional trading bloc in North America, it believed, would force the EC to agree to a new round that addressed US concerns. One of these concerns was the inclusion of services in the GATT. Both the Administration and the US service industries saw the US comparative advantage as now lying in the service sector and were anxious to take advantage of the fast growing international trade in services before that comparative advantage was lost. They believed that an FTA with Canada that included services would increase the pressure on other GATT members to also include services in the new GATT round. US manufacturers saw the efficiency gains that an FTA with Canada would bring as boosting their competitiveness in relation to their EC and Japanese rivals in both the domestic and international markets.

The US decision to agree to the Canadian request for an FTA provides some confirmation of the fourth proposition that institutionalised regional economic integration is a reaction to the costs of growing economic interdependence. In this chapter we have seen how the rising US trade deficit had undermined the support in the US for the GATT and had increased the pressure on both Congress and the Administration to adopt protectionist measures as a means of forcing other countries to open up their markets to US exports. Thus the US decision to enter into an FTA with Canada was not motivated, as was the case with some countries in the EC, by a desire to regain through the joint exercise of economic sovereignty some its ability to regulate the economy that it had lost as a result of increasing economic interdependence. Rather it was more the result of a desire to weaken the pressure for protectionism at home by getting other countries - in this case Canada - to agree to remove barriers to the entry of US exports into their markets and to lock in existing and to encourage further deregulation in these countries.

The US decision to enter into an FTA with Canada also provides confirmation of the fifth proposition, that institutionalised regional economic integration is the result of cognitive change. As was the case with Canada (and the EC), the shift in the dominant economic paradigm from Keynesian to economic liberalism had made policymakers more favourably disposed towards the bilateral option. Nevertheless, this shift was perhaps less significant in the case of the US as their policymakers in the post war period had on the whole been much more inclined to pursue trade liberalisation than their counterparts in Canada. What is significant in the US case is the shift in the US attitude towards bilateral and regional FTAs. Whereas in the past US administrations had generally opposed such agreements because they undermined the multilateral trading regime, it now actively promoted them as a means of defending the multilateral trading regime and the principle of free trade against rising protectionist sentiment at home and abroad. That shift both reflected and was a reaction to a more comprehensive attitudinal shift in Congress and elsewhere away from free trade towards fair trade, managed trade and even protectionism. This more comprehensive shift was in part the result of the changed economic circumstances of the US, namely the worsening trade deficit and the relative decline in US influence over the GATT. This growing disaffection amongst the US elites for free trade
was also the consequence of the various theoretical challenges to the free trade orthodoxy. Of particular significance here were the new developments in international trade theory concerning imperfect competition, the dynamic nature of comparative advantage and the role of governments in creating or enhancing it, and the cultural and social preconditions for free trade.

We now turn to the extension of CUSFTA which had its outcome as NAFTA, the subject of our next chapter.
CHAPTER SEVEN
INSTITUTIONALISED REGIONAL ECONOMIC INTEGRATION IN NORTH AMERICA IN THE 1980S AND EARLY 1990S:
THE NORTH AMERICAN FREE TRADE AGREEMENT

This chapter is concerned with the factors that led to the decision of the Mexican and US administrations and the Canadian government to form NAFTA. Before proceeding to our examination of these factors it is necessary to make two points. The first concerns the positioning of this chapter. Although NAFTA was established after APEC it was to a large extent an extension of CUSFTA. It is therefore appropriate that we deal with NAFTA first. The second concerns to the focus of the chapter itself. Given that many of the factors that played a role in the decision of both the US Administration and the Canadian government were the same as those that had led them to form the Canada-US FTA, the primary focus of this chapter will be Mexico.

The chapter begins with a brief examination of the historical background to the Agreement, followed by a short summary of its contents. It then looks country by country at the factors that contributed to the decision of the Mexican and US administrations and the Canadian government to form NAFTA.1 The chapter concludes with an overview of the factors identified as having contributed to the decision to establish NAFTA and these factors are then examined to see whether they confirm one or more of the five main propositions that were derived from our review of the theoretical literature in Chapters Two and Three. At the end of the chapter an attempt is made to establish the relative importance of each of these propositions in accounting for the emergence of institutionalised regional economic regionalism in North America in the 1980s and early 1990s.

1 There have been some attempts, albeit brief, by scholars to compare and contrast the motivations of the three countries in signing the NAFTA. According to the Mexican scholar Gustavo Vega (1990a, p.2), NAFTA was the consequence of two factors common to all three countries: common domestic policies of deregulation and privatisation; and a common concern over deteriorating current account deficits. Michael Hart (1991, p.87), a Canadian government official and member of the Canadian negotiating team for the FTA with the US, has observed certain parallels between the Canadian and Mexican roads to an FTA with the US. In both countries there has been a long tradition of academic analysis in favour of a bilateral free trade agreement with the US; both countries originally sought sectoral agreements to ensure their principal exports were exempt US contingency laws; and both came to see a bilateral arrangement as a more effective way than multilateral negotiation of solving their bilateral problems with the US. Other scholars have highlighted the asymmetrical nature of US and Mexican interests in signing an FTA. According to Prestowitz et al. (1991, p.1), the US motives were mainly geopolitical, while those of Mexico were principally economic.
Historical background to the Agreement

The push for free trade between the US and Mexico has a much shorter history than the corresponding push for free trade between the US and Canada. In keeping with the long history of anti-Americanism in Latin America and Mexico in particular, the idea of free trade with its northern neighbour had been until quite recently anathema to the Mexican political and business elites. There had been some proposals in the late 1970s and early 1980s from the US side but these had been quickly dropped when it became apparent that such proposals were more likely to increase rather than decrease anti-Americanism in Mexico and to hinder US business interests there. Thus the Carter Administration dissociated itself from US business proposals for hemispheric free trade in face of opposition from the Mexican administration and the Canadian government.2 Reagan, both as a presidential candidate and during his first year in office, had made a similar proposal but again the response had been unenthusiastic.3

As late as 1988 the US Administration appeared to have ruled out any prospect of a free trade agreement with Mexico in the immediate future.4 Yet barely two years later, in June 11 1990 Mexican President Salinas and US President Bush committed their respective administrations to the negotiation of a comprehensive bilateral trade agreement and asked their respective trade ministers to begin preparatory work.5 On August 21 Salinas formally proposed that the two countries begin negotiations in accordance with the fast-track provisions of the US Omnibus Trade and Competitiveness Act of 1988. On September 25 1990 Bush formally requested the permission of both the Senate Finance Committee and the House Ways and Means Committee to negotiate an FTA with Mexico under the fast-track provisions and informed them of Canada's expression of interest in participating in the FTA. On February 5 1991 the Mexican and US administrations and the Canadian government formally proposed the establishment of a North American Free Trade Pact. The US Congress approved the President's request for a two year extension

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2 Story 1982, p.777. These proposals were also taken up by the US Congress, which had incorporated in the 1979 US Trade Agreements Act a request that the Administration study possible new trade arrangements in North America. See Curtis 1985a, p.180.

3 However, Reagan was later to return to the idea. See below this chapter, fn.82.

4 In his testimony before Congress in support of the Canada-US FTA US Trade Representative Yeutter (1988 pp.109-110) maintained that the Mexico was not yet 'prepared to take that big a step.' According to Yeutter, the US was keen to do anything it could to support Mexico psychologically in the liberalisation process that Mexico was undertaking but believed that 'we are still a long way from extending a United States-Canada Agreement into Mexico as a free trade arrangement. I do not think that the Government of Mexico is ready for that yet. There is no indication that they are prepared to take that big a step at the moment, but this is an evolutionary process. If the United States-Canada Agreement works out well ... it may well be that at some point in time, Mexico and perhaps other countries in this hemisphere will become part of this overall program. But I suspect that is several years down the road, at a minimum.'

5 In August 1990 US Trade Representative Hills and Mexican Trade Minister Serra jointly recommended that negotiations begin on a comprehensive bilateral free trade agreement. According to Hills (1991b, p.20), the objectives of the negotiations were the progressive elimination of impediments to trade in goods and services and to investment, the protection of intellectual property rights, and the establishment of fair and expeditious dispute settlement mechanisms.
of his fast-track authority on May 24 1991 and negotiations were initiated on June 12 in Toronto.

On August 12 1992 agreement was finally reached on the provisions of the Agreement and the Agreement was formally signed by the leaders of the three countries on December 17. It was ratified by the Canadian House of Commons on May 27 1993 and by the Canadian Senate on June 23. On the insistence of the newly elected Clinton Administration, Canada and Mexico agreed on August 12 to the inclusion in the Agreement of clauses guaranteeing existing levels of environmental and labour protection. The NAFTA was approved by the US House of Representatives on November 17 and by the Mexican Senate on November 22 and came into effect on January 1 1994.

The contents of the Agreement

According to Hufbauer and Schott the Agreement is essentially an improved and expanded version of CUSFTA. It stipulated the elimination over a period of ten to fifteen years of all tariff and most non-tariff barriers to trade between the three countries. As in the Canada-US FTA there were special arrangements for both the auto and textiles and apparel industries that were designed to discriminate against goods produced wholly or partly outside North America. Under NAFTA this discrimination was considerably increased. The liberalisation of access to the Mexican market was to be phased in more rapidly for established auto manufacturers (mainly US companies) than for newcomers. The Agreement introduced a new method for calculating regional content to eliminate disputes that had arisen between Canada and the US under the rules of origin of the Canada-US FTA. At the same time regional content would be raised from the 50% required in CUSFTA to between 60% and 62.5% by the end of the 10 year transition period. All tariffs and quotas were to be eliminated on regional trade in textiles

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6 Keesing's Record of World Events 39045-46; 39234.
7 Keesing's Record of World Events 39507. The vote was 140 to 124 in the House of Commons and 47 to 40 in the Senate.
8 Keesing's Record of World Events 39269; 39591.
9 Keesing's Record of World Events 39728-29. The vote in the US House of Representatives was not as close as expected - 234 to 200. The Mexican Senate voted overwhelmingly in favour: 56 votes to 2.
10 Hufbauer and Schott 1993, p.2. For a detailed account of the contents of the Agreement, see Hufbauer and Schott 1993; and External Affairs and International Trade Canada 1993.
11 However, a trilateral agreement covering trade in agriculture was not possible and instead separate bilateral agreements were negotiated between Canada and Mexico, and Mexico and the US, that liberalised agricultural trade to differing degrees.
12 External Affairs and International Trade Canada 1993, pp.34-35.
13 As a result of protectionist pressure from the auto industry, duty drawback programs for Mexico-US and Mexico-Canada auto trade could remain until 2001 and the deadline for the elimination of those affecting the Canada-US auto trade laid down in the CUSFTA was extended by two years.
and apparel but again much stricter rules of origin would apply than those under CUSFTA.\textsuperscript{14}

Trade and investment in Mexico’s energy sector was liberalised, though to a lesser extent than that agreed to by Canada in the Canada-US FTA.\textsuperscript{15} The US did not obtain a commitment by Mexico to security of supply in times of crisis, similar to the one it had obtained from Canada in the Canada-US FTA.\textsuperscript{16} There was also some opening of the Mexican government procurement market to Canadian and US bidders.\textsuperscript{17}

NAFTA established common rules for both providers and users of telecommunication and computer services.\textsuperscript{18} The liberalisation of financial services called for by NAFTA was slower and more regulated than that in the CUSFTA. The national treatment provisions - and the exemptions to these - of the CUSFTA in the area of investment were also to apply to Mexico. In particular, by allowing investors to seek redress in a court in any member state, NAFTA also overrode the Calvo Doctrine according to which disputes involving foreign investors in Mexico could only be settled in Mexican courts. NAFTA also prohibited the imposition of new performance requirements on investment and phases out most of the existing requirements.\textsuperscript{19} NAFTA also strengthened protection for US intellectual property in both Canada and Mexico and in what was a crucial gain for the US Canada agreed to end its compulsory licensing of US pharmaceuticals.

Under NAFTA the enhanced security of access to the US market that Canada had obtained under the Canada-US FTA was extended to Mexican goods. Thus the US must exclude both Mexico and Canada from any escape clause action against the import of a good unless it can be shown that their exports of that good contribute significantly to the injury being incurred.\textsuperscript{20} The provisions contained in Chapter 19 of the Canada-US Agreement for the review by an independent binational panel of disputed national anti-

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\textsuperscript{14} Under the Canada-US FTA, to qualify for preferential treatment, garments had to be made from cloth woven within the area covered by the FTA or have undergone substantial transformation. Under NAFTA the yarn must also be spun within the area covered by NAFTA. However, Canada was granted a partial exemption from these requirements. See External Affairs and International Trade Canada 1993, p.37.

\textsuperscript{15} Both Canada and Mexico had been unwilling to remove all restrictions on US investment in their energy sectors. CUSFTA merely locked in the unilateral measures that the Mulroney government had already taken in 1985 and 1986 to ease restrictions on foreign investment and foreign ownership in the energy sector. See Harrison 1988, pp.185-86; and Verleger 1988. In Mexico oil had become a powerful symbol of national sovereignty and opposition to foreign ownership of Mexican oil production was stronger than in Canada. Although under NAFTA Mexico agreed to allow some foreign investment in the petrochemical industry and electricity generation, foreign investment in the Mexican petroleum industry itself remained proscribed. See Hufbauer and Schott 1993, pp.34-35.

\textsuperscript{16} See Chapter Six, p.185; and Hufbauer and Schott 1993, pp.35-36.

\textsuperscript{17} According to External Affairs and International Trade Canada (1993, p.58), NAFTA increased the value of the open procurement market in North America from $20 billion to $78 billion. However, this was only a small fraction of the total value of government procurement markets in the three countries, which it estimated to be $800 billion.

\textsuperscript{18} External Affairs and International Trade Canada 1993, p.69.

\textsuperscript{19} External Affairs and International Trade Canada 1993, p.63.

\textsuperscript{20} Section 201 of the US Trade Act of 1974 authorises the President to impose temporary restrictions on imports that were ‘a substantial cause of injury, or the threat thereof’ to US producers. Under Article XIX of the GATT such restrictions are to be non-discriminatory and to be imposed on all imports of the good or goods in question. See Destler 1992, pp.54,435.
dumping and countervailing duty determinations were strengthened and extended to include Mexico. A trilateral North American Free Trade Commission, composed of cabinet-level representatives from each country, was also established to administer the agreement and deal with disputes over the interpretation and application of the rules.21; Unlike the Canada-US FTA NAFTA also contained an accession clause. To accede to the agreement a country must meet certain terms and conditions to be determined by the NAFTA Commission and must obtain the approval of each existing member.22

Why did Mexico request an FTA with the US?

This section will examine the main factors that led to the Mexican decision to request a free trade agreement with the US. However, given Mexico’s traditional opposition to the idea of free trade with the US and its policy of minimising its dependence on the US market, what must be explained here is the dramatic shift in attitude by the Mexican administration.23 Like Canada, Mexico was the demandeur. But the US had given clear signals in the past that should Mexico request an FTA, it was highly likely that such a request would met.24 Thus while the US also had its reasons for acceding to the Mexican request and we will examine these later in this chapter, this change in the Mexican attitude towards free trade must be considered to have been crucial to the establishment of NAFTA. It is argued here that this change was the result of a number of interrelated factors deriving from changes in the international political economy, in Mexican domestic politics and in the ideas that informed Mexican policymaking.

This section will look first at the factors behind this change in attitude: the growing disillusionment with the traditional import substitution (or IS) model of development, the success of the alternative model of export oriented growth in East Asia and in the northern border region of Mexico itself, the growing influence of US trained Mexican economists on Mexican economic policymaking, and the fall of socialism in Eastern Europe. It will then examine other related factors such as the increasing fear among Mexico’s political elite that without a return to economic growth the ruling party would lose its stranglehold on political power, the need to make Mexico a more attractive destination for foreign direct investment, the need to guarantee Mexico’s access to the US market against rising protectionism in the US, and concern about the likely trade and investment diversion effects of the Canada-US FTA and of emerging regional economic blocs elsewhere.

21 Hufbauer and Schott 1993, p.142.
23 For Mexico’s policy of minimising its dependence on the US market, see Vega 1990b, pp.1-2.
24 According to Richard English, Deputy Assistant Secretary of State, Bureau of East Asian and Pacific Affairs (interview with author June 1992), in a 1988 campaign speech Bush had announced his readiness to negotiate an FTA with Mexico. Yet at the time the feeling in the Administration was that any request from Mexico for an FTA was still a long way off.
The weight of history - abandonment of Mexico's traditional model of development and adoption of the export oriented industrialisation model

Any attempt to explain Mexico's request for an FTA with the US must account for the change in the attitude of the Mexican administration towards both free trade and the United States. The initiation by Mexico of negotiations with the GATT in 1979 concerning the terms of its accession to that Agreement would suggest that such a shift was already occurring in the late 1970s. However, the subsequent rejection of GATT membership by the then President José López Portillo in March 1980 clearly shows that the forces in favour of free trade were still in the minority. 25

According to Story, among the main reasons for the opposition to GATT membership were the continued widespread resentment in Mexico of the US and the fear that membership of GATT would entail a loss of economic sovereignty and constrain Mexico's freedom to pursue its own path of development and industrialisation. There was concern as well that GATT membership would lead to increased economic dependency and greater US control of Mexico's petroleum resources. Opponents also argued that GATT membership would result in widespread bankruptcies among small and medium industries, and lead to increased social and economic disparities and higher unemployment. Mexico, they maintained, would be able to exploit more effectively the political leverage given to it by its petroleum resources through bilateral agreements with the US and other developed countries. 26

The rejection of GATT membership also reflected the continued dominance in Mexican economic thinking of the theories of backwash, unequal development and dependency and in particular, and of the idea that free trade benefited the richer, more developed countries to the detriment of the poorer, less developed countries. 27 These theories provided the ideological basis for what had been Mexico's traditional model of development since WWII, import-substituting industrialisation (or ISI), and their dominance would have to be ended if Mexico were to embrace free trade, either in the form of GATT membership or of a free trade agreement with the US.

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25 Story 1982. According to Story (1982, pp.771, 788-89), opposition to GATT membership came mainly from nationalist intellectuals and economists, private sector protectionists, some sections of organised labour, and government planners. Those in favour included the President himself, some members of his Cabinet and big business. They argued that GATT membership would improve the competitiveness and efficiency of Mexican industry and enhance its access to foreign markets and thus reduce its trade deficit.

26 Story 1982.

27 See above Chapter Two, fn.35. For an analysis of these theories and their impact on economic thinking in Mexico and Latin America, see Weintraub 1984, pp.154-177. These ideas and theories originated in the writings of Myrdal (Economic Theory and Under-Developed Regions 1957) and Hirschman (The Strategy of Economic Development 1958), were further developed by Prebisch and the dependency theorists and seen by writers such as Dell (1966) and Wionczek (1970) to have been confirmed by attempts at regional integration in Latin America such as LAFTA and CACM. For Weintraub (1984, p.24), there is a definite link between Mexico's adherence to the ISI model and its hostility to the US. He argued that 'the conceptual concern about dependency and its political and economic ramifications are compounded by a historically based animosity toward the United States, and practical concern of who loses from free trade and who gains.'
By 1986 that dominance had been overturned and the import substituting model of development had been replaced by export oriented industrialisation and this shift in economic thinking culminated in the decision by Mexico in 1986 to accede to the GATT.\(^{28}\)

There were three main factors behind this shift in economic thinking. First, through their alliance with international economic institutions such as the IMF and the World Bank the pro-liberalisation forces within Mexico's dominant political party were at a moment of severe economic crisis able to seize control of Mexico's domestic and foreign economic policy and create a policy environment that would eventually lead to the establishment of NAFTA.

The impact of the economic crisis in Mexico in the early 1980s, again engendered by the changes in the international economy, differed from that in the US and in Europe. The impact for a developing country like Mexico brought in the international institutions in a way which was to strengthen those forces within the Mexican body politic who favoured increased opening of the economy to the outside world. The dramatic increases in interest rates and the equally dramatic collapse in oil prices of the early 1980s which had sparked the 1982 external debt crisis had made it increasingly difficult for Mexico to continue an ISI development strategy that was financed from overseas borrowings and oil export revenue.\(^{29}\) The 1982 IMF rescue package further strengthened the hand of the newly elected President, Miguel de la Madrid Hurtado, in his efforts to reduce state intervention and increase the role of the market in determining economic outcomes.\(^{30}\) In return for $3.8 billion in loans from the IMF, Mexico agreed to implement a programme of structural reforms that included the reduction of its budget deficit from nearly 18 per cent of GDP in 1982 to 3.5 per cent of GDP by 1985, a cut in government subsidies, the curtailment of foreign borrowing and foreign exchange controls, and a reduction in import protection.\(^{31}\)

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\(^{28}\) This change in thinking is reflected in a statement by Senator Bentsen in 1986 that during his talks with the Mexican President and other members of his cabinet he had gained the impression that both the US and Mexican administrations now had some leverage to do some things (in the way of a bilateral framework agreement for trade) that in the past, may have been politically difficult to accomplish in Mexico.’ See Bentsen 1986, p.130-31.

\(^{29}\) Vega 1991a, p.2; Bueno 1988, pp.112-13; Salinas 1990, p.89; Weintraub 1990a, p.103. There was a $5.5 billion shortfall in budgeted oil revenues in 1981. (See Looney 1988, p.67). Mexico's public sector deficit had grown to 17% of GDP, its foreign debt was $86 billion and service on that debt amounted to 34% of export income. (See Morici 1992, p.90). Inflation had reached 98.8%, there was massive capital flight and capital inflow had virtually ceased. (See *Keesing's Record of World Events* April 1983 Vol XXIX 32070). In 1982 GDP fell for the first time since 1929. (See De la Madrid 1984, pp.66-67). In 1983 GDP declined by 5%.

According to Story (1982, p.771, 780), the ISI strategy was already being questioned before loss of oil revenues at end of 1970s. Trade liberalisation had been seen by President Portillo as a way to make Mexican industries more efficient and internationally competitive, and to improve Mexico's balance of trade by increasing access of Mexican manufactures to foreign markets.

\(^{30}\) Grayson 1988, p.44. According to President de la Madrid (1984, p.69), 'the crucial issue is to increase the competitiveness of our non-oil exports and to re-establish net capital flows that will accelerate the recovery of the Mexican economy.'

\(^{31}\) Grayson 1988, p.47; Hartland-Thunberg and Ebbing her 1986, p.66. According to Grayson (1988, p.45), the increasing importance of economic issues after 1981 saw a reduction in the
However, the improvement in Mexico's balance of payments situation was shortlived and when oil prices tumbled from $25 to $10 a barrel in 1986 Mexico once again turned to the IMF for assistance. In return for $6 billion in new loans Mexico was required to continue its restructuring programme of privatisation, trade liberalisation and deficit reduction, and to remove restrictions on foreign investment. At a time when Mexico was looking to increase its manufactured exports to offset the decline in petroleum exports the ISI strategy was blamed for having made Mexican industries internationally uncompetitive.

Another factor that reinforced this growing disillusionment with Mexico's traditional model of development was the success of the so-called Asian Tigers - South Korea, Taiwan and Hong Kong - widely attributed to their pursuit of the model of export-oriented economic development. This model provided an alternative to the inward looking economic nationalist policies centred on import substitution and the internal market. Mexican policymakers had also witnessed first hand the success of this model with the maquiladora plants in their own export-oriented economic zone along the US border.

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33 Looney 1988, p.69.
34 Castillo 1990, p.8. In a face saving statement Carlos Salinas de Gortari, Planning and Budget Secretary in the de la Madrid administration and Mexican President from 1988 to 1994, declared that the crisis of the 1980s showed that the traditional model of protectionism and dependence on the domestic market 'had fulfilled the purpose for which it was designed and was exhausting its positive effects' and that '(i)n order to grow, it is necessary to export, and that demands competitiveness, technology and access to markets.' See Salinas 1990; 1991, p.3. Salinas maintained that '(t)he only option to revive the economy today is increased trade and orientation to exports.' Even before the 1985-86 crisis, President de la Madrid (1984, p.75) had clearly expressed both his dissatisfaction with Mexico's traditional model of development and his determination to 'continue re-ordering (Mexico's) productive structures and processes in order to be able to compete in the international economy instead of locking (Mexico) inside structures that are, if not archaic, poorly adapted to the changes in international trade.' According to Keith Miceli, Director of Latin American Affairs in the International Division of the US Chamber of Commerce (1992, interview with author), Salinas believed that without a change in economic strategy the future of the PRI could be in jeopardy.

35 Vega 1991a, pp.2-3. There is some disagreement among scholars over the extent to which this model is a vindication of neo-classical or neo-mercantilist principles. Prestowitz et al. (1991, pp.8, 23-24) argued that the Mexican strategy, like that of the NICs, is not based on the laissez-faire model of the United States but on a results oriented neo-mercantilist strategy. They support their argument with a statement by Mexico's Finance Minister Pedro Aspe, in which Aspe claimed that economies of scale and technological change of the post war period have called into question the assumptions of Ricardian theories of free trade and comparative advantage.

36 Set up in 1965 under Mexico's Border Industrialisation Programme, the maquiladora plants are production facilities that are exempted from paying duty on imported raw materials and components as long as the final product is re-exported. See Hufbauer and Schott 1992, pp.91-92. The programme, similar in many respects to the US-Canada Autopact, has proven very successful. The number of plants increased from 12 in 1965 to over 1,400 in 1987, while the number of those employed in the plants rose from over 20,000 in 1970 to over 300,000 in 1987. In 1987 exports from these plants earnt Mexico $1.6 billion or 20% of the total value added in Mexico from manufactured exports. See Weintraub 1990a, p.107. However, Weintraub (1990b, p.10) argued that these plants are an export enclave, and hence poorly integrated with the rest of the economy. As a result there was some concern about the potential threat to national unity posed by the growing development gap between the border
The success of the Asian NICs and of its own experiment in export oriented growth encouraged Mexican policymakers to contemplate replacing the ISI strategy with the export oriented growth strategy.\(^{37}\)

Given these developments, more and more scholars were questioning the theoretical underpinnings of the ISI strategy and arguing that rather than creating a backwash effect and unequal development or divergence, the liberalisation of trade between a middle income less developed country and a high income developed country was more likely to result in economic convergence and the further industrialisation of the lesser developed country.\(^{38}\) As we shall see in Chapter Eight, this mirrors the calculations among ASEAN states much earlier - in the late 1960s and 1970s.

Another important factor contributing to the abandonment of the ISI model and the adoption of the export-oriented industrialisation model was the growing influence over Mexican economic decision making of a new generation of economic leaders and managers that had been trained in US universities and influenced by the increasingly dominant economic rationalist school of economic thought.\(^{39}\) Such leaders firmly believed in the need to limit the role of the government and free up market forces and their policies were guided by the pursuit of economic efficiency and not political ideology.\(^{40}\) Like his

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\(^{37}\) At the same time and for similar reasons there had been a general shift elsewhere in Latin America away from ISI towards policies more in line with export oriented growth model and this, together with the mounting evidence of failure of the socialist model in the USSR and Eastern Europe, had weakened the ability of the left to influence the economic policy of the traditional party of government in Mexico, the Institutional Revolutionary Party or PRI. See Story 1982, p.793; Weintraub 1990, p.4; Miceli 1992 (interview conducted by author). The PRI is the major political party in Mexico. Because it has been in power since 1929, it is also referred to as the 'official' party or 'government' party. See Story 1982, p.778.

\(^{38}\) This argument is made by Sidney Weintraub (1986, pp.161-71). According to Weintraub, the theories of backwash and divergence were not valid for the NICs and other middle income developing countries in Latin America such as Mexico, and that, as the examples of Italy and Ireland in the EC and Portugal in EFTA had shown, such countries were more likely to experience convergence by liberalising their trade with developed countries. Weintraub argued that in order for convergence to happen 'the weaker country must have crossed some technological, savings, educational, and infrastructural threshold.' As Weintraub himself acknowledged in a footnote, this argument is essentially the same as that used by Rostow in the *Stages of Economic Growth: A Non-Communist Manifesto*. Development theory would seemed to have turned full circle.

\(^{39}\) Dornbusch (1990, p.121); Miceli 1992 (interview conducted by author); Mexican official at the Office for FTA, Mexican Embassy, Washington 1992 (interview conducted by author).

\(^{40}\) *Australian Financial Review*, November 30 1990, p.37: Mexico Fights for new freedom; Weintraub 1990a, p.108. Increasingly this new generation of *tecnicos* - the name given to those who acquire their positions in government as a result of their professional expertise, as opposed to the *politicos* or those who acquire their positions as a result of their political influence both within and outside of the PRI - came to dominate the cabinet economic posts, PRI and the presidency itself. Both President Portillo (1976 -1982) and his successor President de la Madrid (1982-1988) were *tecnicos*. See Story 1982, p.782; and Weintraub 1990b, p.34. According to Grayson (1988, pp.44-45), during the de la Madrid sexenio the growing importance of economic issues saw a rise in the influence over government policy of the Finance and Commerce Ministries, the Central Bank of Mexico and the nationalised oil corporation Pemex, where economic rationalism held sway, and a corresponding decline in the influence of the Foreign Ministry and its anti-US and pro Third World leanings. As a result Mexico has abandoned its policies of the last 20 years based on the support of the North-South dialogue and differential treatment for developing countries. See Vega 1990b, p.3. Grayson (pp.50-51) argued that Mexican foreign policy has moved away from defending
predecessor de la Madrid, President Carlos Salinas de Gortari, who actually concluded the FTA, was Harvard educated with a PhD in political economy. He had held the position of Planning and Budget Secretary in the previous administration and had been chosen by de la Madrid to succeed him partly because of his unswerving commitment to liberalisation, economic restructuring, and the removal of Mexico's trade barriers.41

The economic rationalist beliefs of the tecnico not only led them to advocate trade liberalisation and GATT membership but also made them more open to the idea of an FTA with the US. As in Europe and Canada, they argued, not only would the FTA boost productivity and efficiency through encouraging increased specialisation and greater economies of scale, it would also ensure that the state would not be able to intervene in the economy to the extent that it had done so in the past. 42 Their abandonment of the ISI model and their inherent distrust of government intervention in the market also made them less concerned about the loss of economic sovereignty that GATT membership and an FTA seemed to imply. This was because these tecnico perceived that loss as resulting in a greater determination of economic outcomes by market forces and hence as something positive, and not as something negative, as the economic nationalists had perceived it in the past, that would lead to increased US control over the Mexican economy and more particularly its oil.43

From the above it is clear that the shift in economic ideology was an important factor in the decision to request an FTA with the US. It is also clear that international bodies such as the World Bank and the IMF were key instruments in the global push for economic deregulation and free trade through the control they exercised over states in debt. Particular academic institutions like Harvard were also important in facilitating contact between the political and economic elites of the United States and Mexico and in encouraging the spread of those ideas and economic ideologies that were favourable to institutionalised regional economic integration. Yet it is difficult to ignore the important revolutions in neighbouring Central America to that of playing the honest broker between the US and the revolutionary movements.

41 Grayson 1988, p.156. Both Salinas and his Commerce Secretary, Jaime Serra, who had a doctorate in economics from Yale, appointed other US trained economists and political scientists as their advisers. See Hart 1990b, p.3.

42 Salinas 1991, p.2. This point is treated more fully later in this section as a separate factor in the decision by Mexico to request an FTA with the US.

43 This change in economic thinking on the part of both government and business in Mexico also facilitated the establishment of an FTA with the US by bringing Mexican economic policy closer to that of the Reagan and Bush administrations in the US. According to US Trade Representative Hills (1991b, p.21), the FTA with Mexico was possible because of the shift by Mexico away from statist, interventionist policies towards a market-oriented system. According to the US Business Roundtable (Whitmore 1991b, p.778), this change in economic thinking has also been accompanied by a change in the way most of Mexican private sector and government see the US. They now see their futures as tied to North America and see closer cooperation as an advantage, rather than as something to fear. Hostility towards the US, which in the past had been a major impediment to both Mexican membership of GATT and to greater US-Mexican economic integration, was further eroded by the first hand knowledge of the US of many of the tecnico. For a detailed discussion of the origins of the political impediments to a US-Mexico FTA, see Weintraub 1984, pp.14-25.
role of the severe economic crisis of the 1980s in Mexico and elsewhere in creating an environment that favoured this shift in economic ideology.

*Increasing fear that without economic growth the PRI will lose power*

By themselves these fears regarding the detrimental effect of the Canada-US FTA on Mexico's economic growth prospects would have been of limited significance. But their significance was greatly amplified by an already deteriorating domestic economic situation and growing internal pressures for political change. The de la Madrid sexenio had seen a sharp deterioration in Mexico's economy and growing disaffection with the political system and the ruling party, the PRI, in particular. This had led many both in Mexico and the US to argue that the Mexican political system was in grave danger of breaking down.

The political situation in 1988 thus appeared to rule out another round of austerity measures, similar to those imposed by de la Madrid at the beginning of his sexenio. For Salinas the restoration of economic growth was the only solution to Mexico's political and economic crisis. Without economic growth it was apparent that the PRI would be defeated electorally and the administration's economic reforms would be halted or even

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44 According to Castañeda (1985, p.287), the principal challenge facing Mexico in 1985 was 'the total lack of credibility in the political system.' The de la Madrid sexenio had seen an unprecedented decline in the economy and economic welfare. According to Weintraub (1990b, pp.1, 13-14), there was a 13% decline in per capita income and a 45% fall in real wages. Inflation was still not under control - in 1987 inflation was still 130% and Mexico's foreign debt continued to rise - by 1987 it had climbed to $108 billion US. Unemployment, both official and hidden, affected almost 50% of the work force and with 40% of the population under 15 and 800,000 to one million new entrants into the work force each year, the Mexican administration was desperately seeking for ways to restore economic growth and create new jobs. See Grayson 1988, p.157; Weintraub 1990b, p.17.

At the same time there was growing disillusionment with the political system and more particularly with the party that had ruled Mexico since 1929, the PRI. According Weintraub (1990b, pp.18-25), electoral support for the PRI had fallen significantly from 71.6% at the 1982 presidential election to 50.4% at the 1988 presidential election. That decline was most apparent in urban areas. In 1988 Salinas had obtained only 41.9% of the urban vote and had lost the major industrial centres, including the federal capital, to the opposition. See, for example, Castañeda 1985. This argument, and in particular the repercussions that such a breakdown would have on the US, was used in support of the case for NAFTA in the US. There were also increasing divisions within the PRI between politicos and tecnicos over the administration's programme of economic restructuring. See Weintraub 1990b, p.34. Salinas's main opponent in the 1988 presidential election was Cuauhtémoc Cárdenas, a former member of the PRI. For an account of the evolution of the Mexican political system between 1982 and 1988, see Castañeda 1985; and Grayson 1988, pp.161-68. See also Castañeda 1993, pp.68-70, for developments post 1988.

45 Weintraub 1990b, p.18. For Castañeda (1985), the Mexican administration appeared to be caught in a vicious circle. In order to guarantee the survival of the PRI it needed to restore growth. To restore growth it needed to reform the economy. But economic reforms would only increase the economic hardship of certain segments of the population and further undermine political support for the administration. Thus the administration, Castañeda argues, was caught between the necessity of structural economic reform and economic opening, and increasing popular pressure for democratic reforms and political liberalisation.

46 Salinas 1990. According to Salinas, 'the challenge faced by the Mexican economy is to grow and to do so in a lasting and sustained manner. Our country has almost 85 million inhabitants and a further 10 million will join us in the course of the administration. They will demand employment, services and opportunities in addition to those that already exist. Thus, there is no time to lose; growth is our only option.'
reversed.\textsuperscript{48} That growth, Salinas believed, could only come through the increased export of manufactures. An export-oriented growth strategy would require secure and enhanced access to foreign markets and large inflows of foreign investment to restructure and modernise the economy so that Mexican manufactures could become more internationally competitive. By the late 1980s, however, it was becoming increasingly apparent that neither of these requirements was being met, thereby jeopardising the Mexican administration's efforts to restore economic growth to the levels needed to provide jobs for its expanding work force.

\textit{The problem of investment: attraction and diversion}

Thus far we have examined factors that led Mexico to liberalise its trade with the outside world. Yet though these factors must be seen as necessary pre-conditions for Mexico's request of an FTA with the US, they were by themselves not sufficient conditions for that request. Less than two years before his announcement that Mexico would request an FTA, Salinas had on at least two occasions publicly rejected the idea of an FTA with the US or an NAFTA.\textsuperscript{49} But the refusal on the part of Mexico to conclude an FTA with the US was due to a residual fear on the part of the Mexican administration of becoming economically dependent on the US. The Mexican administration no doubt felt that an FTA was unnecessary, believing that membership of GATT together with unilateral liberalisation would enable Mexico to diversify its overseas markets and thus increase its exports without increasing its dependence on the US market.\textsuperscript{50} (This resembled the position of the Third Option of Canada. See above Chapter Six, pp.188-91).

A combination of internal and external factors, however, were to force the Salinas administration to reconsider and request an FTA with the US. One factor that influenced the Salinas administration to change its attitude towards the establishment of an FTA with the US was the conclusion of an FTA between Canada and the US. The Canada-US FTA not only raised the profile of the FTA issue in Mexico, it also gave those in favour a powerful new argument. Unless Mexico concluded a similar agreement with the US, they maintained, trade, technology and investment would be diverted from Mexico to Canada and Mexico's efforts to restructure the economy and restore economic growth would be

\textsuperscript{48} Weintraub 1990b, p.1. According to Weintraub (1990b, p.31), Cárdenas, Salinas's main opponent in the 1988 presidential election, had called for a return to inward-looking policies.

\textsuperscript{49} Weintraub 1990a, p.121, fn.13. This was also the opinion of scholars of US-Mexican relations at the time. They argued that the relatively undeveloped nature of Mexico's economy compared to that of the US or even Canada would at least in the short term prevent it from entering into such arrangements. See in particular Weintraub 1990a, pp.102, 109-10. Although Weintraub ruled out the possibility of a US-Mexico FTA in the near and medium term, he did predict that the pressure on Mexico to conclude an FTA with the US would increase and 'may in time become inexorable.'

\textsuperscript{50} By 1988 Mexico's tariff levels were on a par with those of Canada. For further details concerning the liberalisation process, see Vega 1990a. According to Vega (1990a, p.3), Mexico's maximum tariff was reduced from 100% in 1986 to 20% in 1988. Its average trade-weighted import tariff in 1990 was 6.5%.
As we have seen, the fear of investment diversion was a factor in EC regionalism, and as is evident in the next chapter, the fear of investment diversion in Asia motivated APEC regionalism. These fears were strengthened by studies undertaken at the time of the likely impact of the Canada-US FTA on Mexico. More broadly, the FTA was a part of a strategy to make Mexico a more attractive destination for foreign investment by locking in liberalising reforms. The 1980s had seen a remarkable change in Mexico's attitude to foreign direct investment. In the past the Mexican administration had had a negative view of foreign direct investment, particularly that from the US. It now saw foreign direct investment as playing a crucial role in boosting the country's economic growth rate and actively sought to promote it. In the first years of the Salinas sexenio, however, Mexico's export oriented growth strategy appeared to falter. According to Mexico's President Salinas, in 1989 imports had increased by 26%, raising doubts about the policy of unilateral liberalisation. He argued that Canada before it, Mexico would find the sectoral approach difficult and in the end unsatisfactory.

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51 Weintraub 1991, p.58; Weintraub 1990a, pp.115-16; Vega 1990a, p.9, 1991a, p.3. These scholars agree that Mexico's manufacturing exports would be the hardest hit by any trade diversion. In Chapter Six we saw that one of the principal motivations of Canada for an FTA with the US had been the desire to give Canadian exports preferred access to the US market, either as a result of lower tariffs or greater protection from US non-tariff barriers, thereby increasing the attractiveness of Canada as a site for production and investment. Mexico feared that this increase in the attractiveness of Canada would have a negative impact on its own efforts to boost manufactured exports, attract foreign investment and restructure its economy.

52 Vega 1991a, p.3. An unpublished Mexican government report cited in Vega estimated total trade diversion based on 1988 trade flows at $662 million. The automotive sector alone would account for $421 million of this and the consumer electronics sector for a further $102 million. This would have been offset by $257 million of trade creation. Weintraub (1990a, pp.111-12) identified the automotive products, petrochemicals, iron and steel, other metals, paper products, textiles and apparels as the mostly likely products to be affected. He also saw a potential for the diversion of new investment in these and other areas from Mexico to Canada. Yet scholars such as Weintraub (1990a, pp.102, 110) still maintained that rather than seeking an FTA with the US to offset the trade and investment diverting effects of the Canada-US FTA Mexico was more likely, at least in the short term, to rely instead on the Uruguay Round and more limited bilateral agreements of a sectoral nature. For a discussion of possible Mexican responses to the Canada-US FTA, see Weintraub 1990a, pp.117-19. Weintraub argued that, like Canada before it, Mexico would find the sectoral approach difficult and in the end unsatisfactory.

53 Vega 1990a, p.12; Castañeda 1993, pp.66; Aguilar Zinser 1991, p.42. According to Aguilar the FTA was viewed primarily by Mexican administration as 'an investment promotion pact designed to create a climate of confidence among overseas investors.' This was also the view of US Deputy Under Secretary for Economic and Agricultural Affairs, State Department, Michael Young, and of Eduardo Wallentin from the Office of the FTA, Mexican Embassy, Washington, in interviews with the author in May-June 1992.

54 Middendorf 1991, p.305; Salinas 1990. Under the 1973 Law to Promote Mexican Investment and Regulate Foreign Investment, foreign investment in Mexican companies was limited to a maximum of 49%, with greater restrictions applying to certain sectors. All foreign investment was subject to a screening process undertaken by National Foreign Investment Commission. These restrictions were progressively loosened in 1984 and then in 1988. Under the reforms of May 1989, automatic approval was given to all investments of up to $100 million and 100% foreign ownership was permitted in certain sectors. For further details concerning the history of the regulation and deregulation of foreign direct investment in Mexico, see Hufbauer and Schott 1992, pp.75-80.

55 According to Hufbauer and Schott (1992, p.16), there was a marked deterioration in Mexico's current account balance from a surplus of $4 billion in 1987 to a deficit of $6.3 billion in 1990 and in Mexico's trade account from a surplus of $8.4 billion in 1987 to a deficit of $4.1 billion in 1990.

56 Salinas 1990.
that the secure and stable access to the US market that an FTA would bring would be 'in reciprocity for the liberalisation that Mexico has already carried out'.

Perhaps even more worrying in the eyes of the administration was the flattening out of Mexico's capital intake over the same period. In the first half of 1990 Salinas visited Europe and then Japan in an effort to attract more foreign investment to Mexico. Salinas returned from his visits to Europe and Japan convinced of the need to increase the attractiveness of Mexico to foreign investors, and in particular to those from the US. He realised that to do this he would have to tackle the two main concerns of overseas investors - the uncertainty about the permanence of the reforms and the doubts cast by rising US protectionism on the security of Mexican access to the US market. An FTA, he believed, would provide certainty to investment. It would make Mexico a much more attractive destination not only for US capital but also for investment from Asia and Europe.

Guaranteeing Mexico's access to the US market against rising US protectionism

Cass 1990, p.76.
Salinas returned from his visit to Europe convinced that the changes in Eastern Europe would increase world competition for resources, markets and in particular for scarce investment funds and thus make it more difficult for Mexico to attract the capital that it needed to restructure its economy and make it internationally competitive. See Salinas 1991, p.1; Hart 1990b, p.57; Mexican government official in Washington (interview with author, June 1992). Salinas believed that, for political reasons, European governments would encourage investment in Eastern Europe and that, again for political reasons, West German investment would go to East Germany rather than Mexico. His visit also convinced him that there was little prospect of closer commercial ties with the EC. See Morici 1992, p.89. His visit to Japan in June 1990 only confirmed his impression that investors there had also become hesitant about increasing their investment holdings in Mexico and were more interested in investing either directly in the US or in Asia. See Prestowitz et al. 1991, p.vii; Mexican government official in Washington (interview with author, June 1992).

There was also growing concern in Mexico that the US itself might also become preoccupied with Eastern Europe. See Hart 1990b, pp.57-58; Michael Young, US Deputy Under Secretary for Economic and Agricultural Affairs, State Department (interview with author, June 1992).

Morici 1992, p.91; Castañeda 1993, p.73; Australian Financial Review, November 30 1990, p.39: Mexico Fights for new freedom'; Australian Financial Review, December 7 1990, p.14: 'Mexico is the taste of the times'; Business Week, November 12 1990, p.50: 'Mexico: A New Economic Era'. According to the Vice Chairman of the US International Trade Commission Ronald Cass (1990, p.76), the levelling out of Mexico's capital intake was an indication of the desire on the part of investors for additional assurances about long term stability. According to Weintraub (1990a, p.108; 1991, p.60), there was a fear that the slow growth of the 1980s would be blamed on the economic reforms and thus increase opposition to them. These fears were fuelled by the strong showing of Cárdenas, an opponent of the reforms, in the 1988 presidential elections. (For an account of the arguments used by Cárdenas and other opponents of free trade in Mexico, see Weintraub 1991, pp.60-61). The manner in which the reforms had been introduced also raised doubts as to their permanence. The reforms often took the form of presidential decrees and government regulation and hence could be reversed at any time. Only an FTA, Mexican liberals argued, would give the reforms the force of law and thus assure investors that a future Mexican administration could not return to the economic nationalist policies of the past. See Prestowitz et al. 1991, pp.16-21; Castañeda 1993, p.73; Morici 1991a, p.129; Vega 1991a, p.5; Hart 1991, p.89.

Salinas 1991. Salinas's visit of Europe in January 1990 made him aware of the need to accelerate liberalisation. On his return from Europe he announced the privatisation of the banks and the FTA.

According to Salinas, Mexico was seeking Asian investment to develop high-value-added export-oriented industries. Quoted in Prestowitz et al. 1991, p.24.
However, investors and entrepreneurs were also concerned about the threat that rising US protectionism posed to the access of Mexican goods to the US market.\textsuperscript{63} For Vega, the Mexican administration's principal motivation in requesting an FTA was to increase investor confidence in the stability and security of that access.\textsuperscript{64} Mexico had been highly dependent on the US as an export destination even before the oil slump of the early 1980s. But with highly sought after petroleum products making up over two-thirds of its exports, access to the US market had not been a major concern. But the drop in oil prices in 1982 and again in 1986 saw Mexico embark on a programme to increase its manufacturing exports.\textsuperscript{65} Yet at a time when the US market was becoming an important destination for Mexican exports of manufactures, Mexican access to that market was becoming more problematic as a result of rising US protectionism. Mexican goods were increasingly subject to anti-dumping and countervailing actions in the period 1980 to 1985.\textsuperscript{66}

The Mexican administration began looking for ways to secure Mexican access to the US market and to reduce its dependence on that market. In 1985 it signed a Memorandum of Understanding on Subsidies and Countervailing Duties with the US.\textsuperscript{67} At the same time Mexico joined the GATT in an effort to diversify the markets for its manufactures and thus reduce its vulnerability to rising US protectionism.\textsuperscript{68} Yet its dependence on the US market continued to grow.\textsuperscript{69}

Following a marked deterioration in Mexico's trade account at the end of the 1980s the Mexican administration looked for other ways to increase Mexico's exports. With the Uruguay Round still undecided and little prospects of gaining better access to EC and Japanese markets, it concluded that the bulk of those exports would have to go to the US.\textsuperscript{70} But it feared that any significant increase in Mexican exports to the US might trigger a protectionist reaction in the US or fall foul of US attempts to establish a level

\textsuperscript{63} Vega 1991, p.11.
\textsuperscript{64} Vega 1990b, p.11; Salinas 1990. In the words of Salinas, 'we need our exports to have stable, secure access to the US market'. Given the low level of US tariffs, the principal threat to Mexican access was the non-tariff barrier and US contingent protection. See Weintraub 1991, p.59.
\textsuperscript{65} Bueno 1991, p.75; Vega 1991a, pp.3, 5; Hart 1991, p.89. According to Hufbauer and Schott (1992, p.49), manufactured exports as a percentage of total exports increased from 25\% in 1980 to 55\% in 1989, while petroleum exports fell from 64\% to 37\% over the same period.
\textsuperscript{66} Vega 1990b, pp.12-13; Weintraub 1984, pp.46-55. US Coordinator for Mexican Affairs, Robert Krueger, in testimony given before Congress had argued that the Mexican decision not to accede to the GATT would see an increase in the number of countervailing duty petitions filed by US firms against Mexico. Cited in Story 1982, p.776.
\textsuperscript{67} Vega 1990a, p.10. Under this agreement any countervailing action against Mexico would be subject to the injury test. In return Mexico agreed to eliminate its export subsidies.
\textsuperscript{68} Weintraub 1990a, p.106.
\textsuperscript{69} Mexican exports to the US as a percentage of total Mexican exports grew from 62.55\% in 1982 to 72.4\% in 1986 and 78.6\% in 1990. Mexico's dependence on the US market was even higher for manufactured goods, and according to Vega (1990, p.8), if the maquiladora exports were also included, in 1987 90\% of Mexican manufactured goods would have been exported to the US.
\textsuperscript{70} Vega 1990a, pp.6-8; Salinas 1990.
playing field with countries other than Mexico. 71 At the same time the Mexican administration felt that the deterioration in the trade balance was due to the uncertainty of Mexican producers as to the security of Mexican access to the US market. This uncertainty, it believed, was preventing Mexican producers from making the adjustments and long-term commitments that were needed if Mexico were to obtain the full benefits of freer trade by way of increased exports. 72

This chain of reasoning resembled that of Canada faced with the same circumstances and Mexico reacted similarly. At first Mexico, like Canada before it, tried to negotiate sectoral agreements under the 1987 trade and investment framework. 73 But it too soon realised the limitations of this approach and finally requested an FTA. 74

The orphan syndrome: concern about the growing regionalisation of world economy, its impact on the outcome of Uruguay Round and on Mexico's international competitiveness

Another significant factor in the decision of the Mexican President to request an FTA with the US was the perception that the world economy was becoming increasingly regionalised and that Mexico would suffer significant economic disadvantage if it remained outside the three emerging blocs. 75 There was considerable concern that with the outcome of the Uruguay Round of GATT negotiations still in doubt Mexico could find itself excluded from the emerging regional economic blocs and thus deprived of the increased investment and trade opportunities that membership of these blocs could provide. 76

A further consideration for the Mexican administration in its decision to request an FTA was the effect that the growing regionalisation of the global economy would have on the competition for markets. According to Salinas, these blocs by bringing together countries that are economically complementary, increase the international competitiveness of their members. 77 An FTA between the US and Mexico, he argued, would enable these

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71 Vega 1990a, p.11; Prestowitz et al. 1991, p.viii. There was also concern that growing protectionist sentiment in the US would threaten existing access. See Vega 1990a, pp.9-11.
72 Vega 1991a, p.11.
73 Vega 1990a, p.11; Weintraub 1990b, p.4.
74 For discussion of limitations see Vega 1990a, p.12, fn.13.
75 This fear was strongly expressed by Mexican President Salinas in an address given to the Business Roundtable in June 1990 and in another given to the Economic Club of New York in December 1991. According to Salinas, the three blocs were the EC - particularly after 1992, the Asian Pacific Basin Countries centred on Japan, and Canada and the US.
76 As with Canada, this growing regionalisation of the world economy had also cast doubt on the viability of Mexico's strategy of relying on multilateral liberalisation to increase market access for Mexican exports. By delaying agreement on the Uruguay Round these blocs could deny Mexico the enhanced and more secure access to foreign markets that was essential to its further economic development. According to Salinas (1990), these emerging regional economic blocs could become fortresses and thus delay any further liberalisation of trade in goods and services.
77 According to Salinas (1990), (the complementarity of the US and Mexican) economies is of strategic importance. Japan's success has been owed in part to its incorporation of its neighbours into production processes in a way that goes beyond mere trade relations. This has ensured their strong international competitiveness. For the European Community, the countries of Eastern Europe serve as a reserve of markets and skilled labour to substantially
two countries to also boost their international competitiveness and thus meet this competitive challenge. With Mexico's multilateral trade liberalisation strategy now in doubt and mounting concern about the likely negative impact of global economic regionalisation on Mexico's international competitiveness, the option of an FTA with the US appeared the only viable alternative.

Among these factors the shift in economic ideology, the need for sustained economic growth and rising US protectionism were the decisive ones in Mexico's decision to request an FTA with the US. In the long run of history this was an extraordinary decision. It overturned a century or more of nationalist economic ideology and of anti-Americanism.

Factors behind the US decision

This section examines the factors that contributed to the US decision to agree to the Mexican request for an FTA. Although many of those factors are similar to those that led to the US decision to enter into an FTA with Canada five years earlier, changing economic and political circumstances in the US and elsewhere altered the relative weighting of these factors in the US decision. There were also other factors that were not present in the Canada-US FTA decision, factors that related specifically to US concerns with Mexico or to new developments in the international political economy. This section will therefore focus on these other factors and on the changes in weighting amongst the factors.

There seems to be a general consensus among scholars that the US decision to enter into an FTA with Mexico was driven more by geopolitical concerns to do with Mexico than - as had been the case with the Canada-US FTA - by either domestic or international economic concerns.78 There appears to be three main reasons for this. First, the fact that the relationship between the US and Mexico had traditionally been a much more contentious one than that between the US and Canada would automatically give political considerations greater significance in the US decision to enter an FTA with Mexico. Second, the importance of political considerations was no doubt further increased by the role of Mexico as a regional leader in Central America and as trend setter in both Latin America and the developing world. Third, and perhaps most importantly, the US concern about a possible breakdown in the Mexican political system and the negative effects that increase its relative advantages. For Mexico and the United States, a free-trade agreement between our countries could be the answer to this extraordinary challenge.'

78 Hart 1991, pp.89, 93; Vega 1991b, p.54; Prestowitz et al. 1991, p.1. Hart argued that this is because the FTA would have only a marginal impact on the US GDP. He stressed the need to distinguish between the original geopolitical considerations that motivated the US administration and the concrete trade and investment objectives necessary to win the support of key interest groups and hence guarantee congressional support. Prestowitz expressed the fear that US may be once again sacrificing its economic interests to geopolitical concerns. For Vega the principal objectives of the US were to promote growth and hence strengthen democracy, to halt migration, to facilitate cooperation in areas such as drugs, and to take advantage of Mexico's future market potential.
such a breakdown could have on the US would also explain why political considerations were uppermost in the minds of the US administration when making the decision. Finally, the progressive decline in the US trade deficit from a peak of $160 billion in 1987 to $108 billion in 1990 had reduced the protectionist pressures on Congress and hence the US preoccupation with containing these pressures, a preoccupation which, as we saw in the previous chapter, had been a significant factor in the US decision to enter an FTA with Canada.\footnote{Destler 1992, p.97. The decline in protectionist pressure on the Congress came only after the Congress had passed the Omnibus Trade and Competitiveness Act of 1988. This Act, though arguably less protectionist than some members of Congress would have preferred, strengthened US trade remedy laws and increased the authority of the US Trade Representative. Its most notorious innovation was the so-called 'Super 301' amendment to section 301 of the US Trade Act. This amendment required the US Trade Representative to identify during a two year period only (1989 and 1990) so-called 'priority foreign countries' whose policies and practices were impediments US exports; and to take retaliatory action against any country so designated should it fail to remove those impediments. In 1989 Japan, Brazil and India were named as 'priority foreign countries' but in 1990 only India remained on the list. However, 'Super 301' also induced other countries such as South Korea and Taiwan to concede to US demands for trade policy changes to avoid being designated. While 'Super 301' was often viewed in the United States as a successful weapon against the unfair trading practices of other countries, other countries saw it as further evidence of a shift to unilateralism and managed trade in the conduct of US trade policy. Although Congress did not extend 'Super 301' in 1990, the threat of its reintroduction still remained in the eyes of other countries. For further details concerning 'Super 301', see Destler 1992, pp.97-98, 131-33, 242-43, 442. Destler saw 'Super 301' as a consequence of the failure of the GATT to address legitimate US complaints concerning the protectionist policies of other countries and as preferable to the alternative of increased protectionism against imports.} Yet to some extent this decline in domestic protectionist pressures was offset by a growing preoccupation with the need to boost US international competitiveness and concern about the regionalisation of the world economy. It seems then that although political considerations may have been more salient, economic concerns were still important.

The factors that concern us here, like those in the Canada-US FTA, fall into two categories - those relating to specific US concerns regarding Mexico and those relating to broader US concerns with the changing international economic order and the place of the US in that order. Before we proceed with our discussion of these factors, however, two further points should be made. The first of these concerns our comparison of the factors involved in the Canada-US FTA and the FTA with Mexico. The FTA with Mexico and hence NAFTA attracted far more attention from the US administration, the Congress, US business and organised labour, and from the general public than the Canada-US FTA.\footnote{Weintraub 1991, p.62. While US business was largely disinterested in the Canada-US FTA, the business lobby has been seen as crucial to the successful passage of the NAFTA through Congress.} Some of the reasons for this have already been outlined above and include US concerns about Mexico's political stability and the problem of migration. Other reasons have to do with Mexico's status as a developing country. Thus some business interests were likely to be attracted by Mexico's low cost skilled work force and by the prospect of a rapidly expanding consumer market, while others feared the competition from similar firms south of the border. Organised labour and environmentalists, on the other hand, feared the
negative impact that an FTA with Mexico would have on working conditions and wages and on environmental standards in the US.

The second point concerns the reasons for the US decision to allow Canada to enter into the FTA that it had envisaged with Mexico, thus transforming that FTA into a trilateral agreement known as NAFTA. Given that the decision by the US administration to enter into an FTA with Mexico had been taken prior to that concerning the inclusion of Canada, our primary focus will be on the factors that led to that decision. Discussion of the reasons for the trilateralisation of the FTA will be taken up briefly at the end of this chapter in the section that deals with the decision of Canada to participate in the negotiations between Mexico and the US.

The broader US concerns

The broader concerns that led the US to accept Mexico’s request for an FTA have been canvassed extensively earlier and require no further rehearsal at length here. The main motivations for an FTA with respect to Mexico remained those as for Canada, and the domestic coalition (despite its ambiguities) held for the same reason. Two factors indeed reinforced this general US consensus - a growing concern with US international competitiveness (strengthened since the early 1980s) and the perception of threat as the SIM in Europe was concluding and APEC began to look like a going concern.

We have already mentioned the absence of what had been an important factor in the decision to enter into an FTA with Canada, the desire of the US administration to contain rising domestic protectionist sentiment. Another factor discussed in this section is also one which played no role in the US decision to enter into an FTA with Canada. It was the desire by the US administration to use the FTA with Mexico as a way of encouraging other Latin American countries to embrace market-oriented policies.

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81 This had led to the emergence of a third force in US trade policy formulation, which Hart has called the bilateralist/regionalists, alongside the two more traditional forces represented by the resurgent unilateralist/protectionists and the declining multilateralists. According to Hart (1990b, pp.54-55), the influence of multilateralists was waning due to the lower priority now being given to geopolitical concerns in the determination of US foreign policy. At the same time the influence of the unilateralist/protectionists and the regionalists, who married liberal multilateral ideals with pragmatism, was growing. Hart attributed the fortuitous timing of the FTA proposal of the Salinas Administration to that Administration’s ‘astute reading’ of the ascendancy of bilateralists over US trade policy formulation.

82 According to US Trade Representative Hills (1991b, pp.18, 23), the free trade agreement with Mexico would act as a cornerstone for the President’s vision of a hemispheric zone of free trade, the Enterprise for the America’s Initiative or EAI. The growing awareness in the US of the regionalisation of the world economy, together with the belief that a more prosperous Latin America could help the US overcome its trade deficit and reverse the decline in its international competitiveness, provided further support for those who argued that the US must do more to help Latin America. The end of the Cold War also meant that a higher priority could be given by the US Administration to political and economic instability in its own hemisphere, particularly as some of the problems associated with that instability - large foreign debts, insufficient employment opportunities in licit commercial activities - were felt to be behind some of the problems facing the US such as illegal immigration and rising illicit drug consumption on the one hand and the over-exposure of US financial institutions to Latin American debt on the other. Thus in the latter half of the 1980s there were many calls for US
Yet other broader factors that had played an important part in the US decision to enter into an FTA with Canada were also factors in the US decision to agree to an FTA with Mexico. These were the perceived utility of the FTA as a means of increasing the pressure on other countries, and in particular the EC and Japan, to conclude the Uruguay round on terms that were more in line with US interests; and, related to this, the belief that an FTA initiatives to encourage Latin American governments to pursue liberal economic policies that, it was argued, were needed to bring about long term growth and political stability. Many in the Administration, in business and in the Congress supported the FTA between Mexico and the US at least in part on the grounds that it would not only consolidate economic liberalisation in Mexico but would encourage other Latin American countries to follow the Mexican example.

The idea of a Western Hemisphere free trade area had been raised in 1987 by President Reagan during an official visit to Canada. Reagan (1987b, p.4) described the Canada-US FTA, which was then still being negotiated, as setting a positive example for the Americas and the rest of the world. He talked of a future time 'when the free flow of trade, from the southern reaches of Tierra del Fuego to the northern outposts of the Arctic Circle, unites the people of the Western Hemisphere in a bond of mutually beneficial exchange'. Bush also shared Reagan's vision of a hemispheric zone of free trade. In announcing Canada's decision to join the US and Mexico in the negotiation of a free trade agreement, Bush (quoted in *International Herald Tribune* 6 February 1992, p.1) described the agreement as 'a dramatic first step toward the realisation of a hemispheric free trade zone stretching from Point Barrow in Alaska to the Straits of Magellan.' Bush had first announced his Enterprise for the Americas Initiative (EAI) on June 27 1990, just over two weeks after his acceptance of Mexican President Salinas's request for a free trade agreement. According to Hakim (1992, pp.93-95), the EAI had three parts: a plan for reducing Latin America's bilateral debt obligations to the US government; the establishment of a new Multilateral Investment Fund to be administered by the Inter-American Development Bank and to be financed by equal contributions from the US, Japan and the EC; and a somewhat vague vision of hemispheric free trade. The driving force behind the EAI and the Brady and Baker debt plans that preceded it, Hakim maintained, was the US Treasury Department, which saw the EAI as a means of helping Latin American countries reduce their foreign debt burdens, of rewarding those who had adopted deregulation and market opening measures and of encouraging others to do likewise. Trade was seen as the best way for Latin American countries to overcome the debt crisis, particularly as the alternative of debt relief would have entailed huge losses for US banks. Responding to criticism that the EAI had been ineffective, US Treasury Under Secretary for International Affairs, David Mulford, maintained that the EAI 'had been vital to helping spur many countries to adopt reforms that promoted investment and growth.' See *New York Times* 4 June 1992, D2: 'Brady Invites Latin Nations'. See also Morici 1992, p.93; Miceli 1992, p.4; and Prestowitz et al. 1991, p.v. However, the EAI has also be seen as an attempt by the US to allay the fears of other Latin American countries with respect to the NAFTA initiative. This motivation would seem to be confirmed by the fact that the EAI was announced shortly after the FTA with Mexico. According to Richardson (1990, p.162), the EAI was partly a reaction on the part of the US administration to the private resentment of some Latin American countries at being left out of the Mexican-US deal. According to Rodgers (1990, p.214), the EAI would show that the purpose of NAFTA was not to build a wall around North America.

According to US Trade Representative Hills (1991a, pp.22, 46), a NAFTA would support the Administration's broader objective of open markets and expanded trade globally, by increasing the incentive of other countries to seek open markets with the US. Similar views were expressed by members of the US Congress and US business interests. The NAFTA, it was argued, would increase US leverage in the Uruguay Round vis-à-vis the EC and the Pacific Rim, thereby offsetting the increased leverage that the EC had gained as a result of EC 1992. According to Congressman Schulze (1991b, p.8), EC 1992 had increased EC leverage in the Uruguay Round and the likelihood that the Uruguay Round negotiations would favour the EC more than the US. With NAFTA, he maintained, 'our foot would be on the EC's throat instead of the other way around.' See Schulze 1990, pp.7, 21; Vega 1991b, p.54. According to Congressman Richardson (1990, p.30), NAFTA would put the US in a powerful position to negotiate with other blocs by increasing even further the leverage the US had gained as a result of the Canada-US FTA. For the US Chamber of Commerce (1991, p.148), the creation of a North American economic unit with a combined output of $6 trillion - 25% greater than that of the EC - would give Canada, the US and Mexico individually and collectively increased influence for gaining greater access to other markets. In his testimony
with a developing country such as Mexico could not only set a useful precedent for the inclusion of services, investment and intellectual property in future agreements, be they bilateral, plurilateral or multilateral, but also increase the pressure on other countries to do so.\textsuperscript{84}

From the above it would appear that the US administration's attempts to rebuild a new free trade coalition around the push for bilateral and regional free trade agreements had been at least partly successful.\textsuperscript{85} However, some members of this coalition did not see such agreements, as indeed the Administration did, as stepping stones to the successful conclusion of the Uruguay Round.\textsuperscript{86} They had grown disillusioned with both the

\textsuperscript{84} Masur 1991, p.102. Because of Mexico's important place in the Third World as an opinion leader the incentives for US services and investment companies to support an FTA with Mexico that liberalised trade in services and investment were considerable. The strongest opposition to the US push to have GATT coverage extended to services, investment and intellectual property had come from the Third World and it was felt that the NAFTA in providing a useful precedent regarding the treatment of trade between a developed and a developing nation in these areas might weaken that opposition. See for example Story's assessment (Story 1982, p.794) of the likely effects on other developing countries of Mexico's decision not to accede to the GATT. See also Bueno 1991, p.75. This point was also made by the Business Roundtable (1990), which argued that as a developing country committed to liberalisation Mexico could serve as 'a bridge' to those who continued to oppose liberalisation. According to Vega (1991a, p.14) Mexico was one of the few developing countries to support the inclusion of services in the Uruguay Round.

\textsuperscript{85} Schott (1989, p.6) argues that the FTAs with Israel and Canada increased interest in bilateralism in the US. According to Schott (p.3), Reagan administration officials had broached informally with other countries the possibility of a bilateral FTA and studies were made of the likely effects of FTAs with Australia, Japan, Korea, Taiwan and ASEAN. For a detailed account of the prospects of FTAs between the US and these and other countries, see Schott 1989. Schott himself counselled the US administration against any further FTAs on the grounds that these were not likely to achieve genuine trade liberalisation and were more likely to undermine than strengthen the resolve of other countries to reach agreement on substantial reforms to the multilateral trading rules in the Uruguay Round.

\textsuperscript{86} According to Schott (1989, p.50), while some supporters of FTAs saw them as complementing the GATT, others saw them as a substitute for multilateral trade liberalisation. This attitude was partly the result of a growing perception that GATT had failed to provide the US with the reciprocal access to other countries' markets and that the Uruguay Round was unlikely to remedy this situation. It also reflected an increasingly widespread conviction that FTAs, given the smaller number of participants and the increased bargaining power of the US \textit{vis-à-vis} the other members, were both faster and easier to negotiate than multilateral agreements. The US, it was argued, needed to pursue its own interests bilaterally and regionally. Even some of those in favour of multilateral trade liberalisation had come to see the FTA as a necessary transition to global trade liberalisation. Given the success of GATT in removing tariff barriers any further liberalisation would involve the removal of non-tariff barriers and hence the harmonisation of domestic policies and practices. This, they maintained, was easier at a regional level. Thus according to Congressman Crane (1991, p.6), 'as prospects for a successful conclusion to the lengthy Uruguay Round negotiations appear dim, it is appropriate that we redouble our efforts to reduce trade barriers with our closest neighbours.' A similar view was expressed by Congressman Schulze (1991a, pp.10-11). Schulze saw the lack of significant progress in the Uruguay Round negotiations as reaffirming his 'long-standing suspicions regarding GATT's lack of willingness to address all of the real impediments to global trade.' The Uruguay Round, he maintained, had failed miserably in not incorporating the patent harmonisation issue into the GATT. As a result he was highly sceptical over the supposed benefits of a continuation of the Uruguay Round, and believed that an extension of fast-track would only allow the GATT process to muddle on for another two years. The United States, he argued, 'should concentrate on a US-Mexico FTA, US-
Uruguay Round and the GATT for failing to ensure that free trade was fairly practised by all and saw FTAs as a better way of achieving genuine free trade at least in the short to medium term. Some supporters of a NAFTA, however, although using the rhetoric of free trade, were more interested in protecting the North American market against 'unfair' Asian and European competition.  

Another factor that had played some part in the US decision regarding the FTA with Canada, seems to have had a much more significant role in the US decision to conclude an FTA with its southern neighbour. Concern about declining US competitiveness appears to have increased in US business circles, Congress and the Administration in the five years since the decision was taken to enter an FTA with Canada. This has added weight to the argument that an FTA would do much to enhance US international competitiveness.

Mexico-Canada FTA, a hemispheric free trade area, and last, but I emphasise not least, a US-Taiwan FTA. Such undertakings would clearly expand trade opportunities, frighten and prod GATT into getting serious about multilateral trade expansion, and provide that body with the building blocks to make a truly liberalised and level trading system a reality in the 21st Century and beyond. See also Schott 1989, pp.4-9. According to Vega (1991a, p.4), declining US competitiveness had led to an erosion of support in the US for the MFN principle and multilateralism and the emergence of a new interest coalition in favour of bilateral and regional agreements and unilateral action. This view would accord with Hart's contention that US trade policy is the result of shifts in the relative weight of three pressure groups: the unilateralist/protectionists, the multilateralists, and the bilateralist/regionalists. See above fn.81.

Some US business interests particularly those involved in the textile and apparel and automobile industries believed a protected North American market would be to their advantage. As was the case with the Single market in the EC, many called for measures that would ensure that the benefits of regional free trade would accrue to the participants and not to third countries, the so-called free-riders. Thus Keith Miceli (1992, p.2), Director of Latin American Affairs in the US Chamber of Commerce, called for the establishment of clear rules of origin to 'prevent third countries from acting as "free riders" in the agreement, thus ensuring that trade benefits accrue to both the US and Mexico.' Others, such as Whitmore (1991a, pp.123-24), felt that an FTA with Mexico, in providing preferential treatment to US firms against their Japanese competitors in the growing Mexican market, could be an effective strategy for increasing US exports and protecting the United States' highest value added jobs.

See for example the three reports of the Office of Technology Assessment, an analytical arm of the US Congress: Paying the Bill: Manufacturing and America's Trade Deficit (1988); Making Things Better: Competing in Manufacturing (1990); and Competing Economies: America, Europe and the Pacific Rim (1991). According to the authors of Competing Economies (1991, p.4), 'US manufacturing fails the test of improving competitiveness on two accounts: decisively on meeting the test of international markets, and substantially on increasing standards of living.' Between 1968 and 1988 the US share of world merchandise exports fell from 16% to 13% while its share of world merchandise imports rose from 15% to 17%. At the same time the hourly wage of full-time workers employed in manufacturing declined from its peak of $9.50 in 1978 to just over $8 in 1990, less than the 1964 rate. However, the report is sceptical about the part played by the closed nature of other markets (and hence efforts on the part of the US Trade Representative to open these markets) and the overvalued dollar in this decline. Instead it highlights the contribution of government assistance in the form of industrial targeting to the success of manufacturers in other countries and argues that the primary government response must be a domestic one - a raft of measures aimed at enhancing the competitiveness of a strategic industry in the US. Trade policy measures aimed at opening foreign markets or protecting the targeted industry would play only a subordinate role.

That concern was reflected both in the name and the contents of the 1988 Omnibus Trade and Competitiveness Act and in the debate concerning the merits of NAFTA. The US administration in particular presented NAFTA as part of an economic programme 'to promote US economic growth and competitiveness by opening world markets and expanding trade.' See Hills 1991b, pp.17, 21-22. This view was also shared by business. According to the President of the National Association of Manufacturers, John Hartley (1991, p.137), 'the principal arguments for negotiating a North American free trade agreement are that it could
There were two main arguments regarding the beneficial effects of NAFTA on US exports and competitiveness. The first was that given the preference of Mexican consumers for US products and the boost to Mexican consumer demand that would flow from the FTA, the FTA would lead to an increase in US exports to Mexico.\footnote{US Trade Representative Carla Hills (1991a, p.20) described the FTA with Mexico as a key strategy in the trade policy of the Bush administration. With exports accounting for over 50\% of the increase in US GNP between 1989 and 1991, the administration had come to see increasing export markets as an important way of boosting economic growth in the US. According to Hills, exports were even more important in 1990 when they generated 88\% of total US economic growth. The administration was particularly aware of the beneficial effects that economic liberalisation in Mexico had had on US export performance. According to Hills (1991b, pp.17), there had been a twofold increase in US exports to Mexico between 1986 and 1990, making Mexico the fastest growing US export market. Hills (1991a, p.20) reasoned that, with 70\% of Mexican imports coming from the US, an FTA would further increase the Mexican demand for US goods and services by removing the remaining barriers to US goods and by stimulating economic growth in Mexico. An FTA, Hills (1991b, p.64) argued, would therefore mean more jobs and more wealth for the US. According to Vega (1991a, p.5), a key longer term US motive for the FTA with Mexico was the belief that a more prosperous Mexico would be a bigger market for US goods. Sandra Masur, Director of Public Policy for Eastman Kodak, maintained that the FTA could easily result in 5\% real growth in Mexico over the next 10 years. See Masur 1991, p.101.

Others such as Olmer (1985, p.17) saw this link between economic growth in Mexico and increased US exports as confirmed by the fact that dramatic increase in the US trade deficit had coincided with the drop in US exports to Latin America due to the debt crisis. By stimulating economic growth in these countries, they argued, the US would boost its exports and reduce its trade deficit. According to Olmer, US exports to debtor countries, most of them in Latin America, dropped by $18 billion between 1981 and 1983. Paul Volker (1990, p.10), Chairman of the US Federal Reserve, argued that the US would be a major beneficiary of renewed growth in Latin America. Whereas the US traditionally enjoyed a large surplus in trade in manufactures with Latin America, in the 1980s this had been considerably reduced as these countries were forced to make structural adjustments. US business interests were also attracted by the prospect of a more prosperous Mexico. They argued that the US had a natural competitive advantage in Mexico in that Mexicans were far more likely to buy US goods than goods from Japan, due to the proximity and the familiarity of Mexican consumers with US goods. Thus it was claimed that seventy cents of each dollar spent on imports in Mexico was used to purchase US goods and that fifteen cents of every dollar of Mexican income growth would back to the US. According to the Business Roundtable (1990), with economic growth and full liberalisation, the Mexican market would offer significant opportunities for even greater exports of US manufactured goods and services.' See also Miceli 1992, p.3; Masur 1991, p.101; US Administration 1991, p.11; Michael Young 1992, interview with author; Whitmore 1991b, p.777; Dornbusch 1990, p.120.

Many in the US administration and business saw Mexico as performing a similar role for the US as Spain, Greece and Portugal for the EC and South East Asia for Japan. See US Administration 1991, p.39; Hills 1991a, p.39; Masur 1991, p.100. According to Middendorf (1991, p.320), observers had been surprised at the fast growth rates of Spain and Portugal and how quickly they became viable markets. With the help of the FTA, they argued, Mexico would take off like the Asian tigers. According to former Assistant Secretary of State for Inter-American Affairs and former Under Secretary of State for Economic Affairs, William Rodgers (1990, p.211), the success of the Asian tigers had been due to the access that the US had provided them to its market. It was now in the US national interest, he argued, to become the 'absorber' for Mexico and Latin America. Economic growth in Mexico would lead to an increase in the demand for capital goods, in which the US enjoys a comparative advantage. According to the Administration (1991, p.40), Mexico already imported 74\% of its capital goods from the US.}
competitors.91 By bringing labour intensive production closer to the US it would reduce the loss of US jobs and investment to locations in Pacific Asia.92

The belief that the international competitiveness of US firms could be increased through an FTA with Mexico was largely the result of a perception that the advanced economies of Japan and Western Europe had increased the international competitiveness of their firms through similar arrangements - either formal as in the case of Western Europe or informal as in the case of Japan and East and South East Asia - with the less advanced economies of their region.93 It was therefore part of a much wider perception among the Administration, the Congress and business that the world economy was becoming increasingly regionalised and might even splinter into three competing blocs.94


92 Increasing global competition had forced many US based firms to shift their labour intensive assembly operations to countries with lower wage levels. Many of these firms had relocated in Pacific Asia. But some had taken advantage of the maquila programme and relocated to Northern Mexico. While problems of distance often forced those that had shifted assembly operations to Pacific-Asia to also source their high technology components in that region rather than in the US, firms that had shifted to Mexico continued to rely on US made components. Thus, it was argued, relocation to Mexico resulted in fewer job losses in the US. According to a 1988 study of US firms by the US International Trade Commission (US Administration 1991, p.13), Mexican assembly operations increased the competitiveness of their US operations. Most firms involved in the study indicated that the alternative to moving labour intensive assembly operations to Mexico, where a substantial amount of US components were used, was to move their operations to the Far East, where fewer US components would be used. Investment in production sharing in Mexico, the US Administration (1991, p.39) argued, has the effect of displacing US imports from Asia or displacing investment in Asia.

According to proponents of an FTA with Mexico, given the tendency of world competition to increase, it was likely that more US firms would have to move their operations offshore. An FTA, they argued, would see them shift to Mexico, where the direct and indirect benefits to the US economy would be greater, rather than to Pacific-Asia or Eastern Europe. It would also bring back some of the assembly operations that had already moved to Asia, and force some of those Pacific-Asian firms that supplied those firms with components to also shift their operations to North America. See Baer 1991, pp.50-51; Dornbusch 1990, p.120; Masur 1991, p.101; US Administration 1991, p.13; Whitmore 1991a, p.129; personal interview with Eric Biel 1992. See also Middendorf (1991, p.307) and Ronald Wonnacott (1991a, p.84), both of whom emphasised the advantage that Mexico enjoys over other locations owing to its geographical proximity to the US. According to Weintraub (1991, pp.62-63; 1990a, p.110), the US would also derive more indirect benefits from any additional economic growth that would result from relocation to Mexico as Mexicans tended to import mainly from the US while Pacific Asian countries obtained their imports principally from other Pacific Asian countries. These arguments, designed to increase support in Congress for the FTA with Mexico, only served to increase fears in East Asia that NAFTA would result in the diversion of investment from East Asia to Mexico. See below Chapter Eight, pp.319-22. According to Baroody (1991, p.551), Mexican labour will replace Indonesian, Malaysian, Thai and Korean labour, as investors learn that Mexican labour is equal in quality, productivity and other respects. According to the US Administration (1991, pp.38-39), some of the new US investment that would flow to Mexico as a result of the FTA would be diverted from other developing countries.

93 See for example the testimony of Christopher Bates, Director, Policy Analysis, Motor Equipment Manufacturers' Association, 1989a, pp.167-68.

94 According to Miceli (1992, p.2) from the US Chamber of Commerce, three economic blocs were emerging and trade, investment, and capital flows were increasing more rapidly within
This perception was no doubt an important factor in the decision of the Bush Administration to accept the Mexican request for an FTA, despite fears that such an action might not only take valuable resources away from efforts to finalise the Uruguay Round but also lend further support to the process of regionalisation.\(^95\) Thus the growing perception in the US that these blocs were emerging constitutes another factor in the US decision to enter into an FTA with Mexico, one which had not played a role in the US decision to enter an FTA with Canada.\(^96\)

Most saw the US moves to foster closer economic relations in the North America as a defensive reaction to both the EC 92 initiative and a more informal Japanese Asian co-prosperity zone.\(^97\) A North American alliance or a Western Hemisphere bloc, it was rather than among regions. The Business Roundtable (1990) argued that, (g)iven Europe's aggressive pursuit of its 1992 integration initiative and new markets in Eastern Europe and Japan's dominant trade, investment and financial position in Asia, there is a need to develop a comprehensive North American trade and investment strategy:

Economic integration between Mexico and the US was thus seen as benefiting the US economy in the same way that economic integration between Spain and Portugal and the EC had benefited the more industrialised economies of the EC and economic integration between South East Asia and Japan had benefited Japan. According to US Under Secretary of State, Robert Zoellick (Far Eastern Economic Review, October 24.1991, p.26: 'Double Standards'), the extension of the US-Canada FTA to include Mexico would enable US firms to follow the example of their EC and Japanese counterparts, which had increased their competitiveness and kept high paying jobs by sourcing components in Southern /Eastern Europe and Asia respectively. Zoellick argued that if the US shifted lower wage, lower value-added jobs to Mexico, integrating them with higher wage US manufacturing, they would be in a better position to take on competition from Japan and the EC. The FTA would thus enable the US to shift to higher value added production and to increase the technological intensity of US manufacturing. It would amplify what was already happening on a smaller scale with the maquila along the US-Mexican border. See Morici 1991a, pp.8-9, 94-95; 1992, pp.95, 104. See also the Business Roundtable (1990); John Bruton, Executive Vice-President of the American Chamber of Commerce of Mexico, 1991, p.328; Hills 1991b, p.29; Michael Baroody, Senior Vice President of the National Association of Manufacturers (1991, p.538-39). A similar argument was also used by Mexican President Salinas to convince the US of the advantages of establishing an FTA with Mexico. According to Salinas (1991, p.3), 35% of Japanese manufactures were co-produced with other countries compared to only 5% of US manufactures. But see Prestowitz et al. 1991, p.27, who argued that Mexico will not be content to specialise in lower value-added, labour intensive industries. They (pp.30, 69-70) also argued that unless a tariff of 20% is applied to those goods thatfail to meet the rules of origin requirements the benefits of NAFTA could go largely to non-signatories such as Japan and East Asia.

\(^{95}\) According to Assistant US Trade Representative Murphy (1989, p.18), the US had turned down a number of requests for FTAs as it did not wish to devote too many resources to those undertakings. These same requests, together with a perception that US trade policy was moving towards bilateralism and away from multilateralism, were the source of considerable concern among the countries of the Western Pacific and hence an important factor in the push to establish APEC. See Chapter Eight, pp.287-95.

\(^{96}\) This argument was used in the congressional debates over the ratification of the Canada-US FTA but does not seem to have played a role in the initial acceptance by the US administration in 1985 of the Canadian request. See Chapter Six.

\(^{97}\) Vega 1991b, p.54; Morici 1991b, p.96. According to Morici, the Japanese trading bloc is an informal, private sector one based on the keiretsu. It is the less visible procurement practices of private and government entities and distribution networks rather than a system of tariffs and quotas which ensure preferential treatment for Japanese technology intensive goods over their US and European equivalents in East and Southeast Asian markets. This argument forms part of Morici's broader explanatory framework of competing capitalisms. See Chapter Three, pp.89-90, and fn.108.
asserted, would enable US goods and services 'to compete with the European Community and with Pacific rim regional trading blocs.'

Concerns in the US about EC 92 and the spectre of 'Fortress Europe' were particularly strong in the period 1987 to 1988. According to Stephen Cooney, author of the National Association of Manufacturers' paper 'EC-92 and US Industry', the concerns expressed by the US Secretary of Commerce and various State and Treasury officials had originated with a statement by outgoing EC Trade Commissioner Willy de Clerq that reciprocity would be required for the opening of the EC single market to foreign firms, particularly in the area of services such as banking, investment securities and insurance.

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98 Congressman McGrath 1991, p.15; Congressman Richardson 1990, p.26. According to Congressman Kolbe (1991, pp.84-85), 'the Europeans were looking for EC 92 to give them economies of scale and .. Asia, Japan, and the so-called Five Tigers may well be going down the same path very soon.'

99 These concerns tend to confirm the proposition that part of the rationale behind institutionalised regional economic integration is to counter moves by economic competitors - real or imagined - to establish similar regional arrangements. Thus, according to Murphy (1989, pp.6-28), the then Assistant US Trade Representative for Europe and the Mediterranean, the US fear that EC 1992 could lead to increased barriers to trade and investment was similar to the reaction of the EC a few years earlier to the US-Canada FTA. For an account of US concerns in relation to EC 92, see Colchester and Buchanan 1990: Chapter 15 'Trade with the World Beyond'.

US unease at the evolution of the single market initiative led to the establishment by the US Trade Representative of the Interagency Market Task Force in February 1988 to identify potential problems arising out of EC 1992 and to recommend ways of dealing with them. A private sector task force was also established by the President's Advisory Committee on Trade policy and Negotiations and ongoing discussions concerning the measures in question took place between the US and the EC and its member states. According to Murphy (1989, pp.13-15), the EC had told the US that it had nothing to worry about as these measures were actually directed at the Japanese. Japan was also aware that the Single Market was in part an offensive/defensive strategy directed at Japan. According to Japan's Deputy Foreign Minister, Michiko Kunihiro ('Survey of Europe's Internal Market', p.20), Japan saw parallels in US trade policy and feared that the EC and the US might form a common front against Japan. He argued that in order to prevent this from happening Japan must champion the cause of GATT. These fears were also an important factor in Japan's support for the Australian APEC initiative. See Chapter Eight, pp.292-93.

100 Cooney 1989, pp.24-25; Murphy 1989, p.7. Of particular concern was the Second Banking Coordination Directive which accorded banks of a country that is not an EC member the right to do business throughout the single market only if EC banks were accorded reciprocal rights in that country. According to Colchester and Buchanan (1900, p.104), the reciprocity clause had been intended to increase the EC's bargaining leverage in the negotiations over the inclusion of services in the GATT and to reassure those members who had been traditionally reluctant to abandon national controls over financial services and banking. The problem here is that US is prevented from providing reciprocal access by domestic legislation which maintains strict barriers between commercial and investment banking (the Glass-Steagall restrictions), and which forbids interstate branch banking (the McFadden Act). Hence the insistence by the US that in liberalising its services the EC adhere to the GATT principles of MFN and national treatment. See Freeman 1989b, pp.35-39; Friedman 1990, pp.116-18. The irony of the situation was not lost on the EC Commission which pointed out that the EC had only recently resisted the introduction of the concept of reciprocity into US legislation. See Bull. EC 10-1988, p.11.

Other aspects of the Single Market initiative that were of concern to both the US Administration and business interests were the EC wide quantitative restrictions that would replace national equivalents on imports such as cars; the possibility that community-wide rules of origin might become an arbitrary tool of industrial policy; the formulation of community-wide product standards which could become cover for protection. See Business Roundtable 1989, p.53. US business was particularly critical of the lack of transparency and the failure to involve non-European companies in the formulation process. According to Colchester and Buchanan (1990, p.197), US officials were upset at being denied observer status on the bodies established to set European standards. In its report 'EC 92 and US
In sum, the broader concerns that led US to enter into an FTA with Mexico were largely the same as those that were behind its decision five years earlier to join Canada in an FTA - the concern about the pace and outcome of the latest round of multilateral trade negotiations; and the concern about declining US competitiveness. Between 1985 and 1990 the emergence of a new concern about the growing regionalisation of the world economy had reinforced these earlier concerns. Yet factors that related more specifically to
US concerns with Mexico weighed more heavily than these broader concerns in the US decision to conclude an FTA with its southern neighbour. It is to these factors that we now turn.

Factors relating specifically to US concerns with Mexico

As was the case with the FTA with Canada, the US saw the FTA as a way of locking in market-oriented reforms and hence of preventing a return by future Mexican administrations to the economic nationalist policies of the past. It also saw an FTA with Mexico as a means of giving the US greater security of access to Mexican energy resources in the same way that the FTA with Canada guaranteed its access to Canadian energy resources. But perhaps the most important factor, and indeed one that was not present in the FTA with Canada, was the desire to use the FTA with Mexico to promote economic growth in Mexico in order to consolidate that country's political stability. The promotion of economic growth was also seen as essential to the alleviation of what had become a major problem for the US, the illegal entry of Mexican workers into the US.

Consolidate political stability in Mexico by promoting economic growth and locking in economic reforms

There is general support among scholars, US officials, business representatives and Congress members for the claim that the principal US motivation for an FTA with Mexico was the consolidation of political, economic and social stability in Mexico. Mexican political economic and social stability, it is argued, is vital to US national security. The US administration was convinced that Mexican stability depended on the success of the Salinas reforms in restoring economic growth and that in order to succeed those reforms required a guaranteed access to the US market. There was also a strong feeling that

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101 According to former US Ambassador to the OAS and to the EC, J. Middendorf (1991, p.307), it was far more in the interests of the US to have on its border a Mexico that was secure and stable than one that was unstable.

102 Garza 1990, p.20; Morici 1991a, p.4; Miceli 1992, p.2. This view was also expressed by Michael Young, US Deputy Under Secretary for Economic and Agricultural Affairs in the State Department, in an interview conducted by the author in May 1992 in Washington DC. See also Prestowitz et al. 1991, p.6

103 According to Baer (1990, pp.4-5), the US was also aware of the destabilising effects that economic restructuring had had in Mexico in the past. It was also concerned about the possibility of a transition to a multi-party political system. Thus US Trade Representative Carla Hills (1991b, p.22) argued that the FTA would ‘strengthen the Mexican economy and provide a firm foundation for future economic growth.’ According to Allan Mendelowitz, Director of International Trade, Energy and Finance Issues, National Security and International Affairs Division, United States General Accounting Office (1991, p.246), given that Mexico is a long-term US interest the US has an interest in the success of these reforms and should do anything it can to help solidify and provide benefits for the reforms. The Business Roundtable (1990), an association of Chief Executive Officers of 200 major US corporations, in its publication Building a Comprehensive US-Mexico Economic Relationship: Looking Towards the Future maintained that it was in the political interest of the US to foster a Mexican economic recovery as lack of growth would lead to political instability, increased migration to the US, and fewer market oriented government policies. This view was also shared by John Hartley Chairman of Harris Corp and of the National Association of
Mexico should be rewarded for its embrace of liberal economic policies in its efforts to overcome the debt crisis.104

However, the US was concerned that the failure of the economic reforms would also jeopardise the recent improvement in US-Mexican relations. We have already seen in the preceding section that prior to the 1980s one of the main determinants of Mexican foreign policy had been hostility to the US.105 The request by Mexican President Salinas for an FTA with the US was thus seen by the US administration as a historic opportunity that might not be repeated.106 It was the first time in history that reconciliation between the US and Mexico was believed to be possible.107

As in Canada and Europe both the Mexican and US administrations were of one mind on the need to lock in these reforms because of all that was at stake. Both administrations believed that it was essential to ensure certainty and predictability for US companies exporting to or investing in Mexico, by preventing possible return to more protectionist policies by any future Mexican administration.108 Underlying this desire was a concern about what might happen to the reforms after the Salinas sexenio, particularly as these reforms had taken the form of presidential decrees and hence could easily be reversed.109

*Concern about the flow of illegal immigrants from Mexico into the US.*

The US was also afraid that the failure of Mexico's economic reforms would increase the flow of Mexican illegal workers into the US.110 But illegal immigration had already

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104 Morici 1992, p.93. This would also encourage other Latin American countries to do likewise. See below this chapter, fn.82, regarding Bush's Enterprise for the Americas initiative.

105 This hostility has its origins in the long history of US intervention in Mexican internal affairs and to the fact that in 1847 Mexico had lost half of its territory to the US. See de la Madrid 1984, p.63; Grayson 1988, pp.10-14. This hostility to the US was translated into a determination to demonstrate Mexico's independence in relation to the US. Thus Mexico was a firm supporter of the NIEO in the 1970s and of Central American and Caribbean revolutionary movements, and of Castro in Cuba and the Sandinistas in Nicaragua. See Story 1982, p.774; Castañeda 1985, p.301; Grayson 1988, pp.32-39.

106 Hart 1990b, p.56.

107 Douglas Paal, Special Assistant to the President and Senior Director for Asian Affairs, National Security Council, in interview with author June 1992.

108 Hills 1990, pp.55, 61; 1991b, pp.17-18, 22; US Administration 1991, p.25; Morici 1991a, p.129; Masur, p.101, Hart 1991, p.88. As US Trade Representative Hills (1990, p.51) argued in her testimony before a congressional committee, the FTA would give the reforms force of law. In her testimony before a congressional committee, the Chairman and Chief Executive Officer of Eastman Kodak and Chairman of the Business Roundtable Working Group on US-Mexico Trade and Investment, Kay Whitmore, argued that the reforms needed 'to be built into a legal structure which makes them permanent; something that those of us in the business community who are allocating resources can rely on and plan and invest on'. See Whitmore 1991a, p.122. For a similar argument, see the testimony of former US Ambassador to the OAS and the EC, J. Middendorf (1991, p.308); and Bruton 1991, p.316.

109 The 1973 Law to Promote Mexican Investment and Regulate Foreign Investment was still on the books and the so-called Calvo clause in the Mexican Constitution - requiring foreign companies that operate in Mexico to give up any recourse to their home government in the event of a commercial dispute - was still in force. See Middendorf 1991, p.312; Prestowitz et al. 1991, p.viii.

reached alarming proportions and had become an important political and social issue in the US, so much so that some scholars have argued that one of the principal US motives for the FTA was to find a solution to illegal immigration.\textsuperscript{111} Many in the US administration and Congress and in the business community were convinced that an FTA with Mexico would significantly increase employment opportunities within Mexico and thus reduce the incentive for Mexicans to cross the border illegally.\textsuperscript{112}

\textsuperscript{111} Vega 1991a, p.5. The US political sensitivity to illegal immigration is also reflected by the fact that the FTA liberalises to differing degrees the flow of goods, services and capital between Mexico and the US but not the flow of people. Indeed US Trade Representative Hills (1991b, pp.19, 43), in her testimony before Congress in support of the FTA, makes it quite clear that the possibility of any large scale labour mobility occurring under the FTA had been ruled out by US.

\textsuperscript{112} In its 1990 report entitled \textit{Unauthorised Migration: An Economic Response} the Commission for the Study of International Migration and Cooperative Economic Development - established in 1986 under the Immigration and Control Act - declared that the only way to stop migration was to increase job opportunities in the country of origin, that is, Mexico. See Asencio 1990, pp.143-44. According to the Commission, the only instrument available in the short term to do this was expanded international trade.

The link between the FTA and a reduction in illegal immigration was not a new one. Every year since the passage of the 1985 Immigration Reform and Control Act US Congressman Richardson (1990, pp.28-29) introduced legislation aimed at liberalising trade with Mexico as way of reducing immigration through increased economic development. At first he called for the creation of a US-Mexico Free Trade and Co-production Zone covering an area 200 miles either side of the border. In 1989, however, he dropped the geographical limit, effectively calling for the establishment of an FTA. According to Richardson, President Bush had expressed support for the proposal.

Similar arguments linking the economic growth in Mexico that would flow from the FTA with a reduction of illegal Mexican immigration into the US were made by other administration officials, business representatives and members of Congress. Thus US Trade Representative Hills (1991b, p.23) claimed that economic growth would enhance Mexico's ability to deal not only with immigration but also with other problems such as narcotics, environmental degradation, and human rights infringements. US Representative Kolbe (1991, p.90) argued that an increase in the Mexican standard of living would result in less illegal immigration across the southern border. A similar argument is made by former US Ambassador to the OAS and to the EC, Middendorf (1991, p.307), in his testimony before Congress in support of the FTA on behalf of the Mexican/American Free Trade Association. But see Aguilar (1991, pp.44-45), who claimed that liberalisation and privatisation programmes undertaken in Mexico have only accelerated the migration flow to the US and that unless steps are taken to create greater wage parity on both sides of the border the FTA will only reinforce this trend.

Mexican President Salinas (1990) was also quick to grasp the importance of the illegal migration issue in the US. In an address to members of the Business Roundtable in Washington in June 1990 he declared that '(i)n Mexico we seek to export goods, not labour.' He went on to argue that '(t)o date, the lack of opportunities in Mexico and better paid jobs on the other side of the border have been the main driving forces behind Mexican migration. .. The answer does not lie in building new walls, but in tearing down those that still exist.'
The growing political importance of Texas and the Southwest in US politics

The growing political importance of Texas and the Southwest in US politics in the 1970s and 1980s was also a factor in the US decision to enter into an FTA with Mexico. These areas had strong economic and cultural ties with Mexico and thus had a vested interest in promoting economic growth south of the border. Thus support for the FTA was particularly strong in these areas and less so in the declining industrial centres of the north-east which feared that an FTA would only accelerate their decline and the loss of jobs both to the south and Mexico.\textsuperscript{113}

Give US guaranteed access to Mexican raw materials particularly oil and gas

The US also saw the FTA with Mexico as a means of securing its access to Mexican reserves of oil and gas in the same way that it had seen the Canada-US FTA as a means of securing US access to Canada's oil and gas reserves.\textsuperscript{114} The importance of these reserves to the US has to be seen in the context of the growing US dependence on imported oil, the volatility of the political situation in the Middle East from where the US drew 25\% of its oil imports, and the oil crises of the 1970s.\textsuperscript{115} The significance of securing access to

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\textsuperscript{113} Interviews conducted by the author in May and June 1992 with Thelma Askey, Minority Trade Counsel with the Ways and Means Committee of the US House of Representatives, and Mary Jane Wignot, a Ways and Means Committee aide. The border states had gained considerable benefits from increased US-Mexico trade and from the maquiladora programme in particular. In 1990 Texan exports to Mexico were valued at $13.3 billion and accounted for 47\% of all US exports to that country. Californian exports to Mexico were worth $4.7 billion in 1990. Mexico took over 32\% of total US exports from Texas and almost 18\% of those from Arizona. It was estimated that more than one third of all retail sales in the southern border states of the US were made by Mexicans. According to one study, for every new job created in Reynosa in Mexico, at least one other is created indirectly in McAllen Texas. See US Department of Commerce, 1991; Embassy of Mexico 1992, \textit{Mexico/United States Free Trade: Fact Sheets}. Given the importance of Mexico to the southern border states it was not surprising that many political and business leaders from those states had already expressed a strong desire for the US to negotiate an FTA with Mexico, even before the Salinas request. See Richardson 1990, p.30. As was mentioned earlier, Richardson, a senator from New Mexico, had been making proposals for a free trade zone on either side of the border since 1986. See also Senator Kolbe’s account of the benefits to Arizona of increased US trade with Mexico, Kolbe 1990, p.36; 1991, p.90.

The increased relative importance of Texas and the Southwest both politically and economically was also reflected in the growing number of persons from these states in high level positions. President Reagan was from California and his successor George Bush was from Texas, as were both Robert Mosbacher, Commerce Secretary in the Bush administration, and Bush’s Secretary of State, James Baker. All were clearly supportive of an FTA with Mexico and Bush in acceding to the request by President Salinas for an FTA is said to have acted against a recommendation by his trade advisers that any decision on an FTA with Mexico be deferred until after the conclusion of the Uruguay Round. See \textit{Business Week}, November 12 1990, p.51: ‘Mexico: A New Economic Era’; Lowenthal 1990, p.39; Destler 1992, p.98. Bush’s advocacy of NAFTA also reflected electoral concerns. According to Bush re-election campaign aides, the agreement would help Bush win over the predominantly Democrat-voting Mexican Americans in California, Texas, Arizona and Illinois. See \textit{Washington Post} 17 May 1992, A28. Senator Bentsen, the chairman of the Senate Finance Committee, the key Senate committee on trade, was also from Texas. Bentsen had been involved with Mexico for over 50 years and had close ties with Salinas. Interview with Eric Biel, International Trade Counsel, Senate Finance Committee, June 1992. Morici 1991a, p.129; Vega 1991b, p.54; Hart 1991, p.89.

\textsuperscript{114} Morici 1991a, p.129; Vega 1991b, p.54; Hart 1991, p.89.

\textsuperscript{115} Middendorf 1991, p.308. According to Middendorf, half the oil consumed in the US was imported. Middendorf also emphasised the problem of maintaining sea lines of communications necessary for the transport of oil in a hostile environment.
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Mexico's oil and gas reserves was no doubt even more evident to a President from Texas, a state with considerable interests in oil production, oil services and petrochemicals. The important oil lobby of that state wanted access to the lucrative Mexican oil, services and supplies market. At the same time, according to Allan Mendelowitz, director responsible for International Trade, Energy, and Finance Issues in the National Security and International Affairs Division of the US General Accounting Office, the US petrochemical industry needed more secure access to lower priced Mexican oil and gas supplies if it were to maintain its competitiveness and be able to expand successfully.116

Factors behind Canada's decision

The decision of the US and Mexico to negotiate an FTA was not unexpected by the Canadian government. As early as 1983 the Canadian Department of External Affairs had raised the possibility than any FTA between Canada and the US might be extended to Mexico and the effects of this would have to be considered before any decision to request an FTA with the US was made.117 The inclusion of Mexico was not of obvious benefit to Canada for unlike the US, Mexico was neither an important trading partner nor a significant destination of Canadian investment.118 If anything, as is shown by the following analysis of the factors in Canada's decision to join NAFTA, their relationship was competitive, not complementary.119

It would appear that Canada's main motivation was the fear that a US-Mexican FTA would erode the benefits that Canada had obtained from the Canada-US FTA.120 The

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117 External Affairs Canada 1983, p.211. This consideration was no doubt seen as another reason why Canada should not request an FTA with the US.
118 Hart 1990b, p.7. According to a report from the Royal Bank of Canada (Australian Financial Review, December 7 1990, p.14: 'Mexico is the taste of the times'), it was essential that Canada participate in the negotiations as a Mexican-US FTA could reshape North American trade and investment flows.
119 As for the quite separate question of why the US decided to include Canada in the negotiations rather than concluding a bilateral agreement with Mexico, there appears to be no clear answer. Vega (1991a, p.7) has suggested that the conclusion of separate bilateral deals with the US at the centre - the so-called hub and spoke approach (See below, fn.123) - although it would appear to give the US greater leverage, might actually have had the opposite effect by increasing fears of US economic domination in Mexico and Canada. He has also argued that separate bilateral agreements would be less efficient and give rise to more technical problems. The US might also have felt that given that Mexico was more acceptable to US demands on some questions and Canada on others, a trilateral negotiation would enable it improve on the gains it had obtained under the CUSFTA and, by teaming up with Canada, obtain a far greater liberalisation of Mexico's domestic market than might otherwise have been possible. According to Vega 1991a, p.13, Mexico already afforded greater protection to intellectual property rights and a far more liberal foreign investment regime than Canada under the CUSFTA, and any trilateral FTA negotiations were likely to put pressure on Canada to match Mexico in these areas.
120 Morici 1992, p.89. The defensive nature of Canadian participation is evident in the three basic goals of the Canadian negotiators (External Affairs and International Trade Canada 1993, p.8): to ensure equal access to Mexico so as to create a level playing field; to improve and protect the gains of the Canada-US FTA and to ensure that there was no reduction in the benefits and obligations, to enhance security of access by Canadian firms to the US market.
basic concern here was to maintain Canada's attractiveness to foreign investors, particularly as a site for the production of exports to the US. The US had refused in the CUSFTA negotiations to guarantee that any concession made to other countries would be automatically extended to Canada and there was some fear that the US might be prepared to grant Mexican exports greater security of access to the US market, in terms of safeguards against the imposition of non-tariff restrictions, than Canadian exports, particularly in the auto sector.

Canadian participation in the US-Mexico negotiations was also motivated by the desire to avoid a situation whereby the US through a series of bilateral free trade agreements had free access to the markets of other countries but these countries had no free access to each others' markets. The Canadian government no doubt saw its own participation in any FTA between the US and Mexico as necessary to ensure that Canada would have a say in defining the nature of any future Western Hemisphere FTA. It may also have been influenced by the argument - similar to the one advanced in the US - that NAFTA by giving Canada access to Mexican low cost labour would preserve and increase Canada's international competitiveness vis-à-vis that of the US and members of other trading

122 Ronald Wonnacott 1991a, p.81. According to Wonnacott (1991a, p.85), the Canadian government was concerned that it might lose some of the gains of CUSFTA. It feared that the US-Mexican negotiations might divert resources from the negotiations between the US and Canada on the elaboration of common rules for dumping and subsidies. This had been a key Canadian objective in the CUSFTA negotiations, but had had to be deferred because of the inability of the two negotiating teams to find an acceptable compromise. See Chapter 6, p.187, fn 22, 23. Another Canadian concern was that a separate US-Mexico FTA might jeopardise Canadian efforts to use the CUSFTA to attract higher value added industries, particularly when Mexico had made it clear that it too was seeking to attract higher value added industries.
123 External Affairs and International Trade Canada 1993, p.8; Ronald Wonnacott 1991a, p.82; Vega 1991a, p.6; Warren 1990, p.10. It was argued that such an arrangement, commonly known as 'the hub and spoke' or 'rimless wheel' arrangement, would increase the attractiveness of the US, the hub country, as a production site and decrease the attractiveness of the individual spoke countries such as Canada as destinations for foreign direct investment. Some of the Western Pacific countries harboured similar fears regarding US plans to extend NAFTA to selected countries. See Chapter Eight, pp.319-22. Hart (1991, p.88) argued that Canadian participation in the US-Mexican negotiations was motivated by the fear that some industries, particularly the so-called footloose industries that serve the North American market, would divert investment from Canada to the US as the result of a US-Mexico FTA. According to Hart (1990b, p.8), a member of the Canadian negotiating team in the CUSFTA negotiations, Canada could not afford to allow the US to dictate the future patterns of trade and investment in North America, and more particularly the terms on which Canada must compete with the US and Mexico for US investment.
124 We have already seen in this chapter that some in the US saw a US-Mexico FTA as the first step towards the realisation of President Bush's vision of a hemispheric free trade area. Although many doubted the feasibility of such an initiative in the short and medium term, the Canadian government may have felt that by participating with the US and Mexico in the establishment of a NAFTA it would be setting the ground rules for any future hemispheric FTA and thus ensuring that any future arrangement of this type would be less harmful to Canadian interests.
arrangements. Other factors that may have led to the Canadian decision to join Mexico and the US in an FTA were the desire to increase the Canadian government's leverage against those domestic interest groups opposed to economic restructuring and deregulation and the wish to safeguard and improve the guarantees Canada had obtained under the CUSFTA regarding Canadian access to the US market.

Conclusion

This chapter confirms the three preliminary conclusions of the previous two chapters concerning the emergence of institutionalised regional economic integration in the 1980s and early 1990s. First, NAFTA, like the EC single market and the Canada-US FTA, was not the result of a single factor but of multiple inter-related and mutually reinforcing factors. Second, these factors were not identical nor were they of equal significance for the three countries involved. Finally, although there are factors that are common to the three variants of institutionalised regional economic integration examined so far the relative importance of these common factors in each of the cases is not the same. This holds true even in the case of Canada-US FTA and NAFTA, where despite the participation of the US and Canada in both of these agreements, there are still differences in the relative significance of the factors common to both, not only because the latter agreement involved a third country, Mexico, but also because of the elapse of over five years between the conclusion of the two agreements.

What is striking, however, is the similarity between Canada's and Mexico's motives for requesting an FTA with the US. Like Canada, Mexico had become convinced of the need

\[\text{Like their US counterparts, many scholars and Canadian government officials argued that an industrialised country such as Canada would need to have access to a pool of low cost labour if it were to preserve and increase its international competitiveness. They claimed that, through their membership of formal or informal free trade arrangements, industrialised countries such as Germany, France, the UK and Japan had gained access to the low wage labour of their less developed trading partners and that this access had enabled them through production sharing to reduce to production costs of their exports. The US, they claimed, could expect to increase its international competitiveness in a similar way through an FTA with Mexico. It was essential that Canada join the US and Mexico in an FTA if it was to maintain and preserve its international competitiveness against the US and the emerging trade blocs led by Japan and Western Europe. See in particular Canadian economist Ronald Wonnacott (1991a, p.82); Canadian External Affairs official, Michael Hart (1990b, pp.7-8); Johnson 1991, p.687; and Mexican economist Gustavo Vega 1991a, p.6.}\]

\[\text{By institutionalising the access to the Canadian market of labour intensive products from a low wage country such as Mexico, Canadian economist Ronald Wonnacott (1991a, p.80) argued, the NAFTA would make it easier for the Canadian government to resist demands from domestic special interest groups for the maintenance of tariff and non-tariff barriers.}\]

\[\text{According to Canada's Department of External Affairs and International Trade (1993, p.8), participation in the NAFTA might enable Canada to improve its access to the US market, particularly in areas such as government procurement and countervailing duties disciplines where in the CUSFTA negotiations the US had been reluctant to give ground. See also Hart 1990b, p.8. It is not clear whether the trilateralisation of the dispute settlement mechanism that would occur under a NAFTA would actually be to Canada's advantage. According to Ronald Wonnacott (1991a, p.82) a NAFTA would increase or decrease the voice of Canada in its disputes with the US, depending on whether Mexico sided with Canada or the US.}\]
to reduce its dependency on petrol exports by increasing its export of manufactured goods. To do this, Mexico, like Canada, had realised that it would have to enhance its access to foreign markets and attract the foreign capital necessary to restructure and modernise its manufacturing base. Mexico's nearest large market and its nearest source of foreign capital was the US. But in Mexico as in Canada there was strong opposition to any FTA with the US on the grounds that increased economic dependence on the US would undermine Mexico's economic and political sovereignty. As a result Mexico, as Canada had done before it, had sought to diversify its exports and enhance its access to foreign markets by pursuing multilateral trade liberalisation through the GATT. However, Mexico, like Canada, soon became disillusioned with this approach. A combination of factors - the slow pace of the Uruguay Round, the growing regionalisation of the global economy, the deterioration in Mexico's balance of trade, the lack of interest shown by EC and Japanese investors in Mexico, rising US protectionism - convinced Mexico of the need for an alternative strategy involving closer economic integration with the US. Like Canada, Mexico at first tried to negotiate sectoral free trade agreements with the US but eventually abandoned this approach in favour of a comprehensive FTA.

Despite these similarities, however, there were important differences. The relative importance of these common factors in the decisions of the Mexican and Canadian governments to request an FTA with the US was not the same. Mexico's resistance to the idea of an FTA with the US was stronger and the Mexican request came over five years after that of Canada. Mexico had adopted the multilateral trade liberalisation strategy much later than Canada - Canada was a founding member of the GATT while Mexico only joined in 1986 - and disillusionment with that strategy also came later though much more quickly than had been the case with Canada. There was also one important factor in the Mexican decision that was not influential in the Canadian decision. Although both governments saw the FTA with the US as a way to restore growth to their economies, the Mexican government feared that without that growth it would lose its monopoly on political power in the country, a monopoly it had enjoyed for over half a century. Whereas Salinas saw the FTA as a way of ensuring the continued domination by the PRI of Mexican political life, for Mulroney the FTA at most provided his Progressive Conservative Party with an opportunity to replace its rival as the natural party of government in Canada.

It is also interesting to compare briefly US motivations in CUSFTA with those in NAFTA. As was stated earlier in this chapter, those motivations were largely the same. In both cases the US saw the FTA as a means of reconstructing the domestic coalition in favour of free trade and of increasing pressure on other states to conclude the Uruguay Round on terms that were more favourable to its own interests. Yet there were some important differences. US concerns regarding its international competitiveness and the growing regionalisation of the world economy had increased in the five years since the
decision was taken to enter into an FTA with Canada. And the US decision to join Mexico in an FTA was driven more by geopolitical concerns to do with Mexico than by either domestic or international economic concerns.

The factors that have been identified in this chapter as having led to the decision by Mexico to request an FTA with the US support the five propositions that were advanced at the end of Chapter Three as possible explanations for the emergence of institutionalised regional economic integration in the 1980s and early 1990s. These factors confirm the first proposition that institutionalised regional economic integration was a response to the undermining of the liberal international trading regime and the associated rise of protectionism, particularly in the United States. Faced with the prospect of finding itself excluded from the emerging regional economic blocs and the US market, the Mexican administration abandoned its reliance on the GATT and opted for an FTA with the US. The Mexican decision to opt for an FTA was not a rejection of the principles of free trade enshrined in the GATT but rather a pragmatic decision taken partly out of the conviction that an FTA was more likely in the short term to help overcome Mexico's pressing economic problems, partly out of the belief that an FTA would better ensure the long term survival of the government's economic reforms designed to reduce government intervention in the market and liberalise imports.

The decision of the Mexican administration to request an FTA with the US also confirms proposition two, that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security, and more importantly to boost their competitive position in the global economy. The Salinas administration believed that the FTA would enhance Mexico's economic and political security in several ways. First, it would safeguard Mexico's access to the US market in the face of rising US protectionism. Second, the gains in efficiency and productivity that would arise from an FTA with the US through greater economies of scale, increased specialisation and more intense competition would increase the international competitiveness of Mexican produced goods. Third, by securing Mexico's access to the US market and increasing its international competitiveness, the FTA would also make Mexico a more attractive destination for foreign investment needed to restructure the Mexican economy and reduce its dependence on the export of commodities. It would therefore counter any trade and investment diversion away from Mexico and towards Canada, that might have arisen as a result of the Canada-US FTA. Fourth, the Salinas administration was convinced that the economic growth that the FTA with the US would engender would restore domestic confidence in the ability of the PRI to manage the economy and thus ensure the continuation of PRI rule, which it believed was vital to Mexico's political stability in a time of economic transformation.
The decision of the Mexican administration to request an FTA with the US also confirms the third proposition, that institutionalised regional economic integration is a defensive reaction among rival capitalists (and rival states), whereby both firms and states come to see their welfare from a regional rather than a purely national perspective and there is a nascent regional identity and consciousness. Intra-regional rivalry though still present is increasingly subordinated to the need for intra-regional cooperation in the face of growing inter-regional rivalry. The Mexican administration, like the Canadian government, was concerned about the rise of regional trading blocs. It too wanted to offset the increased competitiveness that these blocs had given firms in other regions through the greater economies of scale, the increased specialisation and, more particularly, the opportunities for production sharing that the integration of a lower wage economy with a higher wage economy could bring. In his efforts to convince US interests of the benefits that the US would obtain from an FTA with his country, Salinas emphasised the growing regionalisation of the world economy and the importance of production sharing to maintaining the international competitiveness of both Mexico and the US.

The Mexican decision to request an FTA with the US would seem to provide some support for the fourth proposition that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence. Mexico, like Canada, had hoped that an FTA would limit the increased opportunity that this growing economic interdependence had given the US to interfere in Mexico's domestic economic regulation by depriving the US of its ability to impose unilaterally trade remedies on Mexican exports. Nevertheless, the Mexican decision to request an FTA with the US was not motivated by a desire by the Salinas administration to offset any decline in its ability to regulate the Mexican economy through increased policy coordination at the regional level and therefore does not confirm this more specific component of the fourth proposition. The Mexican administration, like the Canadian government, did see some definite advantages of an FTA for itself in domestic politics. It saw an FTA with the US as a way of disciplining domestic protectionist forces, and of surrendering certain regulatory powers and ensuring that no future Mexican government could regain them. In this respect the Salinas Administration's view of regionalism is more in accordance with that of Hayek and Olson than that of Philip and Erhard. (See Chapter Two, pp.39-44). As we have seen, it also saw the FTA as consolidating its electoral position domestically.

The decision of the Salinas administration to request an FTA with the US clearly supports the fifth proposition, that institutionalised regional economic integration is the result of cognitive change. In this chapter we have seen how the Mexican decision was in part the result of changes in the ideas that informed Mexican economic policymaking. Of particular importance was the shift in Mexican elite economic thinking away from an import substitution industrialisation development model to a development model that was heavily influenced by both the export-oriented development model of the Asian NIES and
the wave of economic liberalism that was sweeping the world. As we have seen, institutions such as the American universities, the IMF and the World Bank were important both as facilitators and enforcers of this shift in Mexican economic thinking. It is equally apparent that this shift was the product of a combination of experiences and circumstances both in Mexico and elsewhere and the conclusions that Mexican policymakers drew from them.

The US decision to enter into an FTA with Mexico and Canada (NAFTA) also provides support for some of the five propositions regarding the emergence of institutionalised regional economic integration in the 1980s and early 1990s. Since many of the factors that led to the US decision to establish an FTA with Canada are similar to those that led to the US decision to establish NAFTA, many of the propositions confirmed at the end of Chapter Six are also confirmed in this chapter. To avoid needless repetition discussion of these will be brief. Yet given the presence of new factors, in particular those relating specifically to US concerns regarding Mexico, and the change in the relative significance of others, some re-examination of these propositions in the light of these changes is warranted.

The US decision to enter into an FTA with Mexico, like the decision to enter into a similar agreement with Canada five years earlier, provides clear confirmation of the first proposition, that the emergence of institutionalised regional economic integration in the 1980s and early 1990s was a response to the undermining of the liberal international trading regime and the associated rise of protectionism - particularly in the US itself. But unlike in the FTA with Canada where the desire by the Reagan administration to counter the growing domestic protectionist sentiment had been a major factor, as a result of a decline in protectionist pressures in the US, this desire was a less important factor in the decision of the Bush administration to establish NAFTA. The US administration still saw the FTA with Mexico as a way to bolster multilateralism. Yet our analysis of the factors behind the US decision to agree to NAFTA also supports - and to a much greater degree than was the case in the Canada-US FTA - those who argue that regionalism is the result of a desire by states and vested interests within those states to escape the discipline of the liberal international trading order and increase their protection against outsiders. Many in the US were now advocating bilateralism and regionalism not as a complement but rather as an alternative to multilateralism. However, they did so not because they rejected the principle of free trade but because they were convinced that FTAs were a better vehicle for trade liberalisation than the GATT. At the same time there was a growing tendency on the part of some US industries, whose share of the US and North American market was being eroded by foreign competition, to see NAFTA as a way to protect their industries from what they saw as the unfair competition of foreign rivals, and at the same time to afford
them the same advantages as these rivals enjoyed as a result of their privileged access to a larger home market.

The decision of the Bush administration to enter into an FTA with Mexico, like that of the Reagan administration to establish an FTA with Canada, provides confirmation of the second proposition, that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security, and more particularly to boost their competitive position in the global economy. Concern in the US about the declining international competitiveness of the US was even greater than at the time of the decision of the Reagan administration to establish CUSFTA. This gave even more weight to the argument that an FTA would increase US competitiveness by providing US firms with increased economies of scale, greater opportunities for specialisation, a more efficient allocation of resources and increased competition. The US administration also saw the FTA with Mexico as an opportunity to enhance its economic and political security. The FTA with Mexico, like that with Canada, would enhance US energy security. It would make US investments more secure by locking in and extending the reforms undertaken by the Mexican administration. It would boost economic growth in Mexico, thereby reducing the likelihood of a political and economic collapse in Mexico and the flow of illegal Mexican immigrants to the US.

The decision of the Bush administration to establish an FTA with Mexico also supports the third proposition, that institutionalised regional economic integration is a defensive reaction among rival capitalists (and rival states), such that both firms and states come to see their welfare from a regional rather than a purely national perspective and there is a nascent regional identity and consciousness. Both the Bush administration and American business had become increasingly aware of the regionalisation of the global economy. Many saw a link between the decline in US international competitiveness and the emergence of trading blocs such as the EC single market project and the informal regional economic integration in East and Southeast Asia centred on Japan. The FTA with Mexico, they argued, would offset the competitive advantage that firms in these blocs had obtained over the US counterparts as a result of economies of scale, increased specialisation, and more particularly, the opportunities for production sharing that the integration of a lower wage economy with a higher wage economy provided. This was particularly true of the US automobile and clothing and textile industries who sought to protect their North American ‘home’ market from foreign competition through higher local content in the rules of origin provisions of NAFTA.

The decision of Bush to conclude an FTA with Mexico, like that of his predecessor to enter into an FTA with Canada, provides further confirmation of the fourth proposition that institutionalised regional economic integration is a reaction to the costs of growing economic integration. However, as in the FTA with Canada, US was not motivated by the desire to regain through the joint exercise of economic sovereignty over the North
American market with Mexico and Canada any ability to regulate the domestic economy that it may have lost as a result of increasing economic interdependence. Rather it saw NAFTA as another opportunity to weaken domestic pressure for increased protectionism by getting other countries - in this case its third largest trading partner and an important developing country, Mexico - to agree to remove barriers to the entry of US exports into their markets and to lock in and encourage further deregulation in these countries.

The US decision to enter into an FTA with Mexico also confirms the fifth proposition, that institutionalised regional economic integration is the result of cognitive change. In the preceding chapter we saw how the shift in the dominant economic paradigm from Keynesian to economic liberalism had made US policymakers in the Reagan administration more favourably disposed towards the bilateral option, particularly when economic studies showed that FTAs would have a similar effect on the economy to that recommended by supply-side economists. In this chapter it is evident that the same was also true of policymakers in the Bush administration. In both cases that more favourable disposition reflected and was a reaction to a more comprehensive attitudinal shift in Congress and elsewhere away from free trade towards fair trade, managed trade and even protectionism. In the preceding chapter we saw that this more comprehensive attitudinal shift had been partly the result of the changed economic circumstances of the US, namely the worsening trade deficit and the relative decline in US influence over the GATT, and partly the consequence of the various theoretical challenges to the free trade orthodoxy. In the case of the FTA with Mexico, however, it had been reinforced by increasing concern in the US about declining US international competitiveness and the growing regionalisation of the global economy and by arguments that linked these two phenomena not only to each other but to the theoretical challenges to the free trade orthodoxy. Here again as in the FTA with Canada, the economic studies showing the beneficial effects of FTAs in terms of increased international competitiveness were a significant factor.

The decision of the Canadian government to join the US and Mexico in the formation of NAFTA also provides confirmation for the propositions advanced at the end of Chapter Three. We have seen in this chapter that this decision was largely a consequence of a previous decision to request an FTA with the US and of Canada's desire to safeguard and, wherever possible, to extend the gains of the Canada-US FTA. As a result many of the factors involved in the NAFTA decision were identical to those that had led to the CUSFTA decision five years earlier and thus reconfirm the findings of the previous chapter with regard to the propositions. Nevertheless, the lapse of some five years between the signing of the two agreements and the inclusion of a third, less developed country in NAFTA do provide new insights into these propositions, and it is principally with these that we are concerned.
The Canadian decision to join NAFTA lends further support to the first proposition that the emergence of institutionalised regional economic integration in the 1980s and early 1990s was a response to the undermining of the liberal international trading regime and the associated rise of protectionism in the US. By deciding to join NAFTA the Canadian government reconfirmed its preference for bilateralism in the management of its trading relationship with the US and demonstrated that there had been no restoration of confidence on its part in the GATT. Given that the principal motivation for Canadian decision to join NAFTA was the desire to safeguard and enhance the gains of the CUSFTA, the decision provides additional support for the related argument that institutionalised regional economic integration is the consequence of efforts by states to find alternative arrangements that will guarantee access to the markets of their most important trading partners. At the same time it also confirms the contradictory nature of this response to the undermining of the liberal international trading regime. While the Canadian government no doubt saw the FTA with Mexico as providing an external discipline on protection seekers at home and as a way of increasing the pressure for deregulation, both it and Canadian business interests were also motivated by the desire to preserve the preferential access to the US market that they obtained through CUSFTA.

The Canadian government's decision on NAFTA provides even stronger confirmation of the second proposition, that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security, and more particularly to boost their competitive position in the global economy. The Canadian decision was clearly motivated by the desire to offset any competitive advantages that firms from Mexico and the United States might gain over their Canadian rivals in the North American market as a result of the formation of a Mexico-US FTA. It was also motivated by the belief that any FTA between Mexico and the US might become the basis for a wider FTA covering the Western Hemisphere and that by joining the US and Mexico Canada would be better able to ensure that the rules governing this wider FTA were less harmful to Canadian interests.

The decision of the Canadian government to join NAFTA also confirms the third proposition, that institutionalised regional economic integration is a defensive reaction among rival capitalists (and rival states). The Canadian government and business interests were as, if not more concerned by the rise of regional trading blocs as they had been prior to the signing of CUSFTA. They believed that NAFTA, like CUSFTA, would enable Canadian firms to offset the increased competitiveness that these blocs had given their foreign rivals through the greater economies of scale and increased specialisation that access to a larger market could bring. At the same time they were increasingly susceptible to the argument that FTAs, both formal and informal, between more developed and less developed countries had enabled rival firms to increase their competitiveness as a result of
production sharing and that NAFTA could do the same for Canadian firms by providing them with access to the low wage labour of Mexico.

The factors behind the Canadian decision to join the US and Mexico in NAFTA also lend support to the fourth proposition, that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence. Given the economic liberal inclinations of the Canadian government at the time, the decision to join NAFTA on the surface would appear to have been motivated more out of a desire to hasten the pace of deregulation than by a wish to reassert government control over the market through the joint exercise of certain regulatory powers with other states at a regional level. Yet on further examination it is clear that the Canadian government saw both the FTA with the US and the NAFTA as an opportunity to reduce the costs of increasing interdependence between the US and Canadian economies. As Canadian exports to the US continued to rise as a proportion of total Canadian exports, the economic well-being of Canada was becoming more vulnerable to unilateral decisions of the US Congress and Administration concerning the access of foreign producers to the US market. The Canadian government saw in the NAFTA a way to preserve and increase the influence that it had gained through CUSFTA over the terms of access of Canadian goods and services to the US market.

The Canadian decision to join NAFTA also confirms the fifth proposition, that institutionalised regional economic integration is the result of cognitive change. Since the Canadian decision was largely a consequence of the decision to request an FTA with the US, the same cognitive changes that led to CUSFTA played a part in the decision to join NAFTA: the embrace of economic liberalism, and the scepticism of Canadian policymakers regarding the utility of GATT in managing Canada's trading relationship with the US. At the same time arguments advanced by economists that an FTA with Mexico would enhance the international competitiveness of Canadian firms were partly successful in displacing traditional fears that an FTA with a low wage country such as Mexico would have disastrous economic repercussions in terms of employment for a high wage country such as Canada. Support for bilateralism also grew as a result of a new ethos of international economic competitiveness and the struggle for economic survival, not only among firms but also among states. In short there was a convergence of the realist paradigm with that of economic liberalism, with cooperation at a regional level now seen as essential to maintaining and enhancing international competitiveness.
CHAPTER EIGHT
INSTITUTIONALISED REGIONAL ECONOMIC INTEGRATION IN THE
ASIA PACIFIC: ASIA PACIFIC ECONOMIC COOPERATION

An examination of the phenomenon of regionalism is more problematic in the Asia Pacific region than in Europe or North America. This is because, unlike the other two case studies, there are competing propositions, each with a different conception of what the region is or should be. Is the region Southeast Asia, is it East Asia or is it the Asia Pacific? Are the three compatible, that is, do they form free concentric circles of economic cooperation as one commentator has suggested, or are they mutually exclusive? Are Australia and New Zealand part of East Asia?¹

In Southeast Asia there is ASEAN. Of all the existing or proposed regional frameworks this would appear to be the most stable. It has been in existence since 1967 and has weathered the dramatic changes that have taken place in the wider region. At the January 1993 ASEAN heads of Government summit in Singapore it was decided to deepen ASEAN by creating the ASEAN Free Trade Agreement (AFTA).²

Although there have been various attempts to organise the region on a pan-Pacific basis - Kojima’s Pacific Free Trade Area (PAFTA), the Organisation for Pacific Trade and Development (OPTAD), the Pacific Basin Economic Council (PBEC) and the Pacific Economic Cooperation Conference (PECC) - it was only in 1989 that the first intergovernmental organisation Asia Pacific Economic Cooperation or APEC was established. Given the inherent difficulties in organising a region that is so politically, economically and culturally diverse, the pace of its evolution has been quite surprising. Yet APEC is still quite young and despite a recent upsurge in interest by the US and Japan its future is uncertain. This is due in part to persistent tension between its two economic giants Japan and the US and in part to rival proposals to organise regionally on a hemispheric basis rather than on a pan-Pacific basis. In the Western Pacific Malaysia has proposed the establishment of an East Asian grouping, the EAEG, or as it was later called,

¹ This uncertainty as to what actually constitutes the region is reflected in the wide array of names that have been used to designate it and the disputes over which countries should be included. Before the 1980s the word Pacific or Pacific Rim was the most commonly employed term as can be seen from the names of the earlier proposals - PAFTA, OPTAD, and of non-governmental bodies such as PBEC and PECC. In the 1980s Australian efforts at regional economic cooperation focused on the Western Pacific, which obviously excluded the US and Canada. In 1988 Australia’s Minister for Foreign Affairs and Trade Gareth Evans used the Asia Pacific as a synonym for the Western Pacific. Asia Pacific meant the intersection of Asia and the Pacific. This was also the Asia Pacific envisaged by Hawke in his original proposal for a regional organisation in 1989. The growing economic interdependence between Northeast and Southeast Asia in the late 1980s also saw the term East Asia increasingly employed to designate what had been previously thought of as two quite distinct areas of Asia. This term was given formal recognition by the Malaysian proposal in 1990 for an East Asian Economic Grouping.

² Widening ASEAN to include the Indochinese states was also discussed. The 1995 ASEAN Summit saw the subsequent admission of Vietnam into ASEAN.
the East Asian Economic Caucus or EAEC. The EAEG or EAEC is the first serious attempt to form a purely East Asian regional economic grouping since the Japanese tried to establish the Greater East Asian Co-prosperity Sphere by military conquest. Hawke's original proposal had been for the establishment of a Western Pacific body that excluded the US and Canada. The Malaysian proposal, however, not only excludes the US and Canada, but also Australia and New Zealand.

Of these three manifestations of economic regionalism AFTA is the only one to have resulted in the formation of a regional Free Trade Area, along the lines of NAFTA and CUSFTA and to a lesser extent EC 92. When APEC was first established in 1989 the emphasis was on regional consultation and cooperation and proposals for regional trade liberalisation were resisted. It was only in 1994 at the APEC Heads of Government Summit in Bogor Indonesia that agreement was reached in principle on the establishment of an APEC FTA by 2010 for the industrialised member countries and 2020 for the developing member countries. However, unlike the Single European Act and the Canada-US Free Trade Agreement and North American Free Trade Agreement the Bogor Declaration is non-binding. As for the EAEC, it has been adopted in a modified form by ASEAN but has still not been accepted by some key non-ASEAN countries, most notably Japan.

The proposal by Malaysia to establish the EAEG came in the wake of the decision by Canada, the US and Mexico in September 1990 to begin negotiations on NAFTA. It was first publicly announced by Malaysia's Minister for Primary Industry Lim Keng Yaik shortly after the breakdown of the Brussels talks on 7 December 1991. Malaysia had initially referred to the group as a trade bloc or pact. Following initial criticisms, particularly from Japan, that the use of the word 'bloc' or 'pact' to describe the grouping would only add momentum to the trend towards protectionism and regional trade blocs, Malaysia renamed the proposal the East Asian Economic Grouping or EAEG. See Star 11-12-90: 'PM: Go For Trade Pact'; International Herald Tribune 12-12-90, p.16: 'Japan Rejects Idea Of an Asian Bloc'; Far Eastern Economic Review 31-1-91, p.32: 'Building blocs: Japan negative about leading Asian economic pact'; Asian Wall Street Journal 1/2-3-91: 'Malaysia Continues to Adapt Trade Group'. But this was still not enough and in October 1991 Malaysia was again forced to change the name, this time to the East Asian Economic Caucus (EAEC) in order to gain the endorsement of the ASEAN Economic Ministers for its proposal. See ASEAN Economic Ministers 1991, p.11.

There is, of course, no clear relationship between whether an agreement is binding or not and compliance. For further discussion, see below, pp.326-27, fn.184.

At the Fourth ASEAN Summit held in Singapore in January 1992 the ASEAN leaders, while recognising the need for consultations among East Asian economies on issues of common concern, failed to reach a consensus on the EAEC proposal and recommended that the proposal be further studied and refined. It was not until 1993 that ASEAN members finally agreed that the EAEC could operate as a subgrouping within APEC. Malaysia has nonetheless persisted in its efforts to strengthen the identity of the EAEC. In 1994, while its proposal that the EAEC vote as a single bloc within APEC on major issues was unsuccessful (see Sydney Morning Herald 23-7-94: 'Push for an Asian bloc within APEC'), the foreign ministers of nine (ASEAN plus China, South Korea and Japan) of the eleven potential members of the EAEC met for the first time to discuss the EAEC. 1995 brought further successes with Japan gradually conceding ground on the EAEC. Japan had refused to attend a meeting of the ASEAN economics ministers and their counterparts from Japan, China and South Korea in April 1995 unless Australia and New Zealand were also invited. Mahathir responded with a threat to boycott the Osaka APEC leaders summit. However, at a lunch of East Asian foreign ministers during the ASEAN PMC in August that year, Japan agreed to attend the first summit of East Asian and EU leaders to be held in March 1996, despite a Malaysian veto of Australian participation. In December 1995 the EAEC proposal came a step closer to implementation when a summit of ASEAN leaders agreed to a proposal by Singapore that Japan and South Korea should be invited to attend annual ASEAN leaders summits. Yet despite these favourable developments the EAEC has still to be formalised either as a caucus.
For reasons of space this chapter will deal only with APEC. The ASEAN Free Trade Area and the East Asian Economic Caucus will not be discussed separately here, though their establishment was clearly a response to many of the same factors which led to the setting up of NAFTA and APEC as well as being a response to the existence of NAFTA and APEC.

In this chapter I proceed as follows. First I look briefly at past efforts to institutionalise regional economic cooperation in the Asia Pacific with the purpose of identifying the reasons for their failure and in particular the obstacles that had to be overcome before APEC could be established. After a brief analysis of the achievements of the first APEC meeting I examine the factors that were instrumental in the decision in November 1989 to establish APEC. There follows a brief examination of the reasons for the failure of the 1989 meeting to institutionalise APEC and to establish APEC as a forum for the negotiation of regional trade liberalisation. factors. I then look at the evolution of APEC from the 1989 Canberra meeting to the 1984 meeting in Bogor at which the heads of government of the APEC economies committed themselves to the achievement of regional free trade by 2020. I consider the factors that led to this commitment and to the institutionalisation of APEC before examining briefly the remaining obstacles to the establishment of an APEC FTA. I conclude by reviewing the factors that were involved in the establishment and subsequent evolution of APEC in order to see whether these lend further support to the propositions advanced at the end of Chapter Three concerning the emergence of institutionalised regional economic integration in the 1980s and early 1990s.

Historical background: the obstacles to earlier proposals for intergovernmental cooperation in the region

There have already been some excellent accounts of past efforts at institutionalised regional economic integration and it is not my intention to replicate these here. Instead I will focus on the obstacles to past efforts in order to understand what was so different about the circumstances in the late 1980s that enabled the APEC initiative to succeed where previous initiatives had failed.

Soesastro identifies three phases in the development of Pacific economic cooperation. The first period from the early 1960s to 1967 he described as a period dominated by Japanese initiatives, principally aimed at establishing a free trade area centred on Japan. Soesastro, however, does not discuss other attempts at regional economic integration that preceded the Japanese efforts to establish a Pacific Free Trade Area (PAFTA) in the 1960s. Admittedly some of these such as the Organisation for Asian Economic Cooperation (OAE) were limited to Asia while others such as the Southeast Asia Treaty Organisation or SEATO

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6 For more detailed accounts of the past efforts at institutionalised regional economic integration in the Asia Pacific, see Soesastro 1983 and 1994a; Morley 1987.
7 Soesastro, however, does not discuss other attempts at regional economic integration that preceded the Japanese efforts to establish a Pacific Free Trade Area (PAFTA) in the 1960s.
Following the failure of proposals for pan-Asian regionalism, Japan's efforts to promote regional economic cooperation focused principally on both the larger Asia Pacific region and on Southeast Asia. (For a detailed account of Japanese efforts to promote economic cooperation in Southeast Asia and in particular with ASEAN, see Shiro Saito 1990, pp.140-78). In 1965 Professor Kojima of Hitotsubashi University in Japan advocated the establishment of a Pacific Free Trade Area among the developed countries of the region, namely Japan, the US, Canada, Australia and New Zealand, which would grant preferential access to the developing countries of Asia and Latin America similar to that granted by the EEC to the former colonies of member states. Kojima's proposal was motivated partly by the concern that the entry of the UK into the EEC and the formation of a North Atlantic Free Trade Area could deprive Japan, Australia and New Zealand of the markets they needed to maintain economic growth, partly by the conviction that regional economic integration would result in the loss of considerable sections of their manufacturing industry and large scale unemployment. Australia, in particular, feared that, in any free trade area with Japan and the US, for Australia the losses would outweigh the gains, and that the benefits from free trade would accrue principally to Japan, the US and Canada. See Arndt 1967. The United States appeared to be reluctant to become involved in something that it felt was contrary to its global interests. In the conduct of its economic relations with other countries, the US was said to have a preference for global or direct bilateral relationships. Economic regionalism, it was argued, was antithetical to the key US post-war global economic and trade policy aim - the creation and defence of a liberal international economic system. It is significant that, although the US promoted regional security arrangements such as SEATO, it resisted attempts by other countries to give SEATO an economic dimension. See Kojima 1968, p.23;
1968 to 1977, support for Pacific economic cooperation spread to other countries in the region, particularly among business and academic circles, and as this occurred, the nature of economic cooperation that was envisaged was modified to an OECD-like model of consultation and cooperation. The third period from 1978 to the present saw the gradual

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Patrick 1975, pp.1-2, 7; 1977, p.655; Borthwick 1987, p.126; Singh 1966, pp.212-15. According to the Department of Foreign Affairs (Australia) 1989b, pp.145-46, this lack of interest was also due to the successful conclusion of the Kennedy Round of Multilateral Trade Negotiations which had brought significant reductions in tariff barriers and allayed the fears of regional countries concerning the consolidation of the EC.

9 There was growing interest in the subject of Asia Pacific economic integration in both business and academic circles. In 1967 Japanese and Australian business interests formed the Pacific Basin Economic Council or PBEC, a non-governmental organisation composed of business representatives from the five developed countries of the Asia Pacific. (For a fuller discussion of the origins of PBEC, see Morris-Suzuki 1981). The following year the Japanese government sponsored the first of a series of Pacific Trade and Development Conferences (PAFTAD) to discuss the PAFTA proposal. (See Drysdale 1988, pp.210; 1984, p.1; Soesastro 1983, pp.21-22; Morris-Suzuki 1981, pp.455-56). These conferences are held annually in different countries in the Asia Pacific. They are attended by policy-oriented academic economists, often closely linked to government economic policymakers, and government officials in their private capacity. In the 1970s the conferences highlighted the advantages of greater economic cooperation among countries in the Asia Pacific in the areas of trade, investment and development and more importantly led to a proliferation of research into the subject of Asia Pacific regional economic cooperation. In 1972 the establishment of the Australia-Japan Economic Relations Project, a collaborative effort between the Japan Economic Research Centre or JERC and the Research School of Pacific Studies of the Australian National University, provided further impetus to the idea of Pacific economic cooperation. The research project was nominally headed by Okita Saburo, who was then Director of JERC, and Sir John Crawford, who was then Chancellor of the ANU. The day-to-day running of the project was conducted by Peter Drysdale in Australia and Kiyoshi Kojima in Japan. Jointly funded by the Australian and Japanese governments the project produced papers and reports favourable to increased economic cooperation in the Asia Pacific. According to Morley (1987, pp.14-150, both the project and the PAFTAD led to the creation of an epistemic community or 'influential interlocking international interest group of professional economists' centred mainly on Japan and Australia that supported some form of institutionalised economic cooperation in the region. For a discussion of the importance of this epistemic community as a factor in the eventual establishment of APEC, see below, pp.306-08.

10 In 1968 following the failure of his PAFTA proposal to win acceptance Kojima (1968, pp.25-26) modified his proposal. As a first step towards the more institutional economic integration of PAFTA he proposed to further functional economic integration through the formation of an Organisation for Pacific Trade and Development or OPTAD along the lines of the OECD. The proposal was further developed by Drysdale in 1977 and by Drysdale and Patrick in 1979. (See Drysdale 1977; Drysdale and Patrick 1979). But whereas Kojima had argued the case for PAFTA largely in terms of the need both to offset and to emulate the formation of the EEC, the rationale for OPTAD proposal presented by Drysdale (1977, p.611) was the need for intergovernmental consultations to manage the problems that were the result of rapidly increasing economic interdependence in the region and in particular to avert possible conflict over access to scarce raw materials and energy and to markets at a time of unusually prolonged and general recession and rising protectionism. Foreshadowing one of the principal factors in the establishment of APEC a decade later, Drysdale and Patrick maintained that the establishment of a regional institution was essential to ensure that the phenomenal economic growth in the region would not be adversely affected by an erosion of the global institutions such as the GATT or by growing tensions in the US-Japan economic and political alliance and changes in the strategic and political balance in the North and Southeast Asia, which had underpinned that growth in the past. Drysdale and Patrick 1979, pp.12-14; Drysdale 1981, pp.431-33. Drysdale and Patrick (p.13) believed that the establishment of an Asia Pacific regional institution would counterbalance the preponderance of established Atlantic and European interests in the shaping of international economic policy at a time when those interests appeared to be 'directed towards trade share stabilisation and reactive protection of the present international order, and against constructive adjustment to dynamic economic growth such as that taking place in Asia and the Pacific.' This argument was employed by the Hawke government to support the establishment of APEC. See below, pp.288; and p.291, fn.59.
realisation of the idea of Asia Pacific economic cooperation, first through the functional economic cooperation of PECC and finally through the institutionalised regional economic cooperation of the intergovernmental consultative forum of APEC.

Of particular interest to this thesis is the rejection of some form of regional intergovernmental cooperation at the beginning of Soesastro's third period in favour of a non-governmental form of cooperation. Towards the end of the 1970s there was renewed interest from the Japanese government in Pacific economic cooperation. In January

The Drysdale and Patrick proposal also represented a significant change in terms of membership of the proposed regional body. While the OPTAD that Kojima and Drysdale had initially proposed was to be comprised only of five developed countries of the region, the 1979 proposal of Drysdale and Patrick called for the establishment an organisation that would also include the Pacific Basin market-oriented developing countries. These were the ASEAN Five: Indonesia, Malaysia, the Philippines, Singapore and Thailand; the three Northeast Asian developing countries: South Korea, Taiwan and Hong Kong; and Papua New Guinea and the small South West Pacific States. (See Drysdale and Patrick 1979, p.21). The inclusion of the developing countries was no doubt partly the result of their increased importance as suppliers of scarce resources, and partly the result of the establishment of UNCTAD and the demands for a new international economic order that better reflected the interests of developing countries. At this point, however, the proposal was still largely limited to academic circles - officials were on the whole not interested or divided on the issue.

On becoming Prime Minister in 1979 Ohira had set up The Pacific Basin Cooperation Study Group under the chairmanship of Okita to 'study how to enhance regional cooperation and harmonious relations within the Pacific Basin group'. (See Far Eastern Economic Review December 21, 1979, p.47: 'Exploiting the Pacific Tide'). Scholars have suggested various possible motives for the decision by Ohira to establish the Pacific Basin Study Group. According to Gordon (1983, p.247), the proposal came as a surprise to the Japanese Foreign Ministry and many saw it as an election ploy to win over the Miki faction which was favourable to Pacific economic cooperation. Some saw it as simply a new slogan to take the place of the 'omni-directional foreign policy' slogan of Ohira's predecessor Fukuda. See Nakajima 1980, p.2. However, for Akaneya (1987, p.37) Ohira's proposal for a Pacific Community was a reaction to the shifts in US foreign policy following following the Vietnam War. It was, he argued, both an effort in burden-sharing with the US and an attempt maintain US interest in the region at a time when the US seemed to be inclined towards winding down its commitments. This view was supported by Morris-Suzuki (1981, pp.457-60). By making considerable financial contributions to any new Pacific organisation, she argued, Japan believed it might be able to meet the demand of the US that Japan make a greater contribution to the defence of the Pacific, in a way that was likely to be more acceptable both at home and abroad. However, for Morris-Suzuki, the renewed Japanese interest in Pacific Basin economic cooperation was also a response to Japanese concerns about protectionism, economic security and its international role. Not only would it enhance Japan's economic security by making its supplies of raw materials and energy more secure, it would also provide an ideal framework for Japan to place its relationship with the US on a more equal footing and to play a greater leadership role in Asia without reviving the bitter memories associated with Japanese domination prior to 1945. Dickson (1983) also attributed the Japanese government's renewed interest in Pacific cooperation to concerns about protectionism and economic security. The Japanese government, he argued, hoped that such cooperation would ensure both the continued openness of important export markets in the face of mounting protectionism and the security of its energy supplies from countries such as Indonesia and Malaysia in the aftermath of the oil shocks of the 1970s.

In its final report the Committee failed to endorse the OPTAD proposal. It was no doubt aware of the considerable opposition to the establishment of an intergovernmental organisation such as OPTAD, particularly from the ASEAN countries, and recommended instead the adoption of a long term gradualist functionalist approach. (See The Pacific Basin Cooperation Study Group 1980, pp.77-80; Soesastro 1983, pp.32-37, 44-45). It would appear that Ohira had originally envisaged something much more ambitious including the creation of a yen bloc in Asia. See Gordon 1983, p.248; Far Eastern Economic Review December 21, 1979, pp.47-59: 'Exploiting the Pacific Tide'. The proposal of the Study Group is similar to the PECC proposal that was adopted by the participants at 1980 Pacific Community Seminar. See below, p.283. The Study Group called for the establishment of a private committee composed of about 15 to 20 persons who had influence with their respective governments. After a holding a series of
1980 the Australian Prime Minister Malcolm Fraser as a result of an initiative by Japanese Prime Minister Ohira agreed to sponsor a seminar in Canberra on the Pacific Community concept. Fraser felt that market forces and existing bilateral arrangements were no longer adequate to deal with the complex issues arising out of growing regional international conferences to discuss past and future Pacific Basin cooperation, the committee would become a private consultative forum for promoting Pacific Basin cooperation and eventually an authoritative standing organisation that could express joint opinions or make recommendations to governments. At the same time it saw the need for a more pragmatic task-oriented approach to regional cooperation and called for the establishment of working groups to undertake concrete projects on specific matters of common concern. According to Soesastro (1983, p.33), the proposal was a deliberate attempt to separate the 'low politics' of economic cooperation from the 'high politics' of intergovernmental cooperation. It also has certain resonances with the neofunctionalist theory of regional economic integration of the 1950s and 1960s. See Chapter Two, pp.47-53. But see Hoffmann (Chapter Two, pp.56-57) on the limits to economic cooperation; and Cooper (Chapter Three, fn.8) on the intrusion of trade issues into high foreign policy.

AFAR December 1979-January 1980, pp.645-46; Crawford 1982, pp.63-64. According to Fraser (1980), The Pacific Community Seminar was to be the first of a series of non-governmental seminars to be held in academic or similar institutions within the region over a period of years with the aim of developing a consensus on Ohira's proposal for a Pacific Basin Community.

There were several factors in the Australian government's support for the establishment of a regional economic institution in the late 1970s and early 1980s, factors which, as we shall see later, were also important in the subsequent decision of Australia's Prime Minister Hawke to propose the establishment of APEC. First, the post-war period had witnessed a dramatic shift in the focus of Australia's trading relations from the UK and Western Europe to Japan and the Western Pacific. Increasingly Australia had come to see its own economic prosperity as closely linked to that of the countries in the Western Pacific and in particular to that of Japan. Second, in the 1970s Australia, like most of the other developed countries, experienced economic stagnation and was desperately seeking new markets to boost economic growth. The development of the EC had effectively limited Australia's trading opportunities in Western Europe while economic recession and rising protectionist sentiment in US made it unlikely that country would become a more significant market for Australian exports. The economies of the developing countries of East Asia were still growing rapidly and the Australian government was convinced that the Western Pacific would outpace economically both Europe and North America. The government (Peacock 1979a; 1979b) believed that, given the complementary nature of its economy with that of the region, Australia was 'well-placed to reap rich rewards.' However, the Australian government (Street 1982) feared that these opportunities could be lost as a result of the rising protectionist sentiment in the developed countries. It was particularly concerned by the increasing resort by the US and the EC to bilateral solutions to resolve trade deficit problems with Japan, without proper regard to the impact of these on third countries like Australia. The Australian government (Peacock 1979b) believed that the establishment of a Pacific regional organisation would help ensure the survival of the liberal international economic trading system that it regarded as serving Australia's best trading interests and prevent economic disputes and tensions from spilling over into political relationships. Underlying this was the concern that following the US withdrawal from South Vietnam, the announcement of the Guan doctrine and the thawing of relations between the two superpowers, there would be increased domestic pressure on the US government to reduce its military presence in the region. The US security umbrella, it was argued, had underpinned the development of economic interdependence in the region, and a substantial reduction in that presence could undermine that interdependence and the rapid economic growth that had accompanied it. Many saw an intergovernmental regional economic cooperation arrangement as a way of both ensuring a continued US engagement in the region, at least for the time being, and of providing a robust structure that would preserve and enhance regional economic interdependence if and when the US security umbrella was withdrawn. According to Drysdale (interview with author 1992), this concern had been an important factor in the push for an intergovernmental regional economic arrangement by both himself and Sir John Crawford, a former Secretary of the Australian Department of Trade and Industry, a key government economic advisor and the Chairman of the 1980 Pacific Community Seminar. See Drysdale 1981, pp.421-22, 426-29, 432; Anthony 1979.
interdependence and would be better handled by a regional institution.\textsuperscript{13} The academics, businessmen and government personalities at the Pacific Community seminar in Canberra not only rejected both the EEC model of institutionalised regional economic cooperation and the current bilateral status quo but also the OPTAD proposal.\textsuperscript{14} There was a notable reluctance by some ASEAN participants to endorse any new initiative that would involve intergovernmental cooperation.\textsuperscript{15} The fears and concerns expressed by ASEAN participants at the Seminar and ASEAN politicians elsewhere in relation to the Pacific Community concept can be grouped into four interrelated concerns: a general concern about the viability of such an organisation; a concern about the economic consequences; a concern about the politico-strategic implications; and finally a concern about the effect of such an organisation on ASEAN itself.\textsuperscript{16} Because these concerns constituted the obstacles that would have to be overcome before any regional intergovernmental body could be established in the region they are discussed briefly here.\textsuperscript{17}

\textsuperscript{13} Fraser 1980.
\textsuperscript{14} Crawford 1982, p.71. As well as the Japanese proposal, there was another proposal for a Pacific Commission, which was to be a totally private organisation modelled on the Trilateral Commission. See Narongchai 1981, p.172.
\textsuperscript{15} 'Summary Report of Proceedings and Main Recommendations', in Crawford and Seow 1981, p.28. The ASEAN participants listed a considerable number of pre-conditions to the formation of a Pacific Community. These were that a Pacific Community 'must not undermine the strength and cohesion of ASEAN; that it should not have hidden political motivations which would conflict \textit{inter alia} with ASEAN's non-aligned approach; that it must not result in new forms of neo-colonialism; that it should not lead to increased dependence on or domination by the major industrialised economies of the region at the expense of important extra-regional relationships, but should result instead in taking greater account of ASEAN interests especially in the field of trade liberalisation; that it must not involve 'divide and rule' tactics so far as broad developing country interests in the North-South dialogue are concerned; that it must not undermine existing regional and multilateral arrangements; that it must not lead to increased rigidity which might hinder the operation of the principle of comparative advantage, but rather should have the opposite effect; that it should strengthen ASEAN's bargaining position in commercial negotiations; and that it must bring about more meaningful results than have been achieved so far on a bilateral basis.'
\textsuperscript{16} Many of those opposed to the establishment of a Pacific economic community saw these different arguments as interrelated. Luz del Mundo, Deputy Director-General of the Political Office of the Philippines Foreign Ministry, was a participant in the 1980 Pacific Community Seminar. At the Seminar she voiced concern that ASEAN would lay itself open to charges that it was 'a Western-dominated organisation', were it to host a future meeting of the Pacific Basin Community group. See \textit{Far Eastern Economic Review} September 26 1980, pp.90-91: 'Slow start in the Pacific'. Luz del Mundo (1986) saw the establishment of a Pacific economic community as resulting in an increased dependence of the ASEAN countries on the developed Pacific Five with perhaps the former eventually falling under the neocolonial control of the latter. By increasing the control that the Pacific Five exercised over vital sectors of the economies of the ASEAN countries, a Pacific economic community would, del Mundo argued, give the Pacific Five a greater say over the nature and pace of ASEAN economic development and a greater influence over ASEAN's future political directions, including its relations with other countries and its position in the North-South dialogues. While not disputing the claims of the liberal economists that freer trade would increase the sum total of economic wealth in the region, del Mundo claimed that there was no guarantee that all the members would reap the benefits. She also saw the Pacific Community proposal as an attempt by the Pacific 5 to deprive ASEAN of its newly found leverage through its bilateral dealings with non-member states.
\textsuperscript{17} Krause (1983, pp.111-12) identified one further obstacle to the formation of an intergovernmental Pacific organisation in the early 1980s, namely that membership of a Pacific regional organisation was perceived by both Japan and the US to be contrary to their global interests. Yet it is not clear just how significant a factor this perception on the part of Japan and the US was in the failure of the 1980 Canberra Seminar to reach agreement on the establishment of a regional intergovernmental organisation. Indeed there is considerable evidence to suggest that both the US and Japan were in favour of an intergovernmental
The general concern about the viability of a Pacific organisation was not specific to ASEAN countries and had been expressed in the past by those either opposed to or highly sceptical of efforts to form such an organisation. An intergovernmental Pacific organisation, it was argued, was not feasible at least for the time being because of the region's extreme political, social, cultural, economic, ideological, historical, ethnic, linguistic and religious diversities.18

The ASEAN countries were also uneasy about the economic consequences of membership of a new Pacific organisation. There was concern that the enhanced regional economic interdependence that a Pacific Community would foster might only increase the economic dominance of Japan and the US in the region to the detriment of the less developed countries.19 Given the enormous disparities in economic development, such a organisation but were unwilling to push the matter out of deference to ASEAN. Krause himself had argued earlier that the failure of the US State Department to produce a policy statement on Pacific Community was not a result of any loss of enthusiasm for the idea on the part of the State Department but more out of concern that a US initiative could prove counter-productive. See *Far Eastern Economic Review* August 22 1980, p.12: 'Moulding a new community'; Dickson 1983. According to Borthwick (1983, pp.280-83), the US State Department under Carter had already canvassed the attitude of the ASEAN countries to the proposal in 1979 and had concluded that a regional intergovernmental organisation would be premature. It felt that any attempt by the US to take the lead in promoting the Pacific community concept could give the mistaken impression that the US would eventually seek to dominate any new regional arrangement. For a more detailed account of the attitude of the Carter and Reagan administrations, both immediately before and after the 1980 Canberra Seminar, see Borthwick 1987, p.133. Through the consultations undertaken by the Pacific Basin Cooperation Study Group, Japan, like the US, had also been made aware of the considerable opposition by ASEAN countries to a regional intergovernmental organisation. It wanted to avoid creating the impression that it was seeking through the establishment of a regional organisation to consolidate its economic domination of the region and recreate the Greater East Asia Co-prosperity Sphere. See Soesastro 1983, pp.33-34; *Far Eastern Economic Review* December 21, 1979, p.48: 'Exploiting the Pacific Tide'; Shiro Saito 1990, p.124; Gordon 1983, pp.251-53. However, Japan, unlike the US, was committed to making a proposal. But to allay ASEAN concerns that proposal was deliberately vague and stressed an informal, functional, step-by-step approach. See Soesastro 1983, p.34, Morley pp.21-22. The vagueness of the Japanese proposal and the failure of US to put forward an its own blueprint, though intended to reassure the ASEAN countries that these two countries did not wish to impose their own blueprint on the region, appears to have been counter-productive in that it only served to increase suspicions among the ASEAN countries that the proposal was a cover for the hegemonic aspirations of these two countries in the region. See Borthwick 1983, p.283; Soesastro 1983, pp.11-12, 37; Morley 1987, p.26.

18 Mahathir 1980, pp.15-16; Ariff 1981, p.27; Sicat 1982, pp.49-50; Khoman 1981, pp.21-23; Crawford 1982, pp.66-67. This argument was taken up by Mahathir Mohamad (1980, p.16), then Malaysia's Deputy Prime Minister, who attributed the failure of the Pacific region to develop regional organisations similar to those in the Atlantic region to 'the paucity of knowledge among the Pacific region countries about each other, their lack of contact and the conflict and competition between the big powers which tend to divide the countries of the region into confronting groups.' Mahathir (1980, p.18) argued that 'the first move towards a Pacific Community should not be a comprehensive economic plan or some such clear-cut formula for cooperation but the tedious one of getting to know each other.' He proposed the establishment of a forum for the discussion of non-controversial issues of common interest such as meteorology, rescue operations, charting the seas and oceans. As countries came know and understand each other better, he argued, they would be willing to place further issues on the forum's agenda and extend the cooperation to new areas so that over time a sense of community would develop and mutual help and cooperation would become almost second nature.

19 Khoman 1981, pp.23-24; Krause 1983, pp.109-11. See statement by Mahathir (1981 *Far Eastern Economic Review* October 30, p.34) that 'the end result would most probably be the dominance by the more forceful members of the group. It would not be a regional grouping, it would be a region under the influence of some of them.' For Indonesia's concern regarding the dominance of Japan and US, see Soesastro 1981, p.26. Concern about Japan's economic
Community, it was feared, could only widen the gap between the developed and undeveloped further. Membership of a Community dominated by the liberal market ideology of the developed members would, it was argued, limit the development policy options of developing countries and hinder domestic development. It would also constrain developing countries within the Community in their relations with non-member countries.

The politico-strategic concerns were closely related to the issue of membership. The developed countries, particularly the US, and the liberal economists involved in the push for a Pacific Economic Community wanted membership of a new Pacific organisation limited at least initially to those countries whose economies 'are arranged basically on market principles'. The exclusion of the communist countries from membership of the dominance of the region was rooted in the bitter experience that some Southeast Asian countries had had of Japanese economic domination within the Greater East Asian Co-prosperity Sphere during WWII. Fears about US dominance may have been fuelled to some extent by the claim by Drysdale and Patrick (1979, pp.20-21) that 'OPTAD could be a useful vehicle for the effective revitalisation of US economic leadership in the Asian-Pacific region.' Although Drysdale and Patrick saw that leadership as benign and in the global interest, and believed it would act as a restraint on protectionist tendencies within the US and thus uphold the liberal international trading system, others did not see US participation in quite the same way. See below, fn.21.

Krause 1983, pp.106-07. This fear was consistent with the arguments of dependencia economists who saw trade between the developed and the developing countries as the cause of the underdevelopment rather than the solution to it. It was also consonant with the arguments of certain liberal economists regarding the need for infant industry protection and some import substitution if developing countries were to industrialise and not remained trapped at the less lucrative primary production end of the international production hierarchy. According to Ariff (1981, p.27), Malaysian officials feared that a Pacific Community would lead to increased domination of the South by the North and 'North-South polarisation through the powerful backwash effects which would divert resources away from the developing countries in the Pacific region.' See also Lee 1980, pp.39-40. Ariff (1981, p.29) argued that the fact that Australia hosted the Seminar also made some ASEAN countries less favourably disposed to the proposal. ASEAN countries had been highly critical of the Fraser government's failure to reduce its restrictions on the import of labour-intensive manufactured goods from developing countries. See also Renouf 1986, pp.167-68.

Krause 1983, pp.107-08. The ASEAN countries feared that their efforts to diversify their economies through increasing their exports to non-member countries and thus reduce the economic dominance of Japan and the US would be thwarted. Their ability to use agreements with outside countries, particularly with other developing countries, as leverage against the US and Japan would be reduced. Indeed many saw the Pacific Community as a deliberate attempt by developed countries to divide the South and thus weaken the push for a New International Economic Order. There had been suggestions that one of the areas for Asia Pacific cooperation might be North-South relations. See, for example, English 1980. Philippines Ambassador del Mundoz (1986, p.115) argued that ASEAN membership of a Pacific Community would give the developed members of the Community stronger leverage over ASEAN's position in the North-South dialogues. According to Soesastro (1981, p.26), the Indonesian government was not convinced that the North-South issues would be better handled within a Pacific Community and was concerned that membership of such a Community might be inconsistent with Indonesia's position in the North-South controversy. But see Mahathir (1980, pp.19-22) who maintained that the Pacific region should try to find a way out of the stalemate in the North-South dialogue by facilitating the transfer of technology by the developed to the developing countries and by permitting an orderly transfer of lower-value added manufacturing from the developed to the developing countries. This, he claimed, would reduce the disparities in development and achieve a more symmetrical interdependence.

Drysdale and Patrick 1979, p.22. Drysdale and Patrick (p.23) were obviously aware that the membership of Communist countries in a Pacific organisation would not be acceptable to the US. They argued that the 'strategic concerns of the US and others suggest that it may not be wise to include the Communist nations in OPTAD membership.' By suggesting that OPTAD could be 'a useful forum for consultations and even development of a concerted, coordinated
proposed organisation, however, led to fears by some ASEAN countries that a Pacific Basin arrangement would see the reinforcement of a communist/non-communist cleavage in the region as part of a new US containment strategy to consolidate its position in Southeast Asia following the collapse of its ally South Vietnam in 1975. There was concern particularly in Indonesia and Malaysia that membership of a Pacific arrangement would be inconsistent with the non-aligned status of some of ASEAN member countries and would jeopardise their standing in the Grouping of Non-Aligned Movement.

The ASEAN countries were also fearful that membership of a broader regional economic organisation might undermine ASEAN itself. There were two main concerns expressed here regarding the possible negative impact of a Pacific Community on ASEAN. First, it was felt that despite being in existence since 1966, solidarity among ASEAN members was still not firm enough, particularly in the area of economic cooperation. Given the greater significance of both the US and Japanese markets to ASEAN countries and the largely competitive nature of the ASEAN economies, a Pacific

approach to doing business with the Asian Communist states', particularly China. Drysdale and Patrick, may have inadvertently contributed to the fears of some ASEAN members that the US may use the Pacific organisation to force them to adopt a common US inspired policy vis-à-vis the Communist countries. The PECC proposal that emerged from the 1980 Canberra Seminar also limited membership of the Pacific Economic Cooperation Committee initially to persons from the North American and Western Market economies represented at the Canberra Seminar. See 'Summary Report of Proceedings and Main Recommendations', in Crawford and Seow 1981, p.31.

Ghazali 1980, p.207, Krause 1983, pp.112-13. The attitude of the ASEAN countries was no doubt coloured by their experiences with past regional organisations such as SEATO and ASPAC. See Han 1981, pp.106-07. Unfortunately for the advocates of a Pacific Community, these fears were no doubt heightened by the Soviet invasion of Afghanistan in December 1979, which many believed would see the end of detente between the two superpowers and the beginning of a second Cold War. See Lee 1980, p.39.

Malaysia's then Minister of Home Affairs, Tan Sri Muhammad Ghazali bin Shafie (Ghazali 1980, p.208), made quite clear his country's unwillingness to support 'a Pacific Basin concept that in effect is a recycling of a Pacific "containment" scenario, albeit with new combinations of antagonists, even if the arrangement were instituted in the name of economic enlightenment and with the promise of tangible economic rewards.' See also the statement by Ghazali (quoted in Gordon 1983, p.248) that '(a) Pacific community concept that promises little beyond the freezing of the present international division of labour and the entrenchment of the current political and military divisions of the developed North will be quite distasteful to ASEAN.' The ASEAN countries were also alarmed by suggestions that the People's Republic of China might be allowed to join further down the track. Such suggestions led some Southeast Asian governments to suspect that the Pacific Basin arrangement might be an attempt to create a new tripartite anti-Soviet alliance between the US, Japan and PRC under the guise of economic cooperation. See Nakajima 1980, p.8

See Ariff (1981, p.28) regarding the concern of the Malaysian government, and Soesastro (1981, p.26) regarding a similar concern expressed by Indonesia. It was also felt that it would undermine efforts to make ASEAN a Zone of Peace, Freedom and Neutrality or ZOPFAN. See Ahmad 1981, p.50; Fifield 1983, p.195. The Kuala Lumpur Declaration of November 1971 had called for the creation of ZOPFAN.

Krause 1983, pp.113-15. In the words of Malaysia's Minister of Home Affairs Ghazali (1980, pp.210-11), 'a precondition essential for ASEAN acceptance (of a Pacific Community) is a guarantee that the arrangement will not impair the relations among the ASEAN nations themselves and ASEAN's wider Southeast Asia, Pacific, and global links.' A similar view was expressed by Philippines Minister of Economic Planning, Gerardo Sicat. According to Sicat (1982, p.57), ASEAN's first priority was to strengthen its own organisation, while its second priority was the pursuit of bilateral dialogues with other groups and countries. See also Pang 1981, p.119. Even Singapore, which had most to gain economically from the establishment of a Pacific economic community was concerned to preserve the political stability that ASEAN had brought to the region. See Pang 1981, p.120; Chia 1983, p.187; Tan 1981, p.37.
Community, it was argued, could undermine ASEAN solidarity and unity.\textsuperscript{26} The second concern was that a Pacific Community would deprive ASEAN of its newly found leverage through its bilateral dealings with non ASEAN member states, such as the US and Japan.\textsuperscript{27}

Given the strength of ASEAN opposition to institutionalised regional economic integration in the Asia Pacific, participants at the 1980 Canberra Seminar decided that a 'hasten slowly', organic approach, along the lines of the Japanese proposal, that would build on the existing non-governmental arrangements for regional economic cooperation would be the best way to proceed. They, therefore, recommended a standing committee of about twenty-five persons -to be known as the Pacific Cooperation Committee - be established to coordinate the expansion of exchanges of information within the region and to set up task forces to conduct major studies of issues of regional concern.\textsuperscript{28}

\textbf{The first ministerial-level meeting in Canberra 6-7 November 1989}

The opposition of the ASEAN countries to the OPTAD proposal in 1980 effectively ruled out the establishment of institutionalised regional economic cooperation until 1989 when as a result of another meeting in Canberra, this time of ministers in their official capacity, APEC was formed.\textsuperscript{29} Toward the end of the 1980s there had been a revival of

\textsuperscript{26} Ariff 1981, p.28; Soesastro 1981, p.26. In 1977 intra-ASEAN exports accounted for only 14\% of total ASEAN exports, while intra-ASEAN imports represented only 16\% of total imports. See Han 1981, p.105. It was argued further that, because of the limited diplomatic resources of the ASEAN countries, a Pacific Community, would divert resources from the task of consolidating ASEAN. See Krause 1983, pp.113-15.

\textsuperscript{27} del M undoz 1986; Krause 1983, pp.113-15; Ariff 1981, p.28. The Japanese proposal for a Pacific Community had been seen as an attempt by Ohira to dilute Japan's commitment to ASEAN under the so-called Fukuda Doctrine, to reduce the increased leverage ASEAN had obtained in its relations with Japan, and to prevent ASEAN from escaping its economic sphere of influence by entering into partnership with other countries in Europe, the Middle East and Latin America. See Lee 1980, p.43; del Mundo 1986, pp.116-17; Gordon 1983, pp.248-49.

\textsuperscript{28} Crawford 1982, p.72. However some ASEAN countries were at first unwilling to support even these modest proposals and it was not until 1982 that the second Pacific Economic Committee Conference or PECC was held in Bangkok as a result of an initiative by a keen supporter of the idea, the Deputy Prime Minister of Thailand, Th anat Khom en. According to Harris (1994, p.5), the Indonesian Foreign Minister at the time had claimed that Indonesia did not have to react to the idea since it was not sufficiently concrete and the Malaysian government had refused to back the holding of a second meeting in 1981. Khoman (1981) was also a participant in the 1980 Canberra Pacific Community seminar. In a statement to the seminar he drew attention to the psychological and political obstacles to the establishment of a Pacific organisation but declared himself in favour of such an organisation.

\textsuperscript{29} The proposal was announced on 31 January 1989 by the then Prime Minister Bob Hawke (1989a) during a visit to South Korea. According to Sandy Hollway (1992 interview with author), who was at the time Hawke's principal private secretary and had accompanied him to Seoul, Hawke had already begun to question the conventional wisdom within the Australian bureaucracy that the region was not ready for an intergovernmental institutional arrangement at least one year prior to the Seoul announcement. That wisdom, Hollway maintains, was based on the assumptions that the region lacked economic coherence and similarity; that it would prove too difficult to define membership; that Australia as a developed European offshoot did not have the right credentials to make such a proposal; that there was insufficient consensus about either the shape or purpose of such an arrangement; that PECC was the right way to proceed with Pacific economic cooperation through its
interest in the establishment of some form of intergovernmental regional economic cooperation in the Asia Pacific and the Hawke proposal for an OECD-like organisation was only one of several proposals. Before we proceed to identify the factors that led to this renewal of interest in intergovernmental regional economic cooperation and the success of the Hawke proposal itself it is necessary to have some understanding of the exact nature of the intergovernmental regional economic cooperation that was agreed to at the 1989 Canberra ministerial meeting. This will give us an indication of the extent to which the obstacles to the establishment of such an arrangement in the early 1980s had been overcome.

The achievements of the meeting were modest. By far the greatest achievement was the fact that governments had accepted the Australian invitation to meet at ministerial level to discuss issues of importance to the region. There was certainly no agreement to establish an Asia Pacific Free Trade Area and the formation of a trade bloc was

building of people to people rather than government to government links, and that any attempt to build something more ambitious might put all that had been achieved so far at risk. This conventional wisdom, it would seem was shared at the time by Australia's Minister for Foreign Affairs and Trade, Senator Evans. Just four months prior to the announcement by Hawke of his proposal in Seoul, Evans (1988, p.408) had argued that, given the considerable obstacles to building stronger economic institutional arrangements in the region, in the short term 'it may be most effective to proceed carefully by building dialogue and mutual understanding in a variety of institutions such as the Pacific Economic Cooperation Conference.' In announcing his own proposal Hawke (1989a, p.6) referred to several other proposals for closer regional consultations as proof of the growing interest in closer regional intergovernmental consultations. In March 1988 the former Japanese Prime Minister Nakasone had proposed the establishment of a Pacific Forum for Economic and Cultural Cooperation along the lines of the OECD. In July 1988 US Secretary of State George Schultz had highlighted the need for intergovernmental exchanges on sectoral/structural policies and suggested that these might be carried out under the umbrella of a Pacific Basin Forum. In the first half of 1988 US Treasury Secretary Baker is reported to have been working on a plan to establish a Pacific economic policy coordinating group. In December 1988 US Senator Bradley had called for the formation of a Pacific Coalition on Trade and Development 'to reinforce the Uruguay Round by building consensus on trade issues; to ensure greater economic policy coordination among the countries around the Pacific Rim; and to remove obstacles to developing countries growth.' The Coalition was to comprise the United States, Canada, Australia, Japan, South Korea, Indonesia, Thailand and Mexico. The former Canadian Minister for International Trade Carney had proposed the establishment of an Asian Pacific Wisemen's group. In February 1988 Japan's Ministry for International Trade and Industry (MITI) established the Asia Pacific Trade and Development Study Group to look into Asia Pacific cooperation. In September that year MITI set up the Asia Pacific Cooperation Promotion Conference (1989, pp.95, 100) to investigate the need for Asia Pacific cooperation and the form it should take. In its report the Council (p.130) stated that intergovernmental dialogues on policy cooperation were now needed and called for a regional economic ministerial conference. MITI put forward its own more trade oriented proposal several weeks after Hawke had announced his proposal in Seoul. That proposal envisaged a meeting of the region's economic ministers and had a much broader notion of the region than the Hawke proposal in that it included the US and Canada as well as Australia, New Zealand, Japan, Hong Kong, Taiwan, the ASEAN countries, and China. Japan's Ministry of Foreign Affairs was unenthusiastic about the MITI proposal. See Asiaweek 19-5-89, p.38: 'An Asian Common Market?'; Solomon 1989, p.36; Sydney Morning Herald 23-3-89, p.14: 'Japan (read MITI) has bigger fish to fry.'

The meeting was attended by Ministers from the following countries: Australia, Brunei, Canada, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, and the US. Also present were observers from three Asia Pacific regional organisations: PECC, ASEAN and the South Pacific Forum.
specifically ruled out. Nor was there any formal commitment to regional trade liberalisation.\textsuperscript{32} Rather there was a commitment to pursue trade liberalisation at a global level.\textsuperscript{33} Nevertheless, there was agreement to explore ways of facilitating regional trade with Ministers asking their senior officials to identify and begin the implementation of specific work projects that would enhance the process of regional economic cooperation and facilitate regional trade.\textsuperscript{34}

The meeting also failed to agree to give the APEC process any guarantee of permanence. There was no commitment to establish a Ministerial-level forum or a support mechanism.\textsuperscript{35} Although the Ministers agreed to hold two further Ministerial-level meetings - in Singapore in 1990 and Seoul in 1991, the preparations for these meetings were to be overseen by senior officials from the participating economies, joined by representation from the ASEAN Secretariat.\textsuperscript{36} It was also agreed that there be further meetings, at least every other meeting should be held in an ASEAN member country.\textsuperscript{37} There was, however, no guarantee that APEC would continue beyond 1991.

The ad-hoc nature of the APEC process was also underlined by the endorsement by the Ministers as one of the general principles of Asia Pacific Economic Cooperation of the view that ‘cooperation should be based on non-formal consultative exchanges of views among Asia Pacific economies’.\textsuperscript{38}

\textsuperscript{32} Australia had envisaged five objectives for the APEC process: the strengthening of the individual and collective capacities of regional countries for analysis and policy formulation through the widening of the regional knowledge base; the further liberalisation of trade within the region in a manner that does not discriminate against the rest of the world; the establishment of stronger framework for regional cooperation that could anticipate and alleviate any future trade problems; the strengthening of the ability to project - and protect - regional interests in wider economic fora and negotiations; the undertaking of cooperation in specific sectors. See Evans 1989c, pp.565-66; 1989a, pp.183-84.

\textsuperscript{33} Thus in the joint statement issued at the end of the meeting (Department of Foreign Affairs and Trade (Australia) 1990, p.9) the Ministers reaffirmed their commitment to open markets and to expand trade through the successful conclusion of the Uruguay Round by December 1990. They agreed that continued close consultation within the region should be used wherever possible to promote a positive conclusion to the Round and that Trade Ministers should meet in September 1990 and again in December prior to the what was then thought to be the concluding session of the Round in Brussels 'to discuss the emerging results and consider how to unblock any obstacles to a comprehensive and ambitious MTN result.'

\textsuperscript{34} Among the broad areas for possible cooperation identified by the Ministers were: economic studies; trade; investment, technology transfer and human resource development; and sectoral cooperation in areas such as tourism, energy, trade promotion, environmental matters and infrastructure development. The Ministers themselves identified two particular work projects that they wanted to proceed as soon as possible: a review of data on regional trade flow and developments and on capital flows; and an examination of mechanisms to facilitate the identification of trade, investment and technology transfer opportunities in regional countries. See Department of Foreign Affairs and Trade (Australia) 1989a, pp.16-17. At the APEC Senior Officials Meeting in Singapore in March 1990 agreement was reached on six work projects: review of trade and investment data; trade promotion; expansion of investment and technology transfer in the Asia Pacific region; The Asia Pacific Multilateral Human Resources Development Initiative; regional energy cooperation; and marine resource conservation. It was agreed at a subsequent Senior Officials Meeting to add a seventh work project on telecommunications. See Department of Foreign Affairs and Trade 1990, p.2.

\textsuperscript{35} In his proposal Hawke (1989a, p.6) had envisaged an intergovernmental vehicle of regional cooperation on the model of the OECD, with 'a capacity for analysis and consultation on economic and social issues, not as an academic exercise but to help inform policy developments by our respective governments.'

\textsuperscript{36} Department of Foreign Affairs and Trade (Australia) 1989a, p.17.

\textsuperscript{37} Department of Foreign Affairs and Trade (Australia) 1989a, p.17.

\textsuperscript{38} Department of Foreign Affairs and Trade (Australia) 1989a, p.16.
Factors leading to the first meeting of APEC

From our examination of the agreement reached at Canberra it would appear that there was still a considerable degree of reluctance on the part of some ASEAN members for the reasons stated to participate in a Pacific intergovernmental regional arrangement. Yet despite this reluctance the ministerial-level meeting in Canberra took place and agreement was reached to hold two further such meetings. In this section we examine the factors that led the various governments in the Asia Pacific region to agree to attend the first ministerial-level meeting of APEC. In our discussion we will pay particular attention to those factors that led to the Australian proposal for a regional intergovernmental arrangement. In the following section we will discuss the reasons for the continued opposition by some ASEAN members to a intergovernmental regional arrangement.

The agreement by twelve countries in the Asia Pacific region to attend the ministerial-level meeting in Canberra was the result of six major factors which are set out briefly here and discussed in detail below: 39

- the desire to maintain both the economic interdependence and economic dynamism of the region in the face of uncertainty regarding the durability of the multilateral trading system and the growing global trend towards unilateralism, bilateralism and regionalism;
- the desire of certain states to increase the international competitiveness of their economies and boost economic growth by taking advantage of the economic dynamism of the East Asian economies;
- the concern of the United States to maintain its strategic role as a balancer in the region and thus prevent the region from falling under the sway of another power;
- the related desire by some countries in the region to ensure that the US remained both economically and militarily engaged in the region in order to prevent other economic and/or military powers from dominating the region;
- the shift by ASEAN policymakers in the focus of their economic strategy away from import substitution industrialisation towards export oriented growth;
- the growth of a pro-regional cooperation network, particularly in the ASEAN countries, under the auspices of PECC; and
- the growing self-confidence of the ASEAN countries.

39 In announcing his proposal for a meeting of regional ministers, Australia's Prime Minister Hawke (1989a, p.5) identified four driving forces behind the recent upsurge of interest in regional economic cooperation: growing US bilateral pressure on Japan and the Asian NIEs; the trend towards bilateral or regional trading arrangements; the underlying tensions in the GATT as evidenced by the stalemate in the Uruguay Round of multilateral trade negotiations; and the growing realisation on the part of the countries in the region that their economic futures were interlinked. The Department of Foreign Affairs (Australia) (1989b, pp.5-6) gave five reasons for the renewal of interest in regional economic cooperation: the growing sense of regional identity arising from increasing regional economic interdependence; a convergence of perceptions on economic policy issues; the growing self-confidence of ASEAN; the imbalances and complexities of intra-regional trade; a deterioration in the international economic environment as a result of rising protectionist sentiment.
However, as we shall see in the next section, this last factor must be qualified by the continued opposition of some ASEAN members to the institutionalisation of intergovernmental regional economic cooperation.

The desire to maintain the economic interdependence and economic dynamism of the region in the face of uncertainty regarding the durability of the multilateral trading system and the growing trend towards unilateralism, bilateralism and regionalism

From the first joint statement it is apparent that the principal motive for the first meeting was concern about the stalemate in the Uruguay Round of Multilateral Trade Talks and the concomitant shift by key players such as the US and the EC away from multilateralism to unilateralism, bilateralism and regionalism. As we have seen in preceding sections this was by no means a new factor in the push for regional economic cooperation in the Asia Pacific. Nevertheless, in the late 1980s new developments in the global economy had heightened the concerns of the region’s policymakers about the durability of the multilateral trading system and forced them to give greater priority to the question of intergovernmental regional economic cooperation.

The growing interdependence among the countries of the region, particularly among the countries of Northeast and Southeast Asia had led to a growing awareness of the region as an entity with its own interests to defend. More important, however, was the change in the nature of that trade. There had been a significant shift from the vertical integration of the 1960s and 1970s to horizontal economic integration. This was reflected in the growing importance of manufacturing in the regional economies. By

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40 Thus, according to the Joint Statement (Department of Foreign Affairs and Trade (Australia) 1989a, p.9), the discussions at the 1989 Canberra APEC Ministerial Meeting ‘focused particularly on the need to advance the present round of Multilateral Trade negotiations.’ The Ministers at the meeting ‘agreed that the further opening of the multilateral trading system was of substantial and common interest for all countries in the region, and the Uruguay Round represents the most immediate and practical opportunity to pursue this objective on a broad basis.’ In their Joint Statement the Ministers ‘reaffirmed their commitment to open markets and to expand trade through the successful conclusion of the Round by December 1990.’ They agreed that APEC trade ministers should meet on two occasions prior to the December Meeting of GATT in Geneva and that their senior trade officials should consult regularly to ‘consider how to unblock any obstacles to a comprehensive result.’ They also specifically ruled out the formation of an Asia Pacific trading bloc. This concern about the undermining of the GATT system was also reflected in the Chairman’s Summary Statement (p.14): ‘A key theme which has run through all our deliberations in the last two days is that the continuing economic success of the region, with all its implications for improved living standards for our people, depends on preserving and improving the multilateral trading system through progressive enhancement of, and adherence to, the GATT framework.’

41 Department of Foreign Affairs and Trade (Australia) 1989b, pp.5-6. The 1980s had seen an increase in regional economic interdependence. According to Drysdale (1989, pp.14, 19), Asia Pacific intra-regional trade had grown from 50% in 1965 to 64% in 1988. Nevertheless, as the Malaysian proposal for the EAEC demonstrated, there was still considerable disagreement about just what the confines of that region were.

42 Department of Foreign Affairs and Trade (Australia) 1989b, p.6; Salih 1989, pp.3-4. According to Salih (1989, pp.3-4), in 1965 manufacturing as a share of GDP grew from 20% in 1965 to 30% in 1985 in the Asian NIEs. Salih attributed this shift to three factors: the upsurge in Japanese investment in the region following the 1985 Plaza Accord and the subsequent appreciation of the yen; the relaxation of investment regulations in most ASEAN countries in response to the 1985 recession; and the increasing investments by South Korea and Taiwan in Southeast Asia following the appreciation of their currencies in response to US pressure.

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1985 manufacturing accounted for at least 20% of GDP in all of the ASEAN countries with the exception of Indonesia. The export orientation of this increase in manufacturing production no doubt increased the awareness of the Asian NIEs and more particularly of the ASEAN countries that their economic futures depended on the maintenance and strengthening of the GATT and the need to hold open export markets in developed countries. This helped break down the North-South divide, one of the impediments to intergovernmental regional economic cooperation in the 1970s, and enabled the developing countries to make common cause with the developed countries of the region in defence of the GATT.\textsuperscript{44}

At the same time the increasing economic significance of the region relative to the North Atlantic had given rise to the desire to see that significance reflected in international economic fora.\textsuperscript{45} It was felt that the shift in the centre of gravity of world production was not reflected in international economic institutions, where the interests of the developed countries of the Atlantic region prevailed to the detriment of the countries of the Pacific in particular and of global free trade in general.\textsuperscript{46} A Pacific intergovernmental regional economic arrangement, it was argued, would ensure that the common interests of the countries of the region were given due weight in international economic fora.

Concern about the GATT system of international trade and the rise of regional trade groupings was a significant factor in Australia's decision to launch the APEC proposal in January 1989.\textsuperscript{47} The Western Pacific economies had become the most important and fastest growing market for Australian exports. The Australian government was convinced that Australia's economic well-being depended on the continuing success of the Asia Pacific economies and on the maintenance and enhancement of Australia's access to the markets of those economies.\textsuperscript{48}

Of the four driving forces behind recent calls for enhanced regional cooperation that Australia's Prime Minister Bob Hawke identified when he first announced the proposal,

\textsuperscript{44} Department of Foreign Affairs and Trade (Australia) 1989b, p.6. According to Ferdy Salim (1985, p.367), who was Special Assistant to the Indonesian Minister of Foreign Affairs at the time, the success of the NIEs had made the developing countries increasingly confident that higher stages of development were not beyond their reach.

\textsuperscript{45} According to Drysdale (1989, pp.14, 19), between 1965 and 1988 the Asia Pacific region had increased its share of world trade from 30% to 38%. Even more significant was the fact that the volume of trans-Pacific trade had surpassed trans-Atlantic trade for the first time in 1984. See Elek 1990, p.4.

\textsuperscript{46} Hawke 1984, p.1212.; Evans 1989b, p.280; Oxley 1985, p.997. This argument was not a new one and had been used in the 1970s by those who had advocated the establishment of OPTAD. See above, fn.10.

\textsuperscript{47} According to Evans (1989c, p.564), in 1988 seven of Australia's ten largest markets were in the Western Pacific and the region absorbed over half Australia's merchandise exports and supplied 40% of its merchandise imports. Countries in the Western Pacific accounted for 25% of total foreign investment in Australia and 20% of Australian investment overseas. The Asia Pacific region which included the countries of the Western Pacific as well as the United States and Canada, accounted for 66% of Australian merchandise exports, 65% of its merchandise imports, 45% of total foreign investment in Australia and about 50% of the stock of Australian investment overseas. See Woolcott 1989a, p.707.

\textsuperscript{48} Evans 1989c, p.564.
three were particular concerns about the future of the international trading system.\textsuperscript{49} The first of these were the bilateral trade pressures that had resulted from attempts by the US to reduce its large trade deficits with East Asian countries and in particular Japan.\textsuperscript{50} Australia was worried about the tendency by the US to resolve these through bilateral deals which could be detrimental to the interests of third countries such as Australia.\textsuperscript{51}

According to Hawke, a second driving force was a global trend towards bilateral or regional trading arrangements.\textsuperscript{52} Again Australia was concerned about the possible trade diverting effects of such arrangements on its exports and believed that there was a need for regional dialogue 'to ensure that countries of the region were not tempted or forced into separate arrangements on a bilateral or limited multilateral basis which would discriminate against others.'\textsuperscript{53} In the late 1980s there was growing concern about possible negative effects on non-EC members of the establishment of a truly single market within the confines of the EC. But Australia was particularly alarmed by the active pursuit of both the Reagan and Bush administrations of bilateral or limited multilateral free trade

\textsuperscript{49} Hawke 1989a, p.5. The other driving force identified by Hawke was the growing realisation on the part of the countries of the region that their economic futures were interlinked.

\textsuperscript{50} Australia was particularly concerned at the Super 301 provisions of the 1988 US Trade Law which had been drawn up with Japan, South Korea and Taiwan in mind. Thus Evans (1989c, p.564) expressed his concern at the Super 301 'crowbar'. According to Hawke (1989a, p.6), 'the essence of a properly functioning trading system is, of course, that countries seek multilateral trade balance, not bilateral balance with all countries.' See also Destler 1992, p.132. According to Destler, both Taiwan and South Korea managed to escape being designated as unfair trading partners under Super 301 by making trade concessions to the US. Both Thailand and Malaysia had also been subjected to US bilateral trade pressure. In 1985 the US had threatened Malaysian textiles with countervailing duties and in 1988 these duties were imposed on some Malaysian manufactures. Malaysia was also identified as an unfair trader under Super 301. See Ariff 1991a, pp.96-98. Thailand's rice exports to the US were threatened by the US Food Security Act of 1985. Thailand was also concerned by threats to its steel and tuna exports to the US and by attempts to link the continuation of its GSP privileges to its agreement to enforce US intellectual property rights in Thailand.

\textsuperscript{51} Such deals, it was feared, could result in East Asian countries diverting imports from more efficient Australian suppliers to US suppliers. They could also affect Australia indirectly. Any agreement by the East Asian countries to limit their exports to the US would have a negative impact on economic growth in these countries and on their demand for Australian exports. See Dawkins 1987, p.54. According to the Australian Minister for Trade Negotiations, Michael Duffy (1989b, p.36), Australia did not want artificial restraints placed on the competitiveness or exporting ability of Japan and the Asian NIEs. Australia was particularly concerned about the negative impact these restrictions might have on its efforts to diversify its economy and develop new markets for its manufactures and services. See below, pp.296-99. Hawke (1985, p.11) had already spoken of Australian efforts to combat such pressures on Japan in 1985. In its discussion paper 'Japan's Changing Economic Role in the Region: A New Engine of Growth', DFAT (1988b, pp.16-17) expressed its concern that the trade frictions between the Asian NIEs and industrialised countries, particularly the US, could 'become more pronounced as the NIEs displace Japanese exports into these markets.' The paper warned that '(t)hese frictions may also extend to ASEAN.' The paper went on to argue that 'It will continue to be important for Australia to resist discriminatory bilateral pressures on our major trading partners and to ensure that regional interests are promoted in the context of trade liberalisation in the current Multilateral Trade Negotiations Round.'

\textsuperscript{52} Hawke 1989a, p.5.

\textsuperscript{53} Evans 1988, p.408. See also speech by the Australian Minister for Trade Negotiations, Michael Duffy (1989b, p.36). This concern is reflected in the agreement by Hawke and Japan's Prime Minister Takeshita (1989, p.11) in July 1988 to hold a high-level Australia-Japan Conference to discuss the impact of the EC single market and the Canada-US Free Trade Agreement on the Asia Pacific regional economy. Hawke (1989b, p.181) also spoke of the need to combat the emergence of restrictive trading blocs and to ensure that the international trading system did not fragment into exclusive zones.
arrangements as a means of containing the rising protectionist sentiment in the US and of increasing the pressure on other countries to undertake further trade liberalisation on a multilateral basis. This policy had already led the US to sign free trade agreements with Israel and Canada. But of even greater concern to Australia were proposals for free trade agreements between the US and Japan, between US and ASEAN, between the US and Taiwan and between the US and South Korea. According to the then Secretary of Australia's Department of Foreign Affairs and Trade, Richard Woolcott, Australia had no natural grouping and was therefore fearful of being left out.

Hawke identified as a third driving force behind recent calls for enhanced regional cooperation the 'fundamental tensions within the GATT framework of multilateral trade' as evidenced by the continuing deadlock in the Uruguay Round. Recognising that Australia as a relatively small economy could not use economic or political leverage to defend its trade interests against the large economic powers, the Australian government had made the strengthening of the non-discriminatory multilateral trading system a key objective of Australia's trade policy. Hawke saw the primary task of such regional cooperation as a means of containing the rising protectionist sentiment in the US and of increasing the pressure on other countries to undertake further trade liberalisation on a multilateral basis.

In 1985 Hawke (1985, pp.11-12) declared that Australia, like the ASEAN countries, had 'had to think about possible responses to suggestions for new free trade areas that have emanated from the office of the Special Trade Representative in the United States.' The US had been particularly disappointed by the failure of the 1982 GATT Ministerial Talks to reach agreement on the launch of a new round of multilateral trade negotiations. See Murray Smith 1988b, p.41; Schott 1989, p.4. See Chapter Six, pp.212-13.

In a speech in 1988 Evans (1988, p.408) expressed concern that both the US International Trade Commission and Japan were examining proposals for a Japan-US free trade agreement. According to Schott 1989, p.30, the US International Trade Commission had identified Japan, South Korea, Taiwan, Mexico, ASEAN and Australia as potential FTA partners. For a detailed evaluation of these proposed FTAs, see Schott 1989. Between 1982 and 1985 there were discussions between the US and ASEAN on the establishment of more structured bilateral trading relations, known as the ASEAN-US Initiative. See Soesastro 1990, p.386-89; Borthwick 1987, p.134; Wallis 1984; Armacost 1985, p.36. These discussions were resumed in 1987.

Australia was also listed by the US International Trade Commission as a potential FTA partner. The Australian government's Ministerial Task Force on Long-term Economic Growth had commissioned a study into the implications for Australia of both a US-Australia free trade arrangement and free trade agreements between the US and various Asian countries and Canada. This study had shown that, given the nature of Australia-US trade and the fact that non-tariff barriers rather than tariff barriers constituted the main obstacle to Australian exports into the US, Australia would obtain little, if any benefit from a free trade arrangement with the US. The gains to the US from any agreement that did remove the non-tariff barriers to Australian exports were not very substantial, it argued, and were easily outweighed in the minds of US policymakers by the more significant domestic political costs of their removal. The study also found that Australian exports could be seriously disadvantaged by any bilateral agreement between the US and any of the East Asian countries or Canada. According to the study, '(i)f substantial reductions in trade barriers cannot be negotiated on a multilateral basis but if reductions can be secured around the Pacific, it would be in Australia's interests to join in these negotiations.' See Snape 1986; 1989.

Interview with author 1992. The 'orphan syndrome' was also an important factor in the decisions of Canada and Mexico to request FTAs with the US. See Chapter Seven, pp.245-46, 261-63.

Hawke 1989a, p.5. The government had been particularly concerned at the failure of the Mid-Term Review of the Uruguay Round of multilateral trade negotiations in Montreal in December 1988 when disagreement over agricultural subsidies had threatened to halt the Round. Australia's Minister for Trade Negotiations Michael Duffy (Department of Foreign Affairs and Trade (Australia) 1989c, p.4) had even warned that should the Uruguay Round fail a major international trade war would erupt.

Department of Foreign Affairs and Trade (Australia) 1988a, p.21. According to Denis Gastin, who was a senior bureaucrat in the Department of Trade in the early 1980s, there had been a shift in Australia's trade policy to bilateralism following the failure of the Australian
cooperation as being the reinforcement of support for an open, non-discriminatory trading system operating within an expanded and strengthened GATT. The Australian government considered that such an arrangement would enhance the chances of reaching a satisfactory conclusion to the Uruguay Round by increasing the leverage of regional countries in the multilateral trade negotiations. It also saw such an arrangement as providing Australia and the region with a useful fallback position should the new round of multilateral trade negotiations not eventuate or fail to stem the rising tide of protectionism of the 'old industrial countries'. Yet by 1989 Australia had come to see regional trade government's efforts at the 1982 GATT ministerial meeting to have agriculture included in the next round of multilateral trade negotiations. But by 1987, he argued, despite the success of the bilateral approach in increasing Australia's trade with countries such as China, there was a shift away from bilateralism towards multilateralism. See Australian, Asia and APEC, p.3: 'Menzies led way on our trading image'. This shift to multilateralism was no doubt reinforced by the argument that Australia as a middle power would enjoy much greater influence in multilateral negotiations through coalition building than in bilateral negotiations. See Gareth Evans and Bruce Grant 1991, pp.321-26.

59 Hawke 1989b, p.181. See also similar statements by Duffy (1989b, p.36) and Woolcott (1989b, p.122). According to Woolcott (1989b, p.123), one of the three major benefits from enhanced regional economic cooperation would be to strengthen 'our ability to project the region's economic interests in economic fora in a way which ASEAN, Australia, New Zealand and even Japan alone have not been able to do in the past. Importantly, in this respect, we would hope that cooperation would enhance the prospects of success in the Uruguay Round and subsequent rounds of Multilateral Trade Negotiations, and contribute significantly to the strengthening of the multilateral trading system.' The argument that an increased regional voice would enhance the prospects of success in the Uruguay Round is based on the belief that the economic structures established at the end of WWII no longer reflect the relative economic strength of the Atlantic and Pacific basins and give undue weight to the interests of the Atlantic economic powers, namely the US and the EC, who have become more inward-looking and protectionist and hence less supportive of the GATT system. See Drysdale 1981, p.432, and above this chapter, fn.10. The EC was also concerned that the grouping would use its influence in the Uruguay Round. See Australian 10-7-89, pp.1,2: 'EC threatens to retaliate against Pacific trade bloc'.

60 Australian efforts to increase the regional voice in multilateral trade negotiations pre-date the 1989 Hawke proposal and the success of these earlier efforts no doubt encouraged Hawke to launch the APEC process in 1989. In the wake of the failure of the 1982 GATT ministerial meeting to agree to include agriculture in the next round of multilateral trade negotiations, Hawke (1983, pp.690-91) had called for consultations among Western Pacific countries to ensure that issues of significance to regional countries such as non-tariff barriers, safeguards and agriculture were addressed in a new round. It was hoped that the initiative would establish 'a durable consultative process with the countries of the region on multilateral trade issues.' The other regional countries agreed to Hawke's proposal (the so-called Bangkok initiative) and a series of meetings at senior official level were held. See Miller 1984, p.1063; Dawkins 1985, p.437; and Holloway (interview with author 1992). According to Woolcott (interview with author 1992), Hawke had also been encouraged by the success of so-called Cairns Group of Fair Traders in Agriculture in ensuring that agriculture remained a priority issue in the Uruguay Round of multilateral trade negotiations. It is significant that the meetings of the Cairns Group, which included members of ASEAN, were at ministerial level. For a more detailed analysis of the Cairns Group, see Gallagher 1988. According to Gallagher (1988, p.3), the Cairns Group demonstrated the ability of smaller GATT members to set both the direction and pace of multilateral trade negotiations on contentious issues.

61 Hawke (1983, p.691). At this time, however, Hawke had in mind a grouping of Western Pacific countries. Thus as early as 1983 Hawke had declared that 'if our best efforts fail to overcome the consistent commitment of many of the old industrial countries to patterns of trade that discriminate against the Australia, the ASEAN countries, and other countries in our region ... (t)here would still be scope for negotiations on trade expansion among countries within our own region, on a non-discriminatory basis, but focused on commodities in which countries in our own region are the most competitive suppliers. Australia would be willing to join other countries in our region in a regionally based search for a non-discriminatory agreement on trade expansion that served the national interests of each of our countries.'
liberalisation albeit on a non-discriminatory basis as a goal in its own right and not just an option to be pursued in the event of an unsuccessful Uruguay Round.62

Concern at these developments in the world economy was also shared by the other countries in the Asia Pacific region, giving rise to a heightened sense of shared regional interests and a common regional cause, the maintenance and reinforcement of the multilateral trading system.63 In 1989 Japan's then Prime Minister Noboru Takeshita declared that maintaining and strengthening the free and open trading system was one of the three fundamental principles of Japan's policy toward the Asia Pacific.64 Japan, like Australia, was concerned by the growing resort by the US to bilateral trade pressures in its efforts to reduce its trade deficits with Asian countries and saw advantages in having its own bilateral trade problems discussed in a multilateral regional forum.65 Japan also shared Australia's concern at the growing trend towards bilateral and regional trade

62 Richard Woolcott, who was the Secretary of the Australia's Department of Foreign Affairs and Trade at the time of the APEC initiative and the Prime Minister's special envoy, Australia's Minister for Foreign Affairs and Trade Gareth Evans, and Australia's then Minister for Trade Negotiations Michael Duffy identified regional trade liberalisation as one of the main goals of enhanced regional economic cooperation. See Woolcott 1989b, p.122; Evans 1989c, pp.565-66; Duffy 1989b, p.36. As early as 1985, Australia's then Minister for Trade, John Dawkins (1985, p.437) had raised the possibility of regional trade liberalisation 'under the umbrella of the MTN and on a non-discriminatory basis.' Such an option, he argued, was even more compelling given 't'(he fact that barriers to regional trade are highest in precisely those areas where comparative advantage is greatest'. Other regional countries, particularly those from ASEAN, were unenthusiastic about regional trade liberalisation and the objective of regional trade liberalisation did not figure in the Ministerial Joint Statement that was issued at the Canberra meeting in 1989. Nevertheless, Australia continued to push for the adoption by APEC of a regional trade liberalisation programme. Drysdale and Garnaut (1989, p.55), while rejecting the formation of a Pacific FTA, also saw 'a regional round of negotiations directed toward multilateral concessions, but focused on issues of high regional interest' as the most appropriate response to a failed Uruguay Round.

63 Department of Foreign Affairs and Trade (Australia) 1989b, p.6. At the 1989 Canberra Ministerial Meeting both the South Korean Minister for Foreign Affairs, Choi Ho-Joong (Department of Foreign Affairs and Trade (Australia) 1989a, p.45), and Canada's Minister for International Trade, John Crosbie (Department of Foreign Affairs and Trade (Australia) 1989a, p.56), voiced their concern at the growing trend towards protectionism, inward-looking regionalism and bilateralism, the erosion of the multilateral trading system and the slow progress of the Uruguay Round economic system.

64 Takeshita 1989, p.11; Ministry of Foreign Affairs Japan 1989, pp.29-30. The other two principles were: respect for the views of ASEAN; and promotion of multi-faceted and steady cooperation. See the statement by Japan's Prime Minister Kaifu during a visit to Malaysia (Mainichi 28-4-91, p.3: 'Kaifu-Mahathir talks') that Japan's first priority was to make the Uruguay Round a success. According to an official in Japan's Foreign Ministry, 'Asian nations need a global free-trading system. ... Anything that endangers the Uruguay Round is a negative.'

65 Kikuchi (interview with author 1992). This view was particularly strong in Japan's Ministry of International Trade and Industry (MITI), which, as we have already seen, was working on its own proposal for Asia Pacific regional intergovernmental economic cooperation. Officials in Japan's Ministry of Foreign Affairs (Gaimusho), however, were less supportive of the Hawke proposal, partly out of the belief that ASEAN was unlikely to find the proposal acceptable, partly out of concern that MITI's overhasty approach would prove counter-productive by creating the impression that Japan was intent on forming an economic bloc and therefore only further encouraging protectionist forces in the EC and the US, and partly out of the fear that such an organisation if established would see MITI encroach further into its own domain of foreign relations. Gaimusho was said to prefer the flexibility and informality of PECC. See Far Eastern Economic Review 16-11-89, pp.11-12: 'The backroom boys'.
groupings, and at the EC SIM and the US-Canada FTA in particular. Enhancing its ties with Pacific Asia, Japan believed, would increase its leverage against those in the EC who wanted to increase protection against outside competition. It would also provide it with a fallback position should the US become more protectionist.

The concern of ASEAN members at the erosion of the multilateral trading system and the global trend towards unilateralism, bilateralism and regionalism was no doubt crucial in overcoming the steadfast opposition of some ASEAN countries to the establishment of an Asia Pacific intergovernmental organisation and therefore a key factor in the success of the Hawke initiative in 1989. Some ASEAN countries had already been subject to bilateral pressure from the US and were fearful of renewed pressure from the US through legislation such as Super 301. ASEAN members were also concerned at the growing trend towards bilateralism and regionalism. They were becoming increasingly anxious about the rise of the phenomenon of trade-replacing investment whereby investment, particularly Japanese investment, was being diverted away from the developing countries of South East Asia to the US and the EC in response to both rising protectionism and the

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Inoguchi 1993, p.83. But according to Inoguchi (pp.80-83), Japan's interest in enhancing its ties with Pacific Asia was also motivated by its concern at the growing unreliability of the US and by the desire of Japan to reduce its overdependence on the US economically and militarily. Japan, he argued, was worried about the reliability of its security ties with the US, the US management of its domestic economy and its abandonment of multilateralism and the GATT for unilateralism and bilateralism. Yet, according to Inoguchi, Japan was also trying to reduce its overdependence on the US by strengthening its ties with the EC. He maintained, aware that the Asian market was still not large enough to replace fully that of the US and believed that the EC could provide an alternative market. (Inoguchi 1991, pp.29-30; 1993, p.78). Hence its reluctance to antagonise the EC by creating anything in the Asia Pacific that might be perceived as a trading bloc. On the other hand, he argued, APEC increases the leverage Japan has to ensure that the EC remains open to the outside. See also Lincoln 1993, p.166.

Japan's other strategy for dealing with its concerns about 'Fortress Europe' and rising US protectionism was to invest massively in the EC. According to Lincoln (1993, pp.176-77), between 1985 and 1990 Japan invested four times as much in the US and just under twice as much in the EC as in the Asian NIEs and ASEAN combined. Whereas in 1980 Japanese cumulative foreign direct investment in the Asia was about the same as that in the US and greater than that in the EC, in 1990 Japanese cumulative foreign direct investment in the Asian NIEs and ASEAN was a quarter that in the US (14.2% versus 46.8% of the cumulative total), and somewhat less than that in the EC (17.8%).


See fn.50, p.289 above.

In an address in March 1989 Thailand's Prime Minister Chatchai Choonhavan (1989, p.16) described the rise of protectionism as the most immediate challenge confronting the global economy and national economies. At the inaugural APEC ministerial meeting in Canberra in November 1989, the Brunei Minister of Foreign Affairs Prince Mohamed Bolkiah (Department of Foreign Affairs Australia 1989a, p.47) expressed his country's concern at the growing trend towards protectionism, unilateralism and discriminatory trading arrangements. His Malaysian counterpart, Abu Hassan Haji Omar (Department of Foreign Affairs Australia 1989a, p.54) voiced his concern that in international trade negotiations such as the Uruguay Round there was now less talk of free trade and a greater focus on reciprocity and fair trade. He declared that 'bilateralism and regionalism should not be allowed to gain at the expense of an open and multilateral trading system.' At the meeting similar concerns were expressed by Singapore's Minister for Trade and Industry, Lee Hsien Loong (Department of Foreign Affairs Australia 1989a, p.185), and by the Philippines government in its Background Information Paper on World Regional and Economic Development (Department of Foreign Affairs Australia 1989a, pp.175-76).
promise of enhanced access to a larger market.\textsuperscript{71} Like Australia, the ASEAN countries were also preoccupied by the deadlock in the Uruguay Round of multilateral trade negotiations and saw the maintenance and extension of the open multilateral trading system as the best way to ensure that Southeast Asia remained an attractive destination for foreign direct investment and that the economic growth that they believed to be essential to both regional and national political stability was sustained.\textsuperscript{72} The ASEAN countries clearly saw Asia Pacific economic cooperation as a means of increasing their leverage in the Uruguay Round of multilateral trade negotiations and of ensuring a successful conclusion to the Round.\textsuperscript{73}

As for the US administration, its decision to support the establishment of APEC can be seen as part of a broader shift in administration policy away from a trade policy that was totally multilateral in orientation to one which also saw a role for bilateral and regional arrangements in eliminating the barriers to US exports.\textsuperscript{74} As we have seen in Chapters Six

\textsuperscript{71} Thus at the Eighth ASEAN-EC Ministerial Meeting in February 1989 ASEAN as a whole had voiced its concern at the possible adverse effect of the EC Single Market on ASEAN trade with the EC. See Joint Declaration of the Eighth ASEAN-EC Ministerial Meeting held in Kuching Malaysia, 16-17 February 1989, ASEAN Secretariat 1991, p.55. See also the Philippines Background Information Paper on World Regional and Economic Development that was prepared for the Asia Pacific Economic Cooperation Ministerial Meeting in Canberra in November 1989 (Department of Foreign Affairs Australia 1989a, pp.175-76). See also Salih (1989, p.11) and Wanandi (1990, p.3) regarding the concern of ASEAN members at the possible diversion of Japanese, US and European capital away from Southeast Asia to the enlarged European market.

\textsuperscript{72} According to Simandjuntak (1990, p.329), the increase in the concern of the ASEAN countries with regard to the Uruguay Round and the GATT in general was in part due to their rising dependence on the export of manufactures to the United States market.

\textsuperscript{73} Thus at the 1989 Canberra meeting Indonesia's Foreign Minister Ali Alatas, speaking on behalf of ASEAN, declared that enhanced Asia Pacific economic cooperation should be aimed at 'facilitating more effective, mutual consultations so as to enable participants to identify more clearly and to promote their common interests and to project more vigorously those interests in larger multilateral forums.' See Department of Foreign Affairs (Australia) 1989a, p.37. At the same meeting Dr Subin Pinkayan, Thailand's Commerce Minister, speaking on behalf of ASEAN Economic Ministers, argued that enhanced regional economic cooperation should 'explore the possibilities of enhancing the role of Asia Pacific countries in promoting the success of the Uruguay Round without forming or creating an impression of forming a negotiating bloc.' See Department of Foreign Affairs (Australia) 1989a, p.38. Similar views were expressed by Thailand's Prime Minister (1989, p.16) and by Singapore's Minister for Trade and Industry, Lee Hsien Loong (Department of Foreign Affairs Australia 1989a, p.185).

\textsuperscript{74} This increased interest by the US in Pacific cooperation can be traced back to the early 1980s. According to Borthwick (1987, pp.134, 137), the US administration had been impressed by the support that its proposal for a new GATT round had received from the Western Pacific countries at the 1982 GATT Ministerial meeting and the then US Secretary of State George Schulz saw the expansion of Pacific cooperation as a means of heading off protectionist pressures globally. In 1984 he asked US Ambassador-at-Large Richard Fairbanks to travel the region to seek views on how the US could support Pacific economic cooperation. Following a recommendation by Fairbanks that the US play a more active role in regional organisations such as PECC, the US National Committee for Pacific Economic Cooperation was formed in September 1984. But, given the growing tensions in US-European relations in the early 1980s over issues such as Afghanistan, the euromissiles and the supply of Soviet gas to Western Europe, this increased US interest in Pacific cooperation may also have reflected a more general desire on the part of the US administration to reduce the relative importance of its ties with Europe by consolidating its relations with the countries of the Western Pacific. According to Borthwick (1987, p.135), in 1984 the then US Under Secretary of State for Political Affairs Lawrence Eagleburger foreshadowed a 'shift in the centre of gravity of US foreign policy interests from the trans-Atlantic relationship toward the Pacific Basin and particularly Japan'. These reasons for the increase in US interest in Pacific cooperation in the
and Seven that shift was not only a response to rising protectionism sentiment both within the US and abroad, it was also aimed at enhancing the chances of success of a new round of multilateral trade negotiations.\textsuperscript{75} Thus the US administration not only shared the concerns of the other Asia Pacific countries regarding the threat posed by protectionism to the multilateral trading system, it also shared their desire to increase their leverage in the Uruguay Round negotiations through enhanced regional consultation and cooperation.\textsuperscript{76} The US clearly saw APEC as a means of strengthening the world's open trading system, achieving fair and free trade in Asia, and promoting liberal economic reforms particularly in those countries such as China that were late entrants into the region's economic dynamism.\textsuperscript{77} The US no doubt also believed that APEC might provide it with another means to reduce its substantial trade deficit with East Asia by putting additional pressure on East Asian countries to reduce their barriers to US goods and services.\textsuperscript{78} At the same time it saw APEC as a way to strike a greater balance in its economic relationships with Asia and Europe.\textsuperscript{79}

\textit{The desire to increase international competitiveness and boost economic growth}

The concern of Asia Pacific states to maintain the economic interdependence and economic dynamism of the region was closely linked to the desire of regional states to increase the international competitiveness of their firms and boost domestic economic growth by taking advantage of the economic dynamism of the East Asian economies. The 1980s had seen a growing recognition on the part of governments of the need to enhance the international competitiveness of their economies. We have already seen in the European and North American case studies that this recognition had been a significant early 1980s were also significant factors in the US decision to support the establishment of APEC in 1989.\textsuperscript{75}

\textsuperscript{75} See Chapter Six, pp.210-17; and Chapter Seven, pp.248-51. Nevertheless, it is clear that the US embrace of FTAs (which are protectionist by definition) had only served to increase the doubts of other states concerning the future of the multilateral trading system that the US claimed its policies were intended to strengthen. See also Chapter Three, pp.85-94.

\textsuperscript{76} Both US Secretary of State James Baker and US Assistant Secretary of State for East Asian and Pacific Affairs Richard Solomon clearly saw APEC as a way to strengthen the US bargaining position in the Uruguay Round. According to Baker (1989a, p.65), by furthering the development and integration of market economies within the international system, a new mechanism for multilateral cooperation in the Pacific rim would strengthen the collective force of those that shared US principles.

\textsuperscript{77} Baker 1989b, p.13, Solomon 1990, p.32. According to Baker (1989c, p.59), one of the seven guiding principles of the proposed Pacific rim economic cooperation mechanism should be the forging of a common commitment by market economies to facilitate the free flow of goods, services, capital, technology, and ideas.’ Baker (1989d, p.49) reiterated this goal in his opening statement at the 1989 APEC Ministerial-level Meeting when he declared that one of the purposes of APEC could be to work multilaterally to overcome barriers to trade and investment.’ In 1988 US Under Secretary for Economic Affairs and Agriculture Wallis (1988, p.25) emphasised the limitations of existing arrangements, both bilateral and multilateral, in promoting structural reform in the Pacific Basin economies and considered necessary ‘some further means to bring together the market-oriented economies of the region and those that are clearly committed to moving that direction.’

\textsuperscript{78} APEC could therefore be used as a tool to achieve a level playing field. The US was, however, careful not to emphasise this aim as it was aware that to do so would only increase the reluctance of East Asian countries and in particular of ASEAN members to establish a regional body that included the US. Solomon 1990, p.52.
factor in the decision of the members of the EC to form the Single Market and in the
decision of the Canadian and US governments to establish the CUSFTA and to join with
Mexico to set up NAFTA. This desire on the part of governments to boost the
international competitiveness of their national economies was also an important factor in
the establishment of APEC.

This was particularly so for the developed countries of Canada, the US, Australia and
New Zealand. All four had experienced lengthy periods of slow growth, high
unemployment and worsening trade deficits in the 1970s and 1980s and were seeking
ways to re-invigorate their economies. They saw closer institutionalised economic
integration with the fast growing economies of East Asia as one way of boosting their
own economic growth. They were also concerned that, as non-Asian developed
economies, they might find themselves excluded from any regional governmental body
that might be established to foster closer economic cooperation among the East Asian
economies.

In Chapter Six we observed that one of the significant factors that led to the decision of
the Canadian government to seek an FTA with the US had been its desire to restructure
the Canadian economy so as to decrease its dependence on the export of minerals and
primary products and increase the export of higher value added and more technologically
intensive products. Soon after taking office in 1983 the Hawke Labor government in
Australia became similarly convinced of the need to restructure the Australian economy
and began implementing policies designed to lessen Australia's dependence on the export
of minerals and primary products by increasing its exports of elaborately transformed
manufactures and services.

The decision of the Hawke government to take such action, like that of the Canadian
government, was in part a consequence of the world economic downturn of the early
1980s. The Hawke government's decision to restructure the Australian economy was
made possible by the world-wide shift in economic policy in the 1980s away from

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80 See Chapter Six, pp.192-203. The Canadian government was convinced that the success of
such a restructuring programme would depend on Canada-based firms obtaining access to a
larger market, namely the US, since the Canadian market itself was too small to afford many
of these industries the economies of scale they needed if they were to be internationally
competitive. Guaranteed and unrestricted access to that market, it believed, would therefore
enhance the attractiveness of Canada to both domestic and foreign investors as a location for
higher valued added and more technologically intensive products. At the same time exposure
to the increased competition of a larger market would force Canada-based companies to
increase productivity and efficiency and become more internationally competitive and export-
oriented.

81 The Hawke government was particularly concerned by the alarming increase in Australia's
current account deficit which had rise from 2.9% of GDP in 1978/1979 to 6% in 1985/1986.
While some of this increase could no doubt be attributed to strong cyclical falls in
commodity prices - one such fall between 1985 and 1987 had added $8 billion Australian to
the current account deficit - the government believed the underlying problem was structural
rather than cyclical. Australia's worsening terms of trade were, it argued, the consequence of
the secular decline in the prices of and in the demand for primary commodities, which
accounted for 80% of Australian merchandise exports, and of the failure of its manufacturing
industries to share in the substantial growth in trade in manufactured goods in the post war
Australia's share of world exports had declined from 2.65% in 1953 to 1.1% in 1986. Whereas
in 1953 Australia had been the eighth largest world exporter, in 1986 it ranked as only 20th.
Keynesianism and import substitution industrialisation to economic liberalism and export oriented growth. But it was also the result of the perception of the Hawke government that without a return to sustained economic growth both its social reform agenda and its efforts to improve the living standards of the Australian people would be jeopardised.

Like the Canadian government, the Australian government sought to expose the previously highly protected domestic manufacturing sector to outside competition in order to boost its international competitiveness. But unlike the Canadian government the Australian government rejected any suggestion that it seek an FTA with the US. Instead it chose the path of unilateral trade liberalisation. Nevertheless, it too recognised the limitations of the domestic market in terms of economies of scale and hoped to give its exporters enhanced access to world markets by negotiating a successful conclusion to the Uruguay Round of multilateral trade negotiations and to the burgeoning markets of East Asia through greater and more structured regional economic integration.

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82 Pusey 1991; Kelly 1992, pp.30-33, 60; Emy and Hughes 1991, pp.6-27. For an account of the shift to economic liberalism in Canada and its impact on attitudes to free trade areas, see Chapter Six, pp.203-04. A similar shift also took place in New Zealand following the election of the Lange/Douglas government in 1984.

83 DFAT 1988a, p.15; Button 1985; National Export Marketing Strategy Panel 1985, p.13. The Hawke government (Hawke 1985, p.4) had come to see sustained economic growth as an essential pre-condition for the achievement of Labor's social democratic ideals. The then Minister for Industry, Technology and Commerce Senator John Button (1985) argued that '(Australia) can no longer rely with certainty on our position as a supplier of raw materials to the world to ensure the maintenance of the standard of living to which Australians aspire.' Button attributed the decline in export revenue from commodity exports to rising protectionism in the traditional markets for agricultural products, increasing competition from other exporters of raw materials and a reduced demand for and a sustained fall in the real prices of raw materials. The then Minister for Trade John Dawkins (1985, p.439) underlined the urgency of the situation in which Australia found itself when he declared that 'without a substantial improvement in (Australia's) export performance, Australia's living standards will almost certainly decline.'

84 On coming to office in 1983 the Hawke government therefore made the diversification of Australia’s export regime ‘an overwhelming priority’. See Hawke 1989b, p.180. However, according to the National Export Marketing Strategy Panel (1985, p.14), the export potential of Australian manufacturing was restricted by its lack of competitiveness and by ‘the absence of a sufficiently outward-looking commitment on the part of domestic industry and government alike to growth in export marketing.’ This situation, it was argued, had been largely the result of the government policies of import-substitution and high tariff protection for domestic industries. See Button 1985; National Export Marketing Strategy Panel, 1985, p.14; DFAT 1988a, p.12.

85 According to Bob Hawke (1984, p.1215), ‘(t)he critical linkages between trade policy and growth, together with the steady erosion of multilateral disciplines in international trade lead to an important conclusion. Trade liberalisation policies should now be seen as much in the context of the effective operation of the domestic economy as in the more traditional context of the exchange of “concessions” between trading partners in an international negotiating framework. ... Whatever steps we take to reactivate the process of multilateral cooperation - and clearly this will be of the utmost importance - we should not lose sight of our own enlightened self-interest in pursuing rational trade policies as an integral part of sound domestic economic management.’

The adoption by the Hawke government of a policy of unilateral trade liberalisation gave rise to some debate in Australia as to the relative merits of unilateral trade liberalisation and of the more traditional approach to tariff reduction through bargaining and reciprocity. See Matthews and Ravenhill 1990, and Richardson 1991.

86 The domestic market had become too small to provide local manufacturers with world competitive economies of scale. According to the National Export Marketing Strategy Panel (1985, p.14), the expansion of markets would not only give manufacturers the necessary economies of scale, it would promote a more dynamic and outward looking attitude in industry and would also ensure a more efficient allocation of the nation’s resources.
Making Australia's external environment conducive to its restructuring efforts became an important if not the most important priority of the Hawke government's foreign policy. Fearing that its domestic reforms would have little effect if the major economies were to abandon or flout the rules of open international trade and thus deny Australian exporters access to overseas markets, the Hawke government undertook a number of initiatives designed to 'encourage greater openness in the economies of (Australia's) current and potential trading partners.'

For the Hawke government, the APEC proposal was inextricably linked to its desire to diversify Australia's export base. It hoped that through increased interdependence with and integration into a region undergoing rapid economic growth a restructured Australian economy could expand its traditional trading base with the region beyond commodities to manufacturing and services. The government believed that Australia's well-being depended 'upon the continuing economic success of the Asia Pacific region; and that the prospects of the latter would be enhanced through greater - and more structured - regional economic cooperation.' Yet it feared that given its declining economic relevance to the

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87 Hawke 1989b; Viviani 1990, p.392. This shift in the focus of Australia's foreign policy from security relations - with security defined as military security - to economic relations and Australia's economic security was reflected in the merging of Departments of Foreign Affairs and Trade in 1987 to form the Department of Foreign Affairs and Trade (DFAT). See Viviani 1990, pp.391-93, 402-03; Woolcott 1990a, p.63. According to DFAT (1988a, p.16), the merger also reflected the growing linkages between foreign policy and domestic policymaking. See also Woolcott 1989c.

88 Hawke 1989b, p.181. Some of these initiatives were bilateral, aimed at enhancing Australia's access to important national markets. Others, such as the Cairns Group, were multilateral and sought to improve Australia's access to global markets under the GATT. Still others, such as the Bangkok initiative and APEC were regional initiatives. For a more detailed account of the Cairns Group initiative, see Gallagher 1988. For details regarding the Bangkok initiative, see above, fn.60. Through these regional initiatives Australia hoped to galvanise the support of regional countries around a common position in the Uruguay Round of multilateral trade negotiations, thereby increasing the chances of that position winning out in the final negotiations. But it also saw such initiatives as a way of encouraging regional trade liberalisation and thus of enhancing Australia's access to some of the world's fastest growing markets.

89 Evans 1988, p.407; 1989a, p.183; DFAT 1988b, p.17. According to DFAT (pp.16-17), Australia's restructuring could be assisted by increased flows of Japanese investment into Australia's manufacturing sector as Japan itself restructured its economy by shifting the less competitive sectors of its industry off shore. DFAT, however, feared that these opportunities for diversifying Australia's export base and attracting Japanese investment could be reduced 'if countries in the region come under pressure from the majors, perhaps in the context of continuing or growing bilateral trade imbalances.' See above this chapter, pp.288-90.

90 Evans 1989a, p.183. See also National Export Marketing Strategy Panel 1985, p.2; DFAT 1989b, p.149; and Evans 1989b, p.283. Already in 1986 Hawke (1986, p.996) had argued that Australians had been forced 'to acknowledge that their economic welfare is irrevocably enmeshed with that of the Pacific rim.' According to Hawke (1989b, p.181), one of the tasks of regional intergovernmental economic cooperation would be to 'investigate whether, through improved policy coordination, we might better capitalise on the extraordinary complementarity of the economies of our region and so stimulate even greater economic activity within the Asia Pacific region.' As Prime Minister, Keating also used this argument in the early 1990s to justify the priority his Government accorded APEC. In a speech to the Sydney Institute prior to the 1993 federal election, he declared: 'I am quite convinced that everything else we do in this country depends on our success as a trading nation. ... I am utterly convinced that our prosperity, our national well-being, our ability to maintain and build a good society, depend on our courage in moving boldly to integrate with the economies of East Asia.' Quoted in Sydney Morning Herald 13-11-93, p.28: 'You are now entering the uncommon market'.
region, it might find itself excluded from any body that was established by regional states to foster regional economic cooperation.91

The US was also becoming increasingly aware of the economic dynamism of the East Asian economies.92 Like Australia, it too hoped to use that dynamism to boost its own domestic growth and to reduce its chronic trade deficits by increasing its exports to the region.93 Like Australia, it too feared that its exclusion from any regional intergovernmental economic cooperation body would limit its ability to take advantage of the region’s economic dynamism.94 With the end of the Cold War these economic considerations took on even greater significance towards the end of the 1980s.95

91 The Hawke government was particularly alarmed by Australia’s failure to capitalise on the rapid economic growth of the Newly Industrialised countries in the Western Pacific. Australia’s share of total Western Pacific imports fell from 7% in 1973 to only 4% in 1983. According to the then Minister for Trade John Dawkins (1985, p.436), between 1973 and 1983 Australia’s share of Japanese imports had fallen from 9% to 5% and its share of ASEAN imports had declined from 3.5% to 2.5%. Miller (1984, p.1062) attributed this fall to the decrease in Japanese demand for Australian food products and a 50% reduction in its demand for Australian raw materials between 1974 and 1984. He noted that Australia’s performance as an exporter of manufactured products to the region was relatively much worse than that indicated by the overall figures. There was a growing fear that unless Australia did something to reverse this decline, it risked becoming increasingly irrelevant to the region. See Miller 1984, p.1063. The former Secretary of the Department of Foreign Affairs and Trade Richard Woolcott (1992 interview with author) also spoke of the feeling that Australia was becoming less relevant to Asia as Asian economies grew in size relative to the Australian economy. In a speech in February 1990, Woolcott (1990a, p.63) referred to Australia’s desire to be the ‘odd man in’ the region rather than the ‘odd man out’ as it had been perceived to be in the past. Woolcott also noted the change in the perception of the other countries in the region, who, following the launching of the APEC initiative, had come to see Australia as ‘playing a more important and constructive role in the Asia Pacific region.’ Hawke’s principal private secretary at the time of the launching of the APEC initiative Sandy Hollway (1992 interview with author) stated that the aim of APEC was to build a structure in which Australia could engage itself multilaterally with Asia.

92 US Secretary of State, James Baker (1989a, p.64), in outlining the reasons for a continued US presence in the Pacific and for US participation in any new mechanism to increase economic cooperation in the Pacific rim, stressed the growing importance of the Asia Pacific to the US economy. That importance, he argued, was underlined by the fact that eight of the top 20 US export markets were in the Pacific and 23% of all overseas profits earned by US corporations came from the region. Between 1982 and 1988 US trade with with the region had doubled and in 1988 US trans-Pacific trade was one and a half times US trans-Atlantic trade. According to the Acting Deputy Assistant Secretary of Defence Rear Admiral Wright (1990, p.5), the combined GNP of Asia was equal to that of Europe and was increasing on average three percent faster than that of Europe. The continued economic vitality of the United States, he argued, depended on the success of its Asian relationships.

93 Most of the US trade deficit was in US trade with East Asia, especially Japan, a fact which led many in the US to accuse these countries of unfair trade practices and to demand that US put pressure on them to liberalise their markets. As we have already seen above (p.302), Hawke’s APEC initiative was in part a response to US pressure on certain East Asian economies.

94 The growing US interest in Asia Pacific regionalism in the 1980s reflected the increasing contribution of exports, and in particular those to East Asia to US economic growth. According to US Under Secretary for Economic Affairs Wallis (1984, p.51), in 1984 exports represented 20% of US industrial output compared with only 10% in 1972 while one in every three agricultural jobs and one in every eight manufacturing jobs was export related. He pointed out that in 1983 US exports to East Asia, valued at $52 billion, had provided employment for 1.3 million Americans and that US private investment in East Asia and the Pacific was increasing rapidly.

95 The interest shown by the Reagan administration in the early 1980s in more formal Pacific rim regional economic cooperation was not just a revival of the more traditional US concern to galvanise East Asian countries into an anti-Soviet alliance. In a speech in May 1984 US Under Secretary for Economic Affairs Wallis (1984, p.50) spoke of a shift in the focus of US
The concern of the United States to maintain its strategic role as a balancer in the region and thus prevent the region from falling under the sway of another power

Another significant factor in the US decision to support the establishment of APEC was its desire to maintain its role as the balancer in region and thus prevent any nation or group of nations from becoming the single political and military power in Asia. US Secretary of State James Baker linked the US decision to participate in a new framework for regional economic cooperation to the determination of the US to remain a Pacific power. The US appeared to be concerned about the impact of the decline in its economic dominance on its influence in the region, and in particular on its previous strategy of relying on bilateral relationships with individual countries in the region to maximise its influence. The US feared that as the East Asian nations traded increasingly between themselves, they would become less dependent on the US market and the influence of the US over the region would be diminished. With the end of the Cold War, the emergence of India, China and Japan as new global and regional power centres and the growing economic strength of the East Asian countries, the US was aware that a new regional order

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96 This motive for US participation is evident in the testimony of the Acting Deputy Assistant Secretary of Defence Rear Admiral Wright (1990) before the Subcommittee on Asia Pacific Affairs of the House of Representatives Committee on Foreign Affairs. In his testimony Wright (1990, p.8) outlined the three broad objectives of the US in the region: to prevent any nation or group of nations from becoming the single political and military power in Asia; to support the development of freely elected democratic governments and the spread of free market economic values; and to maintain US political and economic access and influence in the region so as to ensure the continued vitality of the United States as a Pacific power. See also the testimony before the same subcommittee by US Assistant Secretary of State for East Asian and Pacific Affairs Richard Solomon (1990, p.51): 'We intend to remain a Pacific power in every respect, for our engagement in the region remains crucial to the pursuit of fundamental US security and economic interests.'

97 Baker 1989a, p.64.

98 See for example Wright (1990, pp.5-7), who argued that 'the ground is shifting beneath American security strategy (in East Asia). The belief by the US that it could enjoy greater influence through bilateral relations rather than multilateral relations was seen as a reason for the lack of enthusiasm shown by the US for earlier proposals for an intergovernmental regional economic cooperation organisation. See above this chapter, fn.7. See also Sydney Morning Herald 23-3-89, p.14: 'US clings to Pacific policy of divide and rule'. This belief is also said to have been behind the initial US refusal to embrace Australia's subsequent proposal for a CSCE style organisation in the Asia Pacific. It is also evident in the US interest in bilateral trade and investment agreements and FTAs with selected East Asian countries in the 1980s in what became known as the 'hub and spoke' strategy. See this chapter below, fns 166, 167.

99 See the statement by Bergsten, the US representative on the APEC Eminent Persons Group, to this effect, Sydney Morning Herald 29-10-94, p.21: 'US wants deadline for APEC free trade'. Paradoxically the growing economic interdependence in East Asia could be seen as an unintended consequence of the US policy aimed at reducing its trade deficits with Japan. In the 1985 Plaza Accords the US had successfully pressured Japan to revalue the yen upwards. In order to maintain the international competitiveness of its labour-intensive industries, Japan had responded by shifting some production off-shore to the lower wage countries of Southeast Asia. The result was a rise in the level of intra-East Asian trade and regional functional economic integration and an increase in Japanese influence in the region.
was taking shape and was determined 'to play a crucial role in designing its architecture.'

The desire by some countries in the region to ensure that the US remained both economically and militarily engaged in the region in order to prevent other economic and/or military powers from dominating the region

Yet while the US administration was becoming increasingly worried that it might find itself excluded from any new regional economic framework, there was growing concern among the Western Pacific states that the US might of its own accord reduce its economic and military presence in the region. For these states the US strategic and economic presence in the region, like the multilateral trading system, had provided the basis for regional economic interdependence and was thus crucial to the maintenance of the region's economic dynamism.

The initial Australian proposal had excluded both the US and Canada. The US, however, took little time in informing Australia that it wanted to be included. At the

100 Baker 1989a, p.64. See also Solomon 1990, pp.31, 34; Wright 1990, pp.5-6. Rather than simply endorsing the Hawke proposal Baker made his own proposal, which, though deliberately vague, appeared to cover a much broader range of issues than that of Hawke with its narrow economic focus. According to Woolcott (1992, interview with author), Baker wanted the proposal to have a security dimension. Hawke, however, warned Baker that this would effectively kill the proposal and that only a regional grouping that was confined to economic and trade issues could succeed. See also Australian Financial Review 30-6-89, p.5: 'US may review regional body plan'; Sydney Morning Herald 14-6-89, p.14: 'US may have own proposal for region'; Age 7-7-89, p.1: 'Hawke Coup on Regional Forum'. Australia's concerns regarding a possible US proposal were heightened by the proposal made by US Senator Alan Cranston in early 1989 for a Pacific Basin Forum with annual summit meetings of Heads of Government to discuss economic and political/security issues.

101 According to Hawke's private secretary at the time Sandy Hollway (1992 interview with author), this had been a natural consequence of what those involved in drawing up the original proposal had seen as the purpose of the new body. That purpose was to build stronger institutional links between Australia and Asia rather than between Australia, Asia and the US, with whom Australia already had strong institutional ties. Australia had come to see the region as the Western Pacific. Thus Hawke's original APEC proposal was in some ways an extension of his 1983 Bangkok initiative which had been limited to the countries of the Western Pacific. For Hawke (1983, p.691) in 1983 the Asia Pacific region meant the Western Pacific, that is Australia, the ASEAN countries, New Zealand and the market economies of North-East Asia. This was still the prevailing view in 1988 when Australia's Minister for Foreign Affairs and Trade Senator Evans (1988, p.406) in a speech in Washington defined the Asia Pacific as 'essentially the Western Pacific'. The exclusion of the US and Canada by Australia was no doubt also due to the feeling among certain Australian policymakers that the US was part of the problem. The US, they argued, had already signed a free trade agreement with Canada that threatened to discriminate against exports from the Western Pacific and was talking of negotiating similar agreements with Australia's trading partners in the region. Australia had been particularly angered by the US decision in 1985 to subsidise its agricultural exports under the Export Enhancement Program. According to Richardson (1992, interview with author), the exclusion of the US from his proposal had been an emotional reaction by Hawke to US agricultural subsidies and the Canada-US FTA.

102 According to Woolcott (1992, interview with author), shortly after the Seoul announcement the US expressed its 'irritation' at being excluded to Senator Evans, who was on a visit to Washington. Bowan (1992, interview with the author) argued that the initial exclusion of the US, though not intentional, worked to the advantage of the proposal. Despite its initial exclusion of the US from its proposal, Australia soon came to see the US membership of APEC to be in its economic and security interests by helping to ensure that the US maintained its military presence in the region. In a speech in June 1989, Australia's Minister for Foreign Affairs and Trade Senator Evans (1989b, p.282-83) argued that in the
same time it was apparent that some Western Pacific countries were reluctant to join a regional economic cooperation organisation that excluded the US.

Japan in particular insisted that the US be included. Japan no doubt was concerned that the exclusion of the US would only strengthen the protectionist forces in the US and increase the pressure being exerted by the US on Japan to reduce its trade surplus with the US. A multilateral organisation that excluded the US could serve to reinforce impressions in both the US and the EC that Japan and its East Asian neighbours had established a de facto Asian trading bloc and thus provide additional impetus to moves in both North America and Europe towards the establishment of closed trading blocs.

Post war period US security and economic policies had been instrumental in creating a regional environment favourable to economic growth and strategic stability. According to Evans, ‘American power, whether it is economic or military, cannot be withdrawn in any substantial sense without creating uncertainty and anxiety.’ Evans stressed the important contribution of US bases in the Philippines, and the various US alliances in the region such as that with Japan and the ANZUS Treaty, which he said had been ‘important pillars of regional security.’ The desire to maintain the US presence in the region has remained an important factor in Australia’s push to consolidate and deepen APEC. In February 1993 Evans (1993b, pp.6-7) again argued that ‘US strategic power has underpinned political stability in the region and US support for an open, multilateral trading system has helped create the relatively liberal trading environment which has allowed the Asia Pacific economies to achieve the sort of export growth to which I have alluded. ... Australia strongly believes that the United States should commit itself to continuing to play a key role in the region’. According to Evans, ‘(t)he US presence is a stabilising influence as far as regional security is concerned and, when so much of the region’s prosperity depends on continued access to US markets and technological advances, it is vital to keep the US constructively engaged in the region’s economic dynamism.’ Australia also came to share the Japanese view that the region’s important trade difficulties with US could be more easily solved if the US was included in any regional economic body. Evans (1989a, p.185) noted that although ‘some regional countries may regard the US as part of the trade problem or may worry that US participation will mean US domination’, Australia together with a clear majority of potential participants ‘would still like to see the US as part of the solution.’

103 Bowan 1992 (interview with the author); Kikuchi 1992 (interview with the author); Inoguchi 1992, p.408. Jim Bowan was part of the team of Australian diplomats that toured the region in the first half of 1989 to win support for Hawke’s proposal. The other members of the team were the Secretary of the Department of Foreign Affairs and Trade Richard Woolcott, Andrew Elek, and John Richardson. According to Woolcott (1992, interview with author; 1994, pp.2, 8), there were two rounds of regional consultations. The first was with New Zealand, the ASEAN countries, Japan and South Korea. The objectives of that first round of consultations were: to identify the degree of support for the proposal; to identify and deal with any concerns and reservations held by the other countries; to promote the idea of and identify the degree of support for holding a ministerial-level meeting at the end of the year; to ascertain the views of the ASEAN countries as to US participation and as to the participation of China, Taiwan and Hong Kong. The second round was with China, Hong Kong, the US and Canada.

104 Anti-Japanese sentiment was largely the result of the yawning US trade deficit with Japan. In 1988 US imports from Japan exceeded its exports to that country by $48 billion. Many in the US felt that Japan had already established and informal trading bloc in East Asia and was using Southeast Asia as a platform from which to assemble goods which often had a high Japanese content for export to the US. See Sanger 1991, p.14, and Chapter Seven, pp.253-54. Japanese concerns regarding the establishment of a regional body that excluded the US resurfaced with the Malaysian proposal in December 1990 for an East Asian Economic Grouping. Japan’s Minister for International Trade and Industry Eichi Nakao is reported (New Straits Times 1-4-91: ‘Japan cool to proposal to set up new regional trading group’) to have told his Malaysian counterpart Rafidah that nothing should be done to undermine the efforts to keep Washington’s often Europe-oriented attention on the region. Good economic relations with the US, he argued, were essential to the entire region. According to Sato Abe, the Japanese official in charge of the EAEG in MITI, (Business Times 4-4-91: ‘Rafidah to explain EAEG to Japan’) ‘any economic cooperation that excludes the US may not be acceptable.’ It could also significantly reduce the chances of a successful end to the Uruguay Round of multilateral trade negotiations, which arguably was Japan’s primary foreign economic policy objective. See above, this chapter, pp.292-93. According to Seiichiro Saito (1992, p.19), ‘(a)
Japanese policymakers were also concerned that a regional body that excluded the US might bring about a US military withdrawal from Asia and undermine the US-Japan Security Treaty. 106 The US security guarantee, they argued served not only to reassure Japan against the Soviet threat but also reassured other Asian countries that Japan would not threaten them militarily.107 This reassurance, they maintained, had made other Asian countries more tolerant of Japanese economic domination.108 On the other hand, a regional body that included the US might not only reduce US-Japan bilateral tensions and encourage the US to maintain a strong military and economic presence in the region, it would also lessen fears by other Western Pacific countries of Japanese domination. The inclusion of both the US and Canada in such a body might also mitigate the effects of the Canada-US FTA on trans-Pacific trade.

The ASEAN countries, with the notable exception of Malaysia, also supported the inclusion of the US.109 The US was a significant market for their manufactured exports and the ASEAN countries no doubt felt that the inclusion of the US could enhance the security of their access to that market which was under threat as a result of rising protectionism in the US.110 They were also concerned about the growing Japanese global power like Japan should not make regionalism the cornerstone of its foreign policy. See also Inoguchi (1988, p.40) who reiterated the argument of Prime Minister Ohira's Policy Study group that '(t)he economic size of the Western Pacific region is far from sufficient to compensate Japan for the loss of the North American and Western European markets.'

According to Drysdale and Patrick (1979, p.19), the two main groups in Japan in favour of Asia Pacific regional economic association have had quite different reasons for their stances. While the dominant group sees such an association as a means of strengthening Japan's relationship with the US and thus of preventing a breakdown in that relationship, the other group sees it as a way of promoting a leadership role for Japan in Asia and perhaps of providing Japan with a fallback position should the US-Japan relationship break down. The differences between the two groups have been brought to the fore by the Malaysian EAEC proposal.

107 Funabashi 1992, p.30; Nihon Keizai 25-9-91, p.2: 'Asia and Security After New Situation in USSR'. According to Nihon Keizai (25-7-91, p.2), ASEAN countries want the US to remain in the region because they fear that the vacuum that would be created should the US withdraw would be filled by Japan or China. See also Asian Wall Street Journal 24-7-91, pp.1,13: 'Asean Moves Security Issues to Forefront'. Thus Singapore Prime Minister, Goh Chok Tong, is reported to have impressed upon Japan's Prime Minister Kaifu the importance of Japan's role in keeping the US in Asia. See Mainichi 3-5-91, p.2: 'Kaifu talks with Goh Chok Tong'. See also the statement by Japan's Foreign Minister Dr Taro Nakayama (New Straits Times 23-7-91: 'Japan: Increase regional security') that because of the changing international political situation the presence of the US was an increasingly indispensable element for stability in the Asia Pacific region.

South Korea shared Japan's conviction that a US military presence in Asia was essential for its own security and stability and for that of the region. See statement by South Korean Foreign Minister Lee Sang-ock (New Straits Times 23-7-91: 'S. Korea: US presence vital to security in Asia-Pacific').

108 The importance to Japan of maintaining its relationship with the US is also reflected in Japan's announcement in November 1991 that it would only consider joining the EAEC if the US was included. See Nation 12-11-91: 'Malaysia says no to US joining East Asia group'.
109 Woolcott 1992 (interview with the author); Richardson (1992, interview with the author).
110 Salih 1989, pp.8-9; Alagappa 1989, pp.25-31. At the Fourth ASEAN Summit in January 1992 Suharto reportedly told Mahathir that the US was a large market for Indonesia and that Indonesia feared that by supporting the EAEC it could lose that market. See Straits Times 27-1-92, p.24: 'EAEC "needs further explanation"'. In 1989 US absorbed 38% of exports from the Philippines, 23% of those from Singapore, 21% of Thai exports, 19% of Malaysian exports, 16% of Indonesian exports and 4% of exports from Brunei. Japan absorbed 20% of exports from the Philippines, 9% of those from Singapore, 16.5% of Thai exports, 16% of Malaysian
domination of their economies and no doubt felt that the inclusion of the US in a regional economic body would provide a useful counter to Japanese economic hegemony in East Asia.\footnote{111} The significant decline in East-West tensions during the late 1980s had done much to allay concern that a regional economic body that included the US could be wrongly perceived as a pro-American military alliance and thus only heighten security tensions in the region.\footnote{112} A regional body, it was argued, that included the US would keep the US focused on the region.\footnote{113}

The shift by ASEAN policymakers in the focus of their economic strategy away from import substitution industrialisation towards export oriented growth

Other factors lessened the fears that had been harboured in the past by the ASEAN states with respect to institutionalised regional economic integration. The 1970s and 1980s saw a shift in the focus of the national economic strategy of the ASEAN countries away from import substitution to export oriented growth.\footnote{114} This shift was part of a more general world-wide move away from Keynesianism to economic liberalism and was also experienced in developed economies such as the United States, Canada, Australia and New Zealand. Such a shift produced a much greater similarity of perceptions on issues of economic policy by governments of the region, thereby narrowing the traditional North-
South divide between the developing and developed countries, which had been a major stumbling block in the past to the establishment of a regional intergovernmental body for the promotion of economic cooperation. The adoption of market opening and export oriented strategies by the ASEAN countries gave further impetus to the push for regional intergovernmental economic cooperation by increasing their interest in maintaining an open regional and international trading system and in safeguarding and increasing their access to international markets.

The dramatic fall in commodity prices and rise in interest rates of the 1980s gave rise to soaring foreign debt and current account deficits in Thailand, Malaysia, Indonesia and the Philippines. In order to overcome these problems these countries had embraced to varying degrees outward oriented development strategies and economic liberalisation policies and reforms. Even Indonesia, which had the most closed economy of all the ASEAN member countries and had been the major stumbling block to past efforts to liberalise trade within ASEAN, had adopted a series of measures to deregulate the economy and liberalise the entry of foreign goods.

115 According to the Department of Foreign Affairs (1989b, pp.5-6), 'the process of structural adjustment in regional economies has also contributed to a much greater similarity of perceptions on economic policy issues. Given that we have already discussed the shift and its effect on government attitudes towards free trade areas in the US and Canada in Chapters Six and Seven, and in Australia in an earlier section of this chapter, the focus of this section will be the ASEAN countries.


117 Malaysia had already embarked on a programme of export-oriented industrialisation in 1968 when it realised that its domestic market was no longer adequate to sustain its industrial development. Yet it still maintained its import substitution strategy, and the protection it accorded domestic manufacturing industries was actually increased. With the help of government export incentives and favourable external conditions manufactures had increased from 11.9% of total exports to in 1971 to 31.2% in 1984 and 54% in 1989. Despite this increase the dramatic fall in commodity prices in 1985 coupled with an equally dramatic rise in interests rates saw GDP growth plummet from an annual average of 6.7% over the previous five years to -1.5%. To overcome this economic crisis the government adopted structural adjustment policies aimed at cutting the deficit and external debt and at maintaining a competitive exchange rate. It eased restrictions on foreign investment and adopted other measures to increase investment in export-oriented industries. It also privatised some public enterprises. See Ariff 1991a, pp.10-11, 14, 19-21, 29; Shiew 1991, pp.129-30; Salih 1991, p.42.

118 Soesastro 1991a, p.4; Nasution 1991, p.12. These measures were a response to the marked deterioration in Indonesia's economic situation that had occurred between 1980 and 1986 as a result of the dramatic fall in oil prices and rising interest rates. Like Mexico, Indonesia had
The growth of a pro-regional cooperation policy network, particularly in ASEAN, under the auspices of PECC

Another factor that helped reduce the fears of the ASEAN states with regard to institutionalised governmental regional economic cooperation was the prior existence of non-governmental regional economic cooperation bodies such as PECC, PAFTAD and PBEC. According to some of those involved in these activities, such bodies played a key role in the socialisation of political elites, particularly in the ASEAN countries, by facilitating the spread of the idea of Pacific economic cooperation and by providing opportunities for enhanced mutual understanding and personal acquaintance.119 This

become an oil dependent economy with oil exports generating 80% of the country's total export income and almost two-thirds of government revenue. With the fall in oil prices the average annual growth was halved and the current account surplus of 4% of GDP in 1980 was transformed into a 5.5% deficit in 1986. At the same time rising interest rates saw Indonesia's debt servicing requirements rise from 8.1% of exports in 1980 to 37.3% in 1985. See Nasution 1991, p.13. With 40% of Indonesia's external debt denominated in yen, the situation was aggravated by the appreciation in the value of the Japanese currency that occurred following the Plaza Accords of 1985. See Pangestu 1989, p.8. Like Mexico, the Indonesia government saw the need to diversify the country's export base by shifting from import substitution to export oriented growth. At first it attempted to reduce domestic demand and the current account deficit through tighter government regulation of the economy and increased restrictions on imports. However, in 1986 it reversed its strategy and began a series of across-the-board tariff cuts and measures to reduce import restrictions, particularly on inputs to manufactured exports. It also replaced non-tariff barriers by tariffs, deregulated the financial sector, and eased restrictions on foreign investment. Attempts to diversify the country's export base by boosting manufacturing exports have been successful. According to Pangestu (1989, pp.1, 28), manufacturing exports as a share of total exports have increased from 3% in 1981 to 11% in 1985 and 31% in 1988 while oil exports have decreased from 83% of total exports in 1981 to 73% in 1985 and 45% in 1988. For a detailed account of the shift in Indonesia's trade policy during the 1980s, see Pangestu 1989. For a detailed account of Indonesia's deregulation program, see Nasution 1991; and Pangestu 1991.

119 Wanandi 1989, pp.1-2; Soesastro 1990, pp.377-79; Harris 1994, p.20. According to Harris, '(t)here is little doubt that the ASEAN members have been socialised through a process of ostensibly economic cooperation to change their understanding about the way the international system can work in the region.' Some PECC participants and scholars have argued that the PECC process had a more direct role in the establishment of APEC and that the idea for a regional ministerial level meeting to discuss cooperation issues had originated in PECC itself. In late 1987 the Chairman of the Australian Pacific Economic Cooperation Committee (AUSPECC), Sir Russell Madigan (Australian Pacific Economic Cooperation Committee 1990, pp.26-27), had recommended to the PECC Standing Committee that a meeting of regional ministers should be held to discuss economic cooperation issues. The proposal for a regional summit was then discussed at PECC VI in May 1988 in Osaka and was raised by Madigan in a meeting with Senator Evans in December 1988. See Japan National Committee for Pacific Economic Cooperation 1988, p.21; Harris 1989, p.66.

Yet despite PECC support for the convening of a ministerial level meeting many PECC participants were unhappy about Hawke's original proposal for an OECD-like regional organisation, fearing that it might be premature or even inappropriate in the Asia Pacific context and might undermine what had been achieved. According to Wanandi (1989, p.2), there had been a general feeling that government involvement in PECC activities had been unsatisfactory. From the very beginning of PECC, Wanandi argued, participants had been divided between those who saw PECC and its tripartite approach as the best framework for regional economic cooperation, and those who believed that ultimately the most effective vehicle for regional economic cooperation was an intergovernmental body and that PECC was at best a necessary stop-gap measure. Although efforts were made at PECC VI in 1988 to increase government involvement, some still felt that PECC had already reached its limits and that further progress could only be achieved at an intergovernmental level. Thus, in launching his proposal Hawke (1989a, p.5) acknowledged the contribution of PECC in illuminating large areas of common interest in the region but argued that 'its informality, which has helped to broaden its membership, has also made it difficult for it to address policy
process of socialisation was no doubt in part due to the tripartite structure of PECC, enabling academics, business persons and government officials in their private capacity to exchange ideas about Pacific economic cooperation. It was also facilitated by PECC's

issues which are properly the responsibility of Governments.’ Others still believed it would be better to maintain and strengthen the PECC process rather than to create a new body. Former Secretary of the Department of Foreign Affairs and Trade, Stuart Harris (1989, pp.65-66) argued against the establishment of an OECD-like body, which, he claimed, would unnecessarly raise concerns regarding the costs and inefficiencies of such a body, agenda-setting, and the institutionalisation of US and Japanese regional dominance. The tripartite structure of PECC, he maintained, was ‘an important institutional innovation meeting the special characteristics of the region’ and hence preferable to the more formal institutionalised Western approach to economic cooperation. He feared that Australia would have much less influence in a more formalised intergovernmental institution than it had in the less formalised PECC process. As late as October 1988 Australia’s Minister for Foreign Affairs and Trade Senator Evans (1988, p.408) appeared to share the view of Harris. See above, this chapter, fn.29.

Both Higgott (1992, p.187) and Harris (1994, pp.14-18) stressed the importance of PECC’s tripartite structure in facilitating the spread of the idea of regional economic cooperation within the policymaking elites of the countries of the region. Harris attributed the influence of PECC to the close links between individuals and institutions involved in the PECC process and governments, particularly in the Asian countries.

The part played by PECC in the establishment of APEC has been seen by both Higgott and Harris to confirm the claims of certain international relations scholars regarding the role of cognitive change or policy learning and in particular of epistemic communities in moderating the self help behaviour patterns of states and bringing about increased intergovernmental cooperation. (For a more detailed discussion regarding the role of learning and epistemic communities in the re-emergence of regionalism, see Chapter Three, pp.100-03). Higgott (pp.184-86, 188-91) argued that the Asia Pacific economic cooperation community in Australia had all the requirements of an epistemic community identified by Peter Haas (1992, p.3): shared normative beliefs; shared causal beliefs or professional judgements; common notions of validity; a common policy enterprise; an important role in research brokerage; and evolution in an environment of increasing policy uncertainty. Higgott maintained that those involved in PECC and other regional non-governmental bodies such as PBEC and PAFTAD constitute an epistemic community whose common policy goal is enhanced Pacific economic cooperation. Yet both Higgott and Harris expressed reservations about the significance of cognitive change and epistemic communities as a factor in the establishment of the APEC process. Higgott (1992, p.194) argued that the success of the Asia Pacific economic cooperation epistemic community in Australia had not been replicated in other countries of the region and that ‘Australia may represent something of a special case.’ According to Higgott (pp.191-92), the success in Australia was due to the unusual crisis situation of the 1980s in which a crisis of national identity coincided with a severe economic crisis. This situation, he argued, favoured the discarding of old ideas and values regarding Australia’s place in the world and the conduct of its domestic and foreign economic policies, and their replacement by new ideas and values espoused by the Asia Pacific economic cooperation epistemic community. Unlike in Australia, Higgott (1992, pp.183, 193-94) maintained, in the other countries of the region learning had been tactical rather than cognitive - support for enhanced regional economic cooperation represented a tactical response to particular circumstances rather than a fundamental change in values or aims. Drawing on the arguments of Ravenhill and Matthews, Higgott warned that, by disarming itself unilaterally, Australia might find itself at a serious disadvantage in bargaining with other countries of the region who were pursuing a more instrumentalist or realist approach to trade relations.

While conceding that some East Asian countries may not have embraced free trade to the same extent as Australia, Harris (1994, p.21), however, maintained that a cognitive change has occurred elsewhere in the region, particularly in the ASEAN states, in terms of a general acceptance of the beneficial nature of regional economic cooperation at an intergovernmental level. This change, he argued, is likely to be more significant in the longer term than the convergence of economic values, which may be only short-lived. (But he did point to a possible divergence of values due to a growing tendency to re-accentuate the difference between ‘Asian’ and ‘Western’ culture. See Harris 1994, p.20. Many scholars and policymakers have attributed the differences within APEC over the approach to regional trade liberalisation to cultural differences between Asia and the West. See below this chapter, fn.184, 193). And while acknowledging that policy networks such as PECC have played an significant role in effecting this shift in values, Harris (1994, p.21) argued that other factors, such as changing external circumstances and shifting economic paradigms, were also important.
'informal approach to institutional issues', which, Harris argues, had avoided the intrusion of North-South rhetoric and made it possible for both the PRC and Taiwan to participate.\(^\text{121}\)

The success of the PECC process helped overcome the objection that cooperation among such diverse economies was not possible and thus was a factor in the establishment of the APEC process.\(^\text{122}\) By 1986 a consensus had emerged among PECC participants regarding the benefits of enhanced regional economic cooperation and the means by which it should be achieved.\(^\text{123}\) PECC is also said to have played a part in bringing about a convergence of perceptions on economic policy issues among the Asia Pacific countries, a convergence which, as we have already noted above, many see as a factor in the establishment of the APEC process.\(^\text{124}\)

The growing self-confidence of the ASEAN countries

Another factor in the increased willingness of the ASEAN countries to contemplate intergovernmental economic cooperation in the Asia Pacific at the end of the 1980s was the growing confidence these countries had in their ability to hold their own in their dealings with the developed countries of the region, particularly Japan and the United States.\(^\text{125}\) This increasing self-confidence was partly the result of the rapid economic

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\(^\text{121}\) Harris 1989, p.64. Harris was careful to restrict the informality of PECC to its 'organisational-behaviour and political-diplomatic aspects.' The question of Chinese participation was resolved before the Vancouver general meeting which saw the affiliation of both the Chinese National Committee and the Chinese Taipei Member Committee. See Kaneko 1988, p.80. The prior participation of both China and Taiwan in PECC also paved the way for both countries to participate in APEC. See below this chapter, p.314.

\(^\text{122}\) Wanandi 1990, p.7.

\(^\text{123}\) For a brief account of the earlier PECC general meetings up to 1988, see Kaneko 1988. At its 1986 Vancouver meeting PECC issued 'The Statement on Pacific Cooperation' - the so-called Vancouver Statement, which emphasised the economic and social benefits and well-being that economic cooperation would bring to the peoples of the region, and the contribution it would make to the stability, prosperity and progress of the entire region. The Statement also affirmed that enhanced economic cooperation should be 'based on free and open economic exchanges' and be conducted 'in a spirit of partnership, fairness, and mutual respect.' Quoted in Kaneko 1988, p.77.

\(^\text{124}\) Harris 1994, p.19. However, Harris pointed out that this convergence was not solely the result of the PECC process but also a reflection of a general global trend and of the success that other regional countries had had in implementing similar policies. Soesastro (1990, pp.377, 379) highlighted the importance of the policy consultations on trade that occurred in successive PECC Trade Policy Fora in the development of a regional consensus on the multilateral trading system and the Uruguay Round of multilateral trade negotiations and which was later to form the basis of the first APEC Joint-Statement. This consensus was apparent in the 1988 Osaka PECC VI Standing Committee Statement on Pacific Trade Policy (reproduced in the Report of the Sixth Pacific Economic Cooperation Conference published by the Japan National Committee for Pacific Economic Cooperation 1988, pp.27-28), which condemned the use of protectionist trade policies as remedies for macro-economic problems and urged Pacific countries to work towards a successful conclusion to the Uruguay Round. This statement, Harris (1989, p.66) argued, was the first consensus declaration by PECC members and signalled an important change in the attitude of some ASEAN members, who, within the context of the North-South debate, had been sceptical of both the GATT and multilateralism. The adoption of market opening and export oriented strategies by these countries had no doubt increased their interest in the maintenance of the open regional trading system and in safeguarding and enhancing their access to foreign markets.

\(^\text{125}\) Woolcott 1989b; 1990a, p.65; and DFAT 1989b, p.6. According to Kaneko (1988, p.71), there were already signs of this increased self-confidence in 1984 when Indonesian Foreign Minister Mochtar Kusuma-Atmadja had the question of Pacific cooperation added to the agenda of the ASEAN Post Ministerial Conference (PMC) in Jakarta. An Indonesian proposal
development that these countries were experiencing in the 1980s. It was also the result of their practical experiences in dealing with the developed countries in more informal bodies such as PECC and other intergovernmental processes such as the Cairns Group and the ASEAN Post Ministerial Conferences (PMCs).

In sum the establishment of APEC was the result of a number of closely related and mutually reinforcing factors. It was product of changes - either actual or anticipated - in the global and regional political and economic environment, of a shift in the dominant economic paradigm, and of the rise of regional networks that facilitated that shift and promoted economic cooperation at a regional level. Yet, as can be seen from the statements made by ASEAN representatives prior and during the 1989 Canberra APEC ministerial-level meeting and from both the joint statement and the Chairman’s Summary Statement that were issued at the end of that meeting, there was still considerable opposition from some ASEAN members to the institutionalisation of intergovernmental economic cooperation in the Asia Pacific. The most they would accept was the establishment of an informal ad hoc consulting body with no guarantee of permanence and no permanent secretariat. In short, there was considerable ASEAN opposition to Australian plans to institutionalise APEC and to use it as a vehicle for regional trade liberalisation negotiations.

for an annual ASEAN-Pacific cooperation (APC) dialogue between the six ASEAN countries and their five Pacific dialogue partners - the so-called six plus five - was accepted. It was further agreed that specific themes for possible cooperation should be identified and developed and that the first such theme should be human resources development. The APC initiative failed to proceed due to opposition from some ASEAN members, particularly Malaysia. See Wanandi 1990, p.6; Weatherbee 1989, p.29; Ahmad 1985, p.15-17. The 'six plus five' format of the APC is similar to that adopted by the ASEAN Regional Forum which was set up in 1993 as a multilateral forum for the discussion by Asia Pacific countries of regional security matters. See Ahmad 1985, p.19.

127 According to Richardson (1992, interview with author), the Cairns Group enabled the four ASEAN participants to develop habits of cooperation. The ASEAN PMCs refer to the so-called 6 plus 1 meetings, that is the annual meetings of the foreign ministers of the ASEAN countries with each of their counterparts from their dialogue partners: the EEC, the US, Japan, Australia, New Zealand and Canada.
128 Department of Foreign Affairs and Trade (Australia), 1989a, pp.9-19, 35-39. According to Indonesia’s Foreign Minister and Chairman of the 23rd ASEAN Standing Committee, Ali Alatas, ‘implementation of enhanced Asia Pacific cooperation should proceed gradually and pragmatically, especially in its institutionalisation or institutional development, without inhibiting further elaboration and further expansion.’ He also insisted that ‘enhanced Asia Pacific Economic Cooperation should provide a forum for consultation and constructive discussions on economic issues and should not lead to the adoption of mandatory directives for any participant to undertake or implement.’ The chairman of the ASEAN Economic Ministers and Thai Minister of Commerce, Subin Pinkayan, was adamant that APEC should not be a negotiating bloc and that it should not ‘replace nor compete with the open multilateral trading system as embodied in the GATT.’ The countries most opposed were Malaysia and Indonesia. Thailand's ambivalent position appears to have reflected the divisions within both the Thai government and bureaucracy between those in favour of liberalisation and deregulation and those against, divisions which were still apparent in 1994. (See Australian 13-7-93, p.2: ‘APEC calls for fancy footwork’). Singapore was clearly in favour of the APEC proposal.
129 Alatas attributed the success of the APEC initiative to Australia’s efforts to meet the concerns of ASEAN. According to Alatas (quoted in Soesastro 1994b, p.343), the factors in that success were: the pragmatic approach to substantive issues of clear common interest;
The continued opposition of some ASEAN members to an institutionalised intergovernmental regional arrangement

The reasons for this reluctance by some ASEAN countries to join APEC in 1989 were similar to those that had led them to oppose the establishment of an intergovernmental Asia Pacific economic cooperation body in the late 1970s and early 1980s. They feared that APEC would become a large, expensive and inefficient bureaucracy like the EC or UN bodies. They were concerned that APEC might become a forum for trade negotiation that could be used by some of the developed countries to force the less developed ASEAN members to open their markets sooner and faster than they wanted to. Related to this was the concern that the benefits of APEC would flow sensitivity regarding possible operational modalities; and the careful and extensive consultation undertaken by Australia in developing and preparing the initiative.

Mangkusuwondo (1991, pp.86-87; 1994, p.294) identified two reasons for the reluctance in 1989: concern for the erosion of ASEAN; and concern about APEC becoming a forum for trade negotiations, a forum which would be dominated by Japan and the US. This concern had been sparked by Hawke's original vision of APEC in his 1989 Seoul speech as being modelled on the OECD. See Hawke 1989a, p.6. Australia had been quick to reassure ASEAN countries that, although the Pacific organisation would perform a similar role to that of the OECD, it was not Australia's intention that the organisation should be as large or as expensive as the OECD. See Woolcott 1989b, p.124. Behind this concern was the fear that a strong bureaucracy might be able to impose its own agenda against the wishes of some of the member countries. Wanandi (1990, pp.11-12) argued that this problem was compounded by the limited capabilities of the government bureaucracies in some of the ASEAN countries, which would make these countries slow to meet the requirements of their participation in an Asia Pacific organisation. According to Wanandi, any pressure from either the central bureaucracy or other member countries to hasten the process would then be interpreted as an attempt to dictate or dominate the process. The ASEAN countries also feared that the establishment of an Asia Pacific organisation would divert valuable resources from ASEAN and force fundamental changes in its modus operandi.

During the 1980s Indonesia, Malaysia, Thailand and the Philippines had all come under pressure from the US to open their markets and were fearful that the US could use APEC as another means to that end. See Salih 1989, p.8. In his statement to the 1989 Canberra APEC meeting (Department of Foreign Affairs and Trade (Australia), 1989a, pp.35-37), Alatas reiterated the position of ASEAN that enhanced Asia Pacific Economic Cooperation 'should not lead to the adoption of mandatory directives for any participant to undertake or implement.' At the same meeting the Thai Commerce Minister Pinkayan (Department of Foreign Affairs and Trade (Australia), 1989a, pp.38-39) declared on behalf of the ASEAN Economic Ministers that participants should utilise the Asia Pacific Economic Cooperation forum as a means to reduce trade and economic pressures and that they should avoid a situation whereby this forum could be turned into another channel for bilateral trade pressures. This concern was still being expressed in 1994. According to Luhulima (1994, p.318), 'Indonesia, as a developing member of ASEAN, cannot accept the advanced APEC economies persisting in institutionalising the forum and formulate modalities for a free trade scheme, particularly if it is designed to force open other markets for their own commercial benefit.'

Despite the growing export orientation of the ASEAN economies, some ASEAN members were still reluctant to reduce the restrictions on the entry of foreign goods and capital to their markets for both economic and domestic political reasons. There was still considerable apprehension of foreign domination among the business and political elites of these countries that had not long ago gained their political independence. Protected domestic industries, which were often owned by the state or by interests closely allied to the ruling political elites, continued to exercise influence over foreign economic policy. This reluctance to fully open the domestic economy to outside competition was particularly strong in Indonesia, which had resisted moves to establish a free trade area with its ASEAN partners, fearing that the new investments that would be drawn to the region to take advantage of a large barrier free market would flow largely to the more industrially advanced states of Singapore and
disproportionately to the developed countries, leading to 'deepening dependency and heightened frictions and tensions instead of the desired harmony and greater mutual advantage.' They also feared that APEC could further increase Japanese and US economic domination of the region.

Malaysia. See Soesastro 1991a, p.18. Thus, according to Pangestu (1989, p.26), despite its efforts to deregulate its economy in 1989 Indonesia had only removed the anti-export bias and shifted the form of protection from non-tariff barriers into tariff barriers but had yet to actually reduce the actual protection accorded to domestic producers. This, she argued, would prove much more difficult given the strong opposition that such a move was likely to encounter from entrenched vested interests. Even within the relatively more industrially advanced countries of Thailand and Malaysia there was still considerable opposition to trade and investment liberalisation. According to Ariff (1991a, p.20), there was no major reform of the Malaysian tariff structure in the 1980s and 'the protection structure, which was designed under the import substitution phase, is incompatible with the current strategy of export-oriented growth.' The deleterious effects of that structure on the country's exports had, he argued, merely been offset by devaluations and export incentives. The situation was similar in Thailand where, according to Narongchai et al. (1991, pp.15-18), the protection of the domestic market actually increased during the 1980s.

ASEAN countries, such as Malaysia and Indonesia, had participated in the earlier push for a more equitable international economic order - the NIEO, and many policymakers in these countries still found the arguments of the dependency theorists more persuasive than those of the liberal interdependence scholars. Thus in his statement to the 1989 Canberra APEC meeting on behalf of the 23rd ASEAN Standing Committee, Indonesia's Foreign Minister Alatas (Department of Foreign Affairs and Trade (Australia), 1989a, p.36) expressed the fear that 't[he] economic disparities still prevailing in the vast region, and the resulting discrepancies in national capacities to benefit equally from regional growth and progress may well generate deepening dependency and heightened frictions and tensions instead of the desired harmony and greater mutual advantage.' Alatas's concerns were echoed by Thai Commerce Minister Subin Pinkayan, who spoke on behalf of the ASEAN Economic Ministers. See Department of Foreign Affairs and Trade (Australia), 1989a, pp.38-39. For the ASEAN states '(e)nchanced Asia Pacific Economic Cooperation should be based on the principles of equality, equity and mutual benefit, taking fully into account the differences in stages of economic development and in socio-political systems among the countries of the region.' See Department of Foreign Affairs and Trade (Australia), 1989a, p.37. ASEAN, however, was prepared to consider a less formalised form of economic cooperation that addressed the concerns of the developing countries, namely market access, investment and technology transfer, and human resources development. According to an ASEAN paper presented at the 1989 Canberra APEC meeting (Department of Foreign Affairs and Trade (Australia), 1989a, p.217), '(b)eing developing countries, the perception of ASEAN for a meaningful Asia Pacific Cooperation would be for a greater commitment from the industrialised countries in the region not only to increase their investments in ASEAN, but also aim to significantly increase their transfer of technology and know-how to ASEAN.' The willingness of the developed countries of the region to accommodate the concerns of the ASEAN countries, through the establishment of a work programme in the area of investment, technology transfer and human resource development, was no doubt an important factor in the decision of some ASEAN countries to participate in APEC. See Department of Foreign Affairs and Trade (Australia), 1989a, p.16.

The ASEAN countries continued to be concerned that enhanced Asia Pacific economic cooperation might only increase Japanese and US economic domination of the region. According to Luhulima (1994, p.304) and Mangkusuwondo (1994, p.294), Indonesia's reluctance to embrace APEC in 1989 was partly due to its concern that APEC would become a forum for trade negotiation dominated by Japan and the US. Concern about US and Japanese economic domination of the region was also reflected in the statement made by Malaysia's Minister for Foreign Affairs, Haji Abu Hassan Haji Omar, to the Canberra meeting (Department of Foreign Affairs and Trade (Australia), 1989a, p.54) that decision-making on a wide array of economic issues should be broad-based, and not be limited to a handful few. This would ensure that decisions on trade and investment, fiscal and monetary issues provide benefits to all and not just a few.' The ASEAN countries were particularly adamant that APEC 'should not be directed towards the formation of an inward-looking economic or trading bloc', which they feared would further increase their dependence on the US and Japan. See Department of Foreign Affairs and Trade (Australia), 1989a, p.37. According to Salih (1989, p.10), the ASEAN countries were particularly anxious to preserve their trade links with the EC to offset Japanese and US domination of the Asia Pacific. According to Mangkusuwondo
However, the principal concern of the ASEAN countries was that APEC would undermine the identity and cohesion of ASEAN and weaken substantially the collective bargaining power of its members vis-à-vis the outside world. The ASEAN countries were very much aware of the substantial boost that the Vietnamese invasion of Cambodia in 1979 had given to the significance of the regional organisation in the eyes of both its members and outside powers. With the Cold War coming to an end and the likelihood of a Cambodian settlement increasing there was some apprehension among the ASEAN countries that unless a new rallying point could be found ASEAN unity could be threatened.

With the decline in East-West tensions and the growing concern about the future of the GATT, it was apparent that geo-economic considerations were becoming as important, if not more so, than geostrategic considerations. Although ASEAN had been first established in the 1960s to facilitate economic cooperation among its members, its achievements in this area had been quite disappointing. The dynamic growth that ASEAN countries were experiencing owed little to ASEAN and had increased the economic interdependence between individual ASEAN countries and countries outside ASEAN rather than within ASEAN itself. Joining a larger economic cooperation grouping, it was feared, could further undermine ASEAN solidarity and effectively deprive that

(1991, p.85), Indonesia, in particular, wanted to preserve its access to non-APEC markets in order to ensure continued economic growth.

135 In their statements at the 1989 Canberra APEC meeting Alatas and Pinkayan, speaking on behalf of the other ASEAN members, insisted that ‘(i)n any enhanced Asia Pacific Economic cooperation, ASEAN’s identity and cohesion should be preserved and its cooperative relations with its dialogue partners and with other third countries should not be diluted.’ See Department of Foreign Affairs and Trade (Australia). 1989a, pp.35-39. Singapore, however, disagreed with its other ASEAN partners on this point. In his statement to the 1989 Canberra APEC meeting, Singapore’s Minister for Trade and Industry, Lee Hsien Loong (DFAT, 1989a, p.185), declared that ‘Singapore supports the APEC process, because it believes that APEC does not in any way reduce or diminish the importance of ASEAN. APEC is another mode of economic cooperation, complementing ASEAN and extending beyond it. These are overlapping, indeed economic circles of cooperation. They involve different sets of partners and focus on different potential areas of mutual benefit, but they have the same overall objective.

136 Indorf 1987, pp.91-95; Thayer 1990, p.139. ASEAN had played an important diplomatic role in isolating the Vietnam-backed Cambodian regime and in pressuring Vietnam to withdraw its military forces from Cambodia. According to Ahmad (1985, pp.22-23), prior to the fall of Vietnam in 1975 ASEAN ‘had been languishing as a regional body.’

137 See Star 5-7-89: ‘ASEAN not keen on proposal: Fear of hurting ties between members’; Sukhumbhand 1987, p.144-45; Soesastro 1991a, pp.1-2; Kusumaatmadja 1991, pp.138-39; Luhulima 1994, p.304. Already there were signs that the interests of the ASEAN countries were diverging. Malaysia and Indonesia were already divided over the question of ASEAN Pacific Cooperation (APC) while Thailand and Indonesia differed in their approaches to relations with Vietnam and China. For the APC issue, see above this chapter, fn.125. For the differences between Thailand and Indonesia, see Khong and Razak 1987, pp.133-36; Sukhumbhand 1987, p.144-45. Indonesia may have resented the veto power that the Cambodian conflict had effectively given Thailand over ASEAN’s relations with Vietnam. See Kusuma 1990, p.58. It may also have been angered by Thailand’s reversal of its policy towards Vietnam in 1988 without first consulting its ASEAN partners. See Khatharya 1991; Abdul Razak Abdullah 1992, interview with author.

138 Soesastro 1991a, pp.2-3; Simandjuntak 1991, p.185; Kusumaatmadja 1991, pp.138-39. According to Simandjuntak, between 1983 and 1989 intra-ASEAN exports had fallen from 21.8% to 16.3% of total exports and intra-ASEAN imports from 25.6% to 18.7%.
regional organisation of the opportunity to enhance economic cooperation among its members now that its political rationale had declined.

The Cambodian conflict had also greatly enhanced the importance of ASEAN as interlocutor in the eyes of the outside world. The dialogue process which had begun in the early 1970s was formalised into the ASEAN PMC, an annual meeting between the foreign ministers of the ASEAN countries and their counterparts from other Asia Pacific countries and the EC. The ASEAN countries, particularly Indonesia and Malaysia, feared that the establishment of a wider regional body would threaten the centrality of ASEAN in the dialogue process and thus weaken the collective bargaining power of the ASEAN countries vis-à-vis the outside world.139

Subsequent evolution toward a regional free trade arrangement

Nevertheless, over time opposition by the ASEAN countries to the consolidation of APEC has weakened. Between the first meeting in Canberra in 1989 and the 1994 Bogor leaders summit, APEC has evolved gradually - though perhaps more rapidly than had been expected - from an informal, consultative intergovernmental forum with no fixed structure or secretariat and no guarantee of permanence, committed solely to the pursuit of global trade liberalisation and the successful completion of the Uruguay Round, to a firmly established regional organisation with a permanent secretariat and annual

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139 Salih 1989, p.16. The concerns by ASEAN countries about the threats posed by an Asia Pacific regional cooperation body to the cohesion of ASEAN and to its centrality in the dialogue process led it to revive the proposal for ASEAN Pacific Cooperation (APC). Under the proposal, which was outlined in a paper submitted by ASEAN to the 1989 Canberra meeting, the ASEAN PMC would be modified and enlarged - basically through the addition of a dialogue between ASEAN foreign ministers and their Asia Pacific counterparts. (See Department of Foreign Affairs and Trade (Australia), 1989a, p.280) Thus, according to Indonesia's Foreign Minister Ali Alatas (Business Times 5-7-89: 'Asean cautious about joining Pacific group'), 'Indonesia's known preference is to start with and fully utilise existing mechanisms rather than create new ones, and to improve, expand and adapt them to the agreed requirements and objectives.' For a detailed discussion of this proposal see Wanandi 1989.

The proposal met with strong opposition from other countries, particularly Canada, US and South Korea (see Australian 7-11-89, p.1: 'Pacific unites on trade reforms'). Elek (1992 interview with author) argued that building APEC onto the existing ASEAN framework was not a good idea. He maintained that the agendas of the two bodies were different; that the dichotomy between economic and political issues was still strong in ASEAN and would have made it hard for economic issues to be raised in what was essentially a political forum; that there was a need for something more than a discussion forum; that there was the problem of additional participants; and finally that the ASEAN structure would prove inadequate and would be subsumed by the process of Asia Pacific Cooperation.

However, although the Canberra meeting agreed to defer consideration of a support mechanism for time being, the other countries did make some concessions to ASEAN. It was agreed that the next meeting would be held immediately after the next ASEAN-PMC, though not in the same city - Singapore was chosen rather than Jakarta, the venue for the 1990 ASEAN PMC. Future APEC meetings were to be held alternatively in an ASEAN and non-ASEAN country and it was agreed that the ASEAN secretariat should have a role in the preparation of the next one or two ministerial-level meetings. See Wanandi 1990, p.6. Nevertheless, at the end of Canberra meeting Alatas, in referring to the link to ASEAN as an 'umbilical cord', appeared resigned to the fact that APEC would eventually take on a life of its own, quite separately from ASEAN. See Age 8-11-89, p.5: 'Pacific nations resolve to fight on for free trade'.
ministerial-level meetings and a commitment - albeit a non-binding one - to regional free trade by 2020.¹⁴⁰

Over the next four meetings the following advances were made:¹⁴¹

- The work projects that had been agreed to at the Canberra Ministerial Meeting were established and consolidated.¹⁴²
- The membership of APEC was expanded with the admission of China, Taiwan and Hong Kong in 1991 and Chile, Mexico and Papua New Guinea in 1993.¹⁴³ The admission of China, one of the world's largest and fastest growing economies, enhanced the status of APEC in the eyes of member and non-member states.¹⁴⁴ The acceptance by China of Taiwanes and Hong Kong membership was a considerable coup for APEC since it was the first time that both China and Taiwan were represented on a regional governmental forum.¹⁴⁵ The admission of both Mexico and Chile was in part an attempt by some APEC members to mitigate the effects on trans-Pacific trade of NAFTA and its possible extension to South America.¹⁴⁶
- APEC was given a more solid institutional basis. A set of principles and objectives were adopted. A permanent secretariat was established in Singapore and a central fund

¹⁴⁰ Evans (1993a) identified three phases in APEC's development: an initial phase beginning in November 1989 focusing on cooperation in the most innocuous 'OECD' sense - the compilation of common data bases, information exchanges and the informal swapping of policy ideas; a second phase beginning in 1990 added more specific forms of cooperation and policy development in different sectors, such as minerals and energy, telecommunications, and tourism, as well as in cross-sectoral areas like human resource development; and a third phase beginning in 1992 with an emphasis on trade and investment policy.

¹⁴¹ The second ministerial level meeting was held in Singapore in July 1990, the third in Seoul in November 1991, the fourth in Bangkok in September 1992, the fifth in Seattle in November 1993, and the sixth in Bogor (Indonesia) in November 1994.

¹⁴² There were initially seven work projects each designed to promote economic cooperation among the member states in a specific area. See above this chapter, p.285. At the Seoul APEC meeting in 1991 the Ministers agreed to expand the APEC work programme with the adoption of three additional work projects in the areas of fisheries, transportation and tourism.

¹⁴³ However, at their 1993 Seattle meeting the Ministers decided to defer consideration of additional members for three years so that APEC could concentrate on increasing its effectiveness. Australia had initially opposed Chile's membership application on the grounds that it would make the forum too unwieldy and make it harder to reach agreement on regional trade liberalisation. See Weekend Australian 20/21-11-93, pp.1,13: 'APEC's bold plan to free up trade'; p.21: 'US push a worry for APEC'. On the other hand, Malaysia was said to support the widening of APEC membership to prevent further deepening of institutionalised economic integration. See Australian Financial Review 24-11-93 'APEC's entry queue problem'.

¹⁴⁴ At both the Canberra and Singapore Ministerial Meetings participants had affirmed that the participation by the economies of the People's Republic of China (PRC), Taiwan and Hong Kong in future APEC consultative meetings was desirable. Although Australia had consulted the PRC in 1989 regarding the establishment of APEC, PRC participation in the Canberra Ministerial had been opposed by some countries such as the US and Canada on the grounds that the PRC was not a market economy. Indonesia, given that it still had no diplomatic relations with the PRC, was also apprehensive. Opposition to PRC membership stiffened following the Tiansmen Square massacre. See Woolcott 1992, interview with author; and Australian Financial Review 31-7-90, p.3: 'APEC calls on EC to quit stalling'.

¹⁴⁵ The fact that Hong Kong and Taiwan were already members of PECC alongside China no doubt facilitated China's acceptance of their membership of APEC. Since 1993, however, China has become less relaxed about Taiwanese representation on international bodies. For example, it has opposed official Taiwaneses membership of the Council for Security Cooperation in the Asia Pacific (CSCAP), the equivalent of PECC in regional security cooperation.

¹⁴⁶ The admission of Mexico and Chile was agreed to at the Seattle APEC meeting in November 1993, immediately after the ratification of the NAFTA by the US Congress.
was set up to cover its operation costs and some costs of the work projects. The principle of annual ministerial level meetings was endorsed and the holding of informal APEC economic leaders summit at the conclusion of the ministerial level meeting became accepted practice. APEC Finance Ministers have also met to consult on broad economic issues including macro-economic development and capital flows.

- Finally, APEC has committed itself to the long term goal of free and open trade and investment in the Asia Pacific by 2020 and has begun to elaborate a programme to achieve this. It has also adopted a set of Non-Binding Investment Principles.

147 At the Singapore meeting in 1990 there had been continued ASEAN resistance to the institutionalisation of APEC, both in terms of the establishment of a secretariat and a commitment to hold annual ministerial-level meetings, though tacit agreement was given to two further meetings at ministerial-level - in addition to the 1991 Seoul meeting - in Thailand in 1992 and the United States in 1993. See Singapore 29-31 July 1990 'Asia Pacific Economic Cooperation Ministerial Meeting Joint Statement'; Far Eastern Economic Review 9-8-90, pp.9-10; 'Faltering first steps'. There was still no agreement to set up a permanent secretariat at the 1991 Seoul meeting. This was largely the result of opposition from Malaysia, upset at the US reaction to its EAEG proposal, and the other ASEAN members who did not wish to break ASEAN solidarity.

148 According to Bergsten (1994, p.21), the decision to hold another leaders summit in Indonesia in 1994 and Japan's stated intention to hold a similar summit in 1995 have in effect made annual summits a permanent feature of the APEC process. Australia's Prime Minister Keating had called for regular meetings of APEC leaders in a keynote speech to the Asia-Australia Institute in April 1992. See Australian Financial Review 8-4-92, pp.1-2: 'Keating push for regional muscle'; 9-4-92, p.4: 'Uruguay gives new impetus to Asian trade plan'; and 10-4-92, p.12: 'The Prime Minister and Asia'. According to Keating (Australian Financial Review 23-4-92, p.4: 'Keating's plan draws cool response'), occasional summit meetings would give APEC the political weight necessary to make it an effective institution. The proposal gained the support of both US President Bush and Japan's Prime Minister Miyazawa (see Australia Report Vol 2 No 5 June 1992, p.2) but was coolly received by Indonesia's President Suharto.

In June 1993 US President Clinton called for an informal APEC heads of government meeting in Seattle for November that year to coincide with the Ministerial-level meeting. See Australian 8-7-93, p.13: 'At last, some good news on trade from Clinton'. This time Suharto supported the proposal but Malaysia and, to a lesser degree, Thailand were less enthusiastic. See Australian 13-7-93, p.2: 'APEC calls for fancy footwork'. Malaysia's Prime Minister Mahathir eventually rejected the proposal and refused to attend the Seattle meeting. See Australian 15-7-93, p.1: 'Malaysia snubs Clinton-Keating APEC summit'. Mahathir's refusal was no doubt at least in part a response to the strident US opposition to its proposal for an EAEC. See below this chapter, pp.322-23. Both the proposal by Clinton and its acceptance by most of the other APEC leaders was due to a desire to increase the pressure on the EC to conclude the Uruguay Round. It also reflected the growing concern on the part of the Western Pacific APEC members over NAFTA. The summit took place immediately after the ratification of the NAFTA by the US Congress and just prior to the crucial meeting to conclude the Uruguay Round.

In their 'Economic Vision Statement' at the 1993 Seattle meeting, the APEC economic leaders, responding to a recommendation by the APEC EPG for macro-economic policy cooperation, agreed to convene a meeting of APEC Finance Ministers. The 1994 Bogor Ministerial Meeting endorsed the set of Non-Binding Investment Principles that had been developed in response to an initiative by the APEC Economic Leaders at their Seattle meeting. Prior to the Bogor meeting the US, under pressure from US business interests, had expressed its dissatisfaction with the voluntary non-binding investment code, claiming that the code did not go far enough. The US argued that, given its voluntary, non-binding nature, the code should match similar codes developed in the OECD. Although the US gained some support from Canada and Singapore, it failed to convince most of the Asian members and Australia. See the Australian Financial Review 17-10-94: 'US pressure threatens APEC investment code'; 8-11-94, p.16: 'Impasse on investment stand by US'.

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Nevertheless, the process by which APEC came to adopt the goal of regional trade and investment liberalisation has been a gradual one.\footnote{151} Thus after considering the recommendations of the APEC Eminent Persons Group regarding trade liberalisation and facilitation,\footnote{152} the Ministers at the Fifth APEC meeting in Seattle in 1994 decided that only those that were closely linked to ongoing work (largely trade facilitation) should be implemented promptly.\footnote{153} It was not until their meeting the following year in Bogor that the APEC Economic Leaders finally adopted the long-term objective of free and open

\footnote{151}{As we have already seen (see above, this chapter, pp.291-92), some states such as Australia had wanted APEC to adopt this goal from the outset but other states had successfully argued that this was incompatible the primary task of APEC - the successful completion of the Uruguay Round and the strengthening of the multilateral trade regime. Yet it was soon apparent that regional trade liberalisation might be a useful means to increase the pressure on the EC to conclude the Uruguay Round. At their 1990 Singapore meeting the APEC Ministers agreed that, in the interests of promoting a more open trading system after the completion of the Uruguay Round, it was 'desirable' to reduce barriers to trade in goods and services regionally, 'so long as any such liberalisation was consistent with GATT principles and was not to the detriment of other parties.' It was further agreed that 'senior officials should explore possibilities towards this end and that this matter should be further discussed at the Seoul meeting.' See \textit{Australian Financial Review} 31-7-90, p.3: 'APEC calls on EC to quit stalling'.}

\footnote{152}{The fourth APEC Ministerial Meeting in Bangkok in September 1992 adopted an Australian proposal for the formation of an APEC eminent persons group (APEC EPG) with a brief to develop a vision of trade in the Asia Pacific region in the medium term (to the year 2000); to identify constraints and issues which should be addressed by Governments in order to advance the dynamism of trade in the region; and to identify priorities in the region in future multilateral trade negotiations and in the future evolution of GATT. See APEC Eminent Persons Group 1994, p.45. This represented an advance on the 1991 Seoul Ministerial meeting, where a similar proposal by Australia had been unsuccessful. In its report to the Fifth APEC Ministerial Meeting in Seattle in 1994 the APEC EPG (1993, p.61) warned that 'the whole process of Asia Pacific cooperation could falter if it fails to generate new momentum.' The APEC EPG report (pp.62-67) contained the following recommendations: that APEC members pursue an active programme of regional trade liberalisation on a GATT-consistent basis by determining by 1996 both a target date and a timetable for achieving regional free trade; that APEC adopt a series of programmes aimed at regional trade facilitation, such as an Asia Pacific Investment Code, an Asia Pacific Dispute Settlement Process, macro-economic policy cooperation, a regional competition policy, the mutual recognition of product standards, regulations and procedures, and consultations on matters that are potentially trade inhibiting, such as rules of origin and environmental standards; that Informal Leadership Meetings should be convened at least every three years.}

\footnote{153}{The Ministers decided that other recommendations relating to longer term trade liberalisation, including the recommendation that a target date and time table for regional free trade be determined by 1996, required further elaboration by the APEC EPG. They therefore asked the APEC EPG, on the advice of Senior Officials, to prepare more specific proposals on how the recommended long-term vision might be realised for their next Meeting in Indonesia. According to Australia's Minister For Foreign Affairs and Trade, Senator Evans, the main reason for the rejection by the APEC ministers of the EPG recommendation was the failure of the EPG to specify whether regional trade liberalisation would be preferential or open. See \textit{Sydney Morning Herald} 25-11-93: 'APEC falls just short of its apex'. The inability of APEC members to agree on the methodology of regional trade liberalisation was also evident at the Bogor Summit and in the lead up to the 1995 Osaka Summit. See below this chapter, pp.326-31. Some progress was, however, made in other areas. The Ministers endorsed the recommendations of the Informal Group on Regional Trade Liberalisation that the dialogue within APEC on important multilateral and regional trade policy issues be continued and that APEC's action agenda on trade and investment be developed further by a new Committee on Trade and Investment. The Ministers also agreed to hold a meeting of trade ministers after the conclusion of the Uruguay Round 'to review the results of the Round and its implications for region' and 'to consider the next steps for regional and global trade liberalisation.' In their Economic Vision Statement the APEC economic leaders endorsed the development of a set of non-binding investment principles as a first step towards a regional investment agreement.}
trade and investment in the Asia Pacific, as had been recommended by the APEC EPG.\footnote{154} But the economic leaders failed to take up the APEC EPG recommendation on the controversial question of whether the benefits of APEC regional trade liberalisation should be available to non-member countries on a MFN basis or on a mutually reciprocal basis.\footnote{155} They decided to leave this and other questions regarding the elaboration and implementation of the trade liberalisation programme until the seventh Ministerial meeting in Osaka Japan in 1995 (see below p.327).\footnote{156} Thus the central question of whether APEC would be a 'closed' (that is NAFTA type) or 'open' regional organisation remained undecided.

Factors in the decision to realise the goal of free and open trade and investment in the Asia Pacific by 2020

Since the inaugural meeting in Canberra there has been a change in the attitude of some of the principal participants to APEC. This has been particularly true of the ASEAN countries which, with the notable exception of Malaysia, have become much more in favour of strengthening the APEC process. It is the change in the attitude of ASEAN's largest member, Indonesia, which has perhaps been the most significant in the evolution of

\footnote{154} The second report of the APEC EPG (1994) was presented to the Bogor meeting. Although the Economic Leaders adopted the APEC EPG recommendation that the goal of free and open trade in the Asia Pacific be realised by 2020, they did not specify, as the APEC EPG had done, a starting date. They agreed with the APEC EPG that the pace of implementation should reflect the different levels of economic development among the APEC economies, but endorsed a two-way differentiation in the liberalisation timetables, with the more economically advanced economies eliminating their barriers by no later than 2010 and the developing economies no later than 2020, and did not specify an intermediate timetable, as the APEC EPG (1994, p.26) had recommended, for the NIEs.

\footnote{155} This question had divided the members of the EPG. While the APEC EPG (1994, pp.19-20) recommended that APEC as a group should extend its regional liberalisation to non-members on a mutually reciprocal basis, it recognised the right of any individual APEC member to unilaterally extend its APEC liberalisation to non-members on a conditional or unconditional basis. APEC members were still divided on this question in the lead up to the Osaka APEC meeting in 1995. See below this chapter, pp.327-30.

\footnote{156} They did, however, stipulate that trade and investment liberalisation in the Asia Pacific should also result in the reduction of barriers, not only among the APEC economies, but also between APEC economies and non-APEC economies, and that particular attention should be paid to ensuring that non-APEC developing countries also benefited. To ensure that one or more member economies could not prevent the other member economies from facilitating and accelerating cooperation within APEC, the economic leaders did, however, agree that APEC economies that were ready to initiate and implement a cooperative agreement might proceed to do so while those that were not yet ready to participate might join at a later date. This decision marked an important departure from the previously understood principle that APEC decisions were based on consensus and therefore had to be approved unanimously. There appears to have been a refining of what is actually meant by consensus. According to Soesastro (1995, pp.6-7), this decision originated with President Suharto, who as Chair of the APEC Economic Leaders Meeting, had proposed that decisions at the meeting should be made on the basis of a 'broad consensus', and would not necessarily require unanimity. Suharto was supported by Singapore Prime Minister Goh Chok Tong, who endorsed the idea of a 'flexible consensus', and by Thailand's Deputy Prime Minister Supachai, who called for a 'pragmatic consensus'. Soesastro argued that Suharto had adopted the principle of 'broad consensus' decision-making in response to US opposition at the Senior Officials Meeting to the wording of the non-binding investment principles that were to be adopted at the Bogor meeting. See above this chapter, fn.150. However, Soesastro saw the adoption of this new decision-making principle as particularly aimed at Malaysia.
APEC since 1989. Indonesia’s President Suharto is said to have played a major role in obtaining the necessary consensus on the 1994 Bogor declaration in which APEC heads of government committed their countries to the goal of free trade by 2020.

Yet agreement on the goal of regional free trade has also been possible because of an increased willingness on the part of non-ASEAN APEC members like the US and Australia to compromise on important issues concerning the methodology of regional trade liberalisation.

In this section we look briefly at the factors that have led to the evolution of APEC both as a formal regional institution and as a forum for the negotiation of regional free trade between the 1989 Canberra APEC ministerial level meeting and the 1994 APEC leaders summit in Bogor. Most of these factors were already present in the establishment of APEC in 1989 but have been given increased force by economic and political developments that have occurred at the national, regional and global levels between 1989 and 1994. These were: the concern about the future of the multilateral trading system and the outcome of the Uruguay Round; the concern about the possible diversion of trade, investment and development assistance; the need to ensure that the US remained both militarily and economically engaged in the region; the desire of the US to maintain its influence in the region and in particular its strategic role as a balancer; the concern by Australia that it might be excluded from East Asia; and the concern among other Asia Pacific economies over continuing US-Japan economic differences.

There was also one new factor: the establishment of the ASEAN Free Trade Area (AFTA).

The concerns held by both the ASEAN and non-ASEAN countries about the future of the multilateral trading system had been further heightened by the subsequent failure of the Brussels Ministerial Meeting in December 1990 and by the slow pace of the resumed negotiations. Both the ASEAN and non-ASEAN members of APEC had become more convinced of the importance of APEC as a means of increasing their collective bargaining power against the EC. For the strategy to work, however, the EC had to believe that

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157 The Australian-Indonesian partnership, and in particular the much vaunted close relationship between Keating and Suharto, has been crucial to the success of proposals to consolidate APEC. Australia appears to have identified Indonesia quite early on as the key to winning ASEAN endorsement for the consolidation of APEC. Thus, when Keating launched his proposal for regular APEC heads of government meetings, he realised its success depended on gaining the support of Indonesia. (See *Australian* 25-9-92, p.2: 'Japan to woo Suharto on APEC'; *Australian Financial Review* 25-9-92, pp.1-2: 'Japan, Aust expect worst'; *Australian* 14-11-94, p.1: 'Australia, Asia & APEC: The leap to free trade'). Similarly Keating realised the importance of having Indonesia’s President Suharto behind the push for regional free trade. According to Keating (Sydney Morning Herald 14-10-94: 'APEC trade walls to fall'), the fact that the president of a developing country in the region was leading the push put great moral pressure on the more developed countries and made it harder for the developing countries to hide.

158 The APEC Eminent Persons’ Group in their first report (1993, pp.15-19) listed three major threats to continued regional economic growth and interdependence: the undermining of global trading system by rising protectionism; the trend towards inward-looking regionalism world wide; and the fears of a US disengagement from the region, both economic and military, as result of increasing bilateral tensions with Japan and China.

159 The US continued to see APEC as a vehicle for resolving some of the issues facing the Uruguay Round and as a bargaining chip to be employed against the EC. With 1993 as the
APEC provided its members with a credible fallback position should the Uruguay Round prove unsuccessful. The APEC countries were thus more willing than in the past to give APEC a solid institutional basis and to commit themselves to regional trade and investment liberalisation, both of which were considered necessary to transform APEC into a credible alternative to the GATT.\footnote{160}

The Western Pacific countries were especially worried that if the Round itself should end in failure, there would be a proliferation of unilateralism and protectionism in the global trading system. They already saw signs of this in the growing enthusiasm of some GATT members for regional pacts.\footnote{161} The collapse of communism in Eastern Europe in late 1989 and early 1990 had increased the fears of the ASEAN countries that trade, investment and development aid would be diverted from the ASEAN countries to Eastern Europe in order to ensure the survival of the fledgling non-communist governments there.\footnote{162} They were also worried about the increased competition from China, Vietnam and India for investment and export markets.\footnote{163}

The Western Pacific APEC members feared that the establishment of NAFTA and its mooted extension to Latin America would have a similar effect on trade and investment by crucial year for the completion of the Uruguay Round US President Clinton decided to endorse a proposal by Australia's Prime Minister Keating for an APEC leaders summit. See above this chapter, fn.148. The US hoped that an APEC leaders summit in November would boost the international profile of APEC, thereby increasing the pressure on the EC only a month before the December deadline for the completion of the Uruguay Round. In the lead up to the 1993 Seattle APEC meeting the US Assistant Secretary of State for East Asian and Pacific Affairs, Winston Lord, conceded that the further development of APEC might act as a hedge in case the Uruguay Round should fail. (See \textit{Australian} 20-8-93, p.5: 'US rejects"trading entity" role for APEC'). The US Secretary of State Warren Christopher made the intention of the US administration quite clear in the following declaration on the eve of the Seattle APEC summit:

'I think it will not be lost on the European leaders that this meeting is taking place in Seattle and that the countries of the Asia Pacific region are working together toward trade liberalisation, working together toward trade cooperation. I think that will be a strong incentive to those countries in Europe to realise that they need to conclude the Uruguay Round lest, if that fails, APEC turn to other measures to achieve more open trading.' Quoted in \textit{Australian} 17-11-93, p.1: 'We'll turn to APEC if you kill GATT, US tells Europe'.

Thus South Korea's Foreign Minister Lee Sang Ock had called for the strengthening of APEC in the face of a possible failure of the Uruguay Round and the rise of protectionist trading blocs in Europe and North America. See \textit{Far Eastern Economic Review} 24-9-92, 'Apec chooses Singapore'. In 1993 the US representative on APEC's Eminent Persons Group, Fred Bergsten, maintained that APEC could serve as the basis for an alternative international trading system should the Uruguay Round fail. See \textit{Australian} 11-8-93, p.4: 'APEC option for world trade'.


\footnote{161} See Joint Declaration of the Eight ASEAN-EC Ministerial Meeting held in Kuching Malaysia, 16-17 February, ASEAN Secretariat 1991, p.61; Wanandi 1990, p.3.

\footnote{162} This was particularly true of Indonesia. According to Mangkusuwondo (\textit{Australian} 8-11-94, p.2: 'Japan businesses baulk at trade liberalisation'), fear of increased competition from newly emerging economies such as India had led Indonesia to reassess its attitude towards APEC. Indonesia, he maintained, now believed that one way to counter aggressive trade and investment policies of these economies was to support trade liberalisation. Pangestu (\textit{Australian} 8-6-94) attributed the 22 per cent decline in foreign investment approvals in 1993 compared with the previous year and the decline in the growth rates of non-oil exports to the growing competition from China for export markets and investment.
giving exporters from Mexico and the other Latin American countries a competitive advantage over their own in terms of access to the US market.\textsuperscript{164} Japan and the North Asian NIEs were particularly worried that NAFTA might evolve into an exclusionary bloc while the ASEAN countries were concerned that, in order to maintain their market share in the US, North Asian and US producers might shift their factories from East Asia to Mexico.\textsuperscript{165}

The countries of the Western Pacific were further alarmed by a proposal by President Bush in September 1992 to develop a strategic network of free trade agreements with selected countries in Latin America, Eastern Europe and the Western Pacific.\textsuperscript{166} They saw

\textsuperscript{164} The visits by Malaysia’s Prime Minister Mahathir and South Korea’s President Roh Tae Woo to Mexico in 1991 reflect the concern of Asian countries at the establishment of NAFTA and their desire to investigate investment opportunities in Mexico. (See \textit{Far Eastern Economic Review} 10-10-91, p.10: ‘the Mexican wave’). South Korean businessmen were reported to have promised to invest $US1 billion in Mexico. The possibility of a Western Hemisphere free trade area had already been raised by President Reagan in 1987. US President Bush’s proposal for Western Hemisphere free trade was part of his Enterprise for the Americas Initiative, which he announced in 1990, just two weeks after his acceptance of Mexico’s request for a free trade agreement. See Chapter Seven, fn.83. The idea was revived by President Clinton immediately after Seattle APEC leaders Summit in 1994. Clinton declared that the US needed ‘a partnership not only with Mexico but with all of Latin America’. (See \textit{Weekend Australian} 20/21-11-93, p.21: ‘US push a worry for APEC’).

\textsuperscript{165} See \textit{Far Eastern Economic Review} 7-5-92, p.70: ‘Round and round: Japan fails to kick-start Gatt talks’. According to Yamazawa (1992, interview with author), Japan was also concerned by the shift in the focus of US attention or ‘interest diversion’ from the Uruguay Round to NAFTA. The fears of the Western Pacific countries were considerably augmented by statements from US Administration officials that NAFTA would not only increase the competitiveness of US firms \textit{vis-à-vis} their Asian counterparts by allowing them to take advantage of the lower labour costs in Mexico, it would also prevent Asian firms from using Mexico as a back entry into the US market. These statements were aimed at overcoming domestic opposition to NAFTA rather than at reassuring the United States’ Western Pacific trading partners. See the statement by US Trade Representative Carla Hills to this effect in \textit{Far Eastern Economic Review} 27-8-92, pp.50-51: ‘New kid on the bloc’. The US was concerned that Asian firms were setting up assembly plants in the maquiladora region of Northern Mexico in order to take advantage of the lower import duties that the US imposed on goods that entered the US from that region. See Chapter Seven pp.232-33. Intense lobbying by some US firms to increase local content requirements under NAFTA also did little to allay the fears of the Western Pacific countries. US car manufacturers called for the amount of local content required for a good to benefit from the free trade agreement be increased from the existing 50% under the US-Canada FTA to 60 or 70% under NAFTA. The phasing out of the maquiladora system under NAFTA, together with the increase in local content requirements, would significantly increase the duty paid on both components coming into Mexico and on the finished product when it was exported to the US. See \textit{Far Eastern Economic Review} 27-8-92, pp.50-51: ‘New kid on the bloc’.

\textsuperscript{166} Japan and the North Asian NIEs were concerned that the new rules of origin to be adopted under NAFTA would be more restrictive than the existing ones. See Yamazawa 1992 (interview with author); Tanabe 1992 (interview with author); \textit{Far Eastern Economic Review} 7-5-92, p.70: ‘Round and round: Japan fails to kick-start Gatt talks’. The ASEAN countries feared that as a result of these new rules of origin Asian, European and North American multinational enterprises would shift some of their component production from Southeast Asia to North America. These countries were also worried that the NAFTA rules of origin might also curtail the transfer of labour intensive production from Northeast Asia to Southeast Asia that had been a feature of the late 1980s and had been a significant factor in the region’s high growth rate over that period. Since many of these labour intensive products were destined for the North American market, Northeast Asian producers, it was feared, might prefer to shift their operations to North America instead so as to remove any uncertainty concerning the access of these products to the North American market.

See \textit{Australian} 22-9-92, p.1: ‘Keating wins Tokyo to APEC plan’; \textit{Australian Financial Review} 22-9-92, p.3: ‘Keating convinces Japan on APEC role’. The US Commerce Department Deputy Assistant Secretary for East Asia and the Pacific, Franklin Lavin (1992), defended the Bush proposal on the grounds that trade liberalisation would be more easily achieved under this
in this further evidence that the US was prepared to put its own narrow short term interests before the long term interests of the multilateral trading system and of the Asia Pacific region.\footnote{Evans 1993b.}

These concerns about the specific effects of NAFTA and about investment, trade and aid diversion in general no doubt strengthened the position of those policymakers within the ASEAN countries who wanted to make their countries more attractive as foreign investment locations by removing trade and investment barriers.\footnote{In July 1992 Indonesia announced a new set of economic measures aimed at increasing the country's attractiveness as a foreign investment destination. (See \textit{Far Eastern Economic Review} 23-7-92: 'Biting the bullet: Indonesian technocrats urge faster pace of economic reform'). These measures, which included a lowering of tariffs, the removal of some non-tariff barriers, and the relaxation of land-use regulations, were the result of growing concern among Indonesian economists and officials that Indonesia was losing ground in terms of its attractiveness as an investment location to Vietnam, China and India. Thus in 1993 foreign investment proposals were said to be down by 22 per cent. (See \textit{Australian} 8-6-94, p.39: 'Suharto's Surprise'). In 1994 in the lead up to the Bogor APEC Summit, Indonesian President Suharto relaxed the restrictions on foreign investment. They were also a factor in the decision of Malaysia in December 1990 to propose the formation of an East Asian Economic Grouping and that of the ASEAN countries in January 1992 to establish the ASEAN Free Trade Area. See below, this chapter, pp.322-25.} They made ASEAN governments more willing to undertake trade and investment liberalisation at a regional level and were thus a significant factor in the decision to give APEC a firmer institutional basis and in moves to liberalise trade and investment at a regional level.\footnote{In July 1992 Indonesia announced a new set of economic measures aimed at increasing the country's attractiveness as a foreign investment destination. (See \textit{Far Eastern Economic Review} 23-7-92: 'Biting the bullet: Indonesian technocrats urge faster pace of economic reform'). These measures, which included a lowering of tariffs, the removal of some non-tariff barriers, and the relaxation of land-use regulations, were the result of growing concern among Indonesian economists and officials that Indonesia was losing ground in terms of its attractiveness as an investment location to Vietnam, China and India. Thus in 1993 foreign investment proposals were said to be down by 22 per cent. (See \textit{Australian} 8-6-94, p.39: 'Suharto's Surprise'). In 1994 in the lead up to the Bogor APEC Summit, Indonesian President Suharto relaxed the restrictions on foreign investment. They were also a factor in the decision of Malaysia in December 1990 to propose the formation of an East Asian Economic Grouping and that of the ASEAN countries in January 1992 to establish the ASEAN Free Trade Area. See below, this chapter, pp.322-25.} A stronger,
more formalised APEC, they believed, could reduce any diversion effects NAFTA might have on Pacific trade and investment flows.

It would also tie the US more firmly to the Western Pacific. Recent developments had heightened the concern of Western Pacific countries about the consequences of a US military withdrawal from the region and increased their awareness of the importance of APEC as a means of keeping the US engaged both militarily and economically in the region.

The Bush proposal to extend NAFTA (see below) is said to have increased support by Western Pacific countries for Keating's proposal for an APEC leaders summit. (See Australian 22-9-92, p.1: 'Keating wins Tokyo to APEC plan'). The Bush proposal no doubt also increased the determination of Australia to press for some form of regional trade liberalisation through initiatives such as Keating's proposal for an integrated regional market in February 1993. (See Australian Financial Review 9-2-93: 'PM's APEC plan is smart politics'; Sydney Morning Herald 9-2-93: 'Keating plays the APEC card'; Australian Financial Review 15-2-93, p.10: 'Kerin to follow up US interest in APEC initiative'). Keating's proposal, however, was concerned more with harmonising trade and investment rules and standards than with trade liberalisation and Keating was careful to stress that it was not his intention at this point to seek a full free trade area with a minimal internal tariff. Australia saw the creation of an integrated Asia Pacific market as a way of ensuring that efforts by sub-regional agreements such as AFTA and NAFTA to harmonise trade and investment regulations and standards did not create new barriers to exporters from Australia and other APEC countries that were not parties to these agreements. (See Australian Financial Review 15-11-93, p.38: 'Cook urges single trade reform focus'). An Australian proposal to formally link NAFTA to APEC was, however, rejected by US Secretary of State Warren Christopher. (See Australian 22-11-93, p.13: 'Clinton spikes Keating vision').

According to Keating (Australian Financial Review 22-9-92, p.3: 'Keating convinces Japan on APEC role'), APEC would institutionalise US involvement in the Asia Pacific. In his meeting with Indonesia's President Suharto prior to the Seattle APEC leaders summit, Singapore's Prime Minister also stressed the importance of APEC in keeping the US strategically engaged in the Asia and in ensuring that the US market remained open to the exports from ASEAN. (See Australian 8-11-93, p.13: 'Goh puts faith in APEC's objectives'). Goh warned that the rise of trade blocs in Europe and North America could severely limit economic growth in the developing countries of ASEAN. If ASEAN did not give importance to APEC, he argued, it would force the US to look south and north to Canada and Mexico and Latin America and ASEAN countries would then have enormous difficulty in exporting their products.

This was particularly true of the ASEAN countries. The collapse of communism first in Eastern Europe and then in the USSR itself further allayed the fears of the ASEAN countries that an Asia Pacific regional economic body would be misconstrued as an anti-Soviet alliance. At the same time it increased their awareness that as a result of this considerable reduction in the communist threat and a desire on the part of the US electors to 'reap the peace dividend', the US might substantially reduce its military presence in the region, thereby creating a power vacuum that other regional powers such as China, Japan and India, might be tempted to fill. According to Indonesian and regional defence analyst, Jusuf Wanandi (1991b, pp.232-37), the US presence 'is not merely aimed at balancing the Soviet Union, but in the future also at checking China, India, or Japan.' Wanandi claimed that '(f)or ASEAN, the US-Japan alliance is the most important guarantee that Japan will not go it alone in defence.' He also saw the US presence in the region as ensuring that ASEAN did not become overdependent on Japan. Singapore's Prime Minister Goh is reported to have told Indonesia's President Suharto that APEC would assist in keeping the US strategically engaged in the region. See Australian 8-11-93, p.13: 'Goh puts faith in APEC's objectives'. Australia's Prime Minister Keating also underlined the importance of the US presence in the Western Pacific in a keynote speech to the Asia-Australia Institute in April 1992. See Australian Financial Review 10-4-92, p.12: 'The Prime Minister and Asia'.

The concerns of the ASEAN countries were greatly augmented when the US was forced by political pressure from within the Philippines to vacate its bases in that country and by the dispute over the possession of the Spratly Islands in the South China Sea. Thus Wanandi (1991 pp.233-34) has argued that '(w)hile Singapore, Brunei and Thailand have made their support for the bases known in a more direct way than Malaysia and Indonesia, all ASEAN members essentially accept that the Philippines should continue to host them.' According to Djiwandono (1991, pp.125, 127), the US presence in the Philippines had ensured the peace and stability of SEA and there was concern that, if both the USSR and the USA withdrew,
The fears of all the Western Pacific countries - except Malaysia - about the possible US disengagement from the region were further heightened by Malaysia's proposal in December 1990 for the establishment of an East Asian Economic Grouping or EAEG. It was feared that the exclusion by Malaysia of the US from membership of the EAEG - or East Asian Economic Caucus (EAEC) as it is now called - would further encourage those in the US calling for a more isolationist foreign policy. Yet the EAEC proposal also augmented US concerns about its diminishing influence in East Asia and its possible exclusion from that region's new post cold war economic and political arrangements. As a result the US administration under both Bush and the Clinton has been more supportive of proposals to consolidate APEC. In particular, it has shown a greater willingness to compromise on the methodology of regional trade liberalisation and thus facilitated the adoption by APEC of the goal of regional free trade by 2020.

Asia would be dominated by China. ASEAN concerns about about China were heightened by the dispute over the possession of the Spratly Islands in the South China Sea. See Wanandi 1991b, p.237; Habib 1991, pp.262-63; Mak 1993, pp.42-50.

Like APEC, the EAEG proposal was a result of growing concern about the languishing Uruguay Round negotiations and the world wide trend to bilateral and regional trading arrangements. Other factors in the Malaysian decision to propose an EAEG were the growing economic interdependence among the countries of North and South East Asia and the rise of an East Asian identity; a desire to offset the trade and investment diversion impact of the EC and NAFTA; the need to anchor Japan in East Asia; and the need to band together to defend the interests of the developing countries against the perceived attempts by the developed countries to thwart their development. The proposal was also clearly a response to what Malaysia saw as unwelcome developments in the APEC process, namely a shift in the nature of APEC from an informal consultative forum to a more formal institutionalised negotiating body. It no doubt saw the EAEG as both an alternative to APEC - which Mahathir attacked for being a tool of the US - and a means of forestalling APEC's development. According to Mahathir (Australian 21-10-92, p.12), APEC would not be allowed to adopt anything that was not in the interests of the US. Mahathir (1991, p.52) feared that APEC might become 'a vehicle to perpetuate existing asymmetries and policies that place (the smaller, less developed Pacific countries) at a disadvantage.' He believed that the EAEG, through its exclusion of the US and other Western nations in the region, would ensure that the views of the developing countries of Asia were heard.

The Bush administration was also concerned that the establishment of the EAEG would encourage those in the US who were calling for tougher action against the 'unfair' traders of East Asia. In order to strengthen APEC it called for the establishment of a permanent secretariat along the lines of the OECD. See Far Eastern Economic Review 25-7-91, pp.54-55: 'The disappointed idealist'. Like the Bush administration before it, the Clinton administration has responded to the Malaysian proposal by showing greater enthusiasm for APEC. The Clinton administration adopted the Australian proposal for APEC leaders summits and organised the first such meeting in Seattle in November 1993. It also gave strong support to the proposal for regional free trade in the lead up to the Bogor APEC leaders summit. A former US diplomat, Richard Baker (Australian Financial Review 23-11-93: 'APEC confirms a US shift in policy to Asia-Pacific') has argued that the Seattle APEC Summit confirmed a definitive shift in the US approach to the Asia Pacific from one which stressed bilateral trade and security ties to one which seeks to encourage a new multilateral economic and security framework.

However, the US has also responded to the Malaysian proposal by putting pressure on Japan and other East Asian countries to publicly reject the proposal. This has only increased Malaysian opposition to the consolidation of APEC and further fuelled Malaysian accusations that the US is trying to bully East Asian countries.

The EAEC has also increased the support of Australia and Indonesia for the consolidation of APEC. Malaysia's exclusion of Australia from the EAEC has also heightened Australia's concern about its own exclusion from such arrangements and encouraged it to make new proposals to further strengthen APEC so as to make it the primary regional institution. Thus
The ongoing tension between the US and Japan over the large imbalance in their bilateral trade continued to be of concern to the other Asia Pacific economies. The concerns of the other APEC economies were twofold. First, they feared that should Japan fail to respond to US pressure, the US might carry out its threat to impose trade sanctions, thereby sparking a trade war that would split the Pacific down the middle. A trade war between the region's two largest economies, they believed, would represent a severe setback to regional economic interdependence and have disastrous consequences for

Keating's proposals for regular APEC leaders summits and for an integrated regional marketplace were said to responses to both the establishment of NAFTA and Malaysian moves to establish the EAEC.

Malaysia's failure to consult Indonesia prior to announcing its proposal has made Indonesia less inclined to support the EAEG and more willing to support the consolidation of APEC. (See Far Eastern Economic Review 24-10-91: p.65: 'The morning AFTA'). Indonesia insisted that the Mahathir proposal for an East Asian Economic Group be consistent with both GATT and APEC and that it be a caucus within APEC. This difference of opinion between Indonesia and Malaysia over the form that extra-ASEAN regional cooperation should take is not new and reflects a more fundamental difference in their positions on certain foreign policy matters as well as a certain amount of rivalry between the two countries. According to the Far Eastern Economic Review (16-1-92: p.26: 'Crux of the matter: Major leaders differ on style, agenda'). Indonesian diplomats maintained that Mahathir's combative style, particularly in his dealings with the developed countries, irritated Suharto, who preferred a more conciliatory approach. In the view of some regional analysts Indonesia has always understood its membership of ASEAN as self-imposed containment in return for the implicit recognition by the other members of its right to be consulted and have an important say on matters affecting the region. According to Indonesian Foreign Ministry officials, Indonesia's opposition to Mahathir's proposal is largely due to his failure to consult with Indonesia before announcing the proposal. (Leo Suryadinata interview with author January 1992). There is also a feeling in Indonesia that Mahathir has tried to fill the position of leading ASEAN statesperson, a position left vacant when Lee Kuan Yew stepped down as Prime Minister of Singapore and which Indonesia feels more rightfully belongs to President Suharto. (Juwono Sudarsono interview with author February 1992; Leo Suryadinata interview with author January 1992). There is also a certain amount of rivalry between Malaysia and Indonesia in terms of leadership in the Third World and Muslim communities.

In the early 1990s the US Congress maintained its pressure on the US administration to improve the access of US exporters to the Japanese market. In 1992 the Democrats in the US Congress introduced a bill that would renew the Super 301 provision of the 1988 trade law for five years and reduce Japanese car sales in the US, if Japan did not reduce its trade surplus with the US by 20%. See Far Eastern Economic Review 28-5-92, pp.49-50: 'Super 301: the sequel: US bill targets Japanese trade'; Australian Financial Review 14-2-94, pp.1, 12: 'Pacific trade war looms'; Sydney Morning Herald 14-9-94, p.15: 'Japan defies sanctions talk as US economic war looms'. The other Asia Pacific economies were also becoming concerned about the increasing tension between China and the US over the growing US trade deficit with China. They were convinced that a strengthened APEC would provide a multilateral forum in which Japan, the US and China could resolve their differences in a way that enhanced regional economic interdependence and safeguarded the interests of the other economies. Thus, according to Australia's Prime Minister Keating, APEC 'provides a framework to help contain or manage competition between China, Japan and the US and it gives the smaller countries of the region a greater say in the nature and shape of the trading arrangements in the region.' Quoted in Sydney Morning Herald 27-10-94, pp.1, 8: '$15bn trade rests on APEC deal: PM'.

177 See Evans 1993a; Australian Financial Review 14-2-94, pp.1, 12: 'Pacific trade war looms'; Sydney Morning Herald 14-9-94, p.15: 'Japan defies sanctions talk as US economic war looms'. Australia was particularly concerned about the negative impact of such a split for its own growth prospects. According to Evans (1993a), should the Pacific be split into an East Asian and a North American trading bloc, Australian firms could find themselves excluded from open access to one or both of these blocs. In a speech to the Asia-Australia Institute in October 1994, Australia's Prime Minister Keating warned that trade tensions between the US and the North Asian economies could 'fester and attenuate the existing bonds across the Pacific.' According to Keating, a fracturing of the post-Cold War world into competing blocs would threaten the economic dynamism that was vital to both Australia and the region's prosperity. See Australian 27-10-94, p.1: 'Asia the great challenge: PM'; Sydney Morning Herald 27-10-94, pp.1, 8: '$15bn trade rests on APEC deal: PM'.

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economic growth and regional economic and political stability. It would no doubt also precipitate an American military disengagement from the region and thus further undermine both economic and political stability. Second, these other regional economies were also worried that the US and Japan might reach an accommodation that was detrimental to the interests of the other regional economies. 179

There was, however, one new factor that increased the support of the ASEAN countries for proposals to consolidate APEC. The decision by the ASEAN countries in January 1992 to form AFTA, was, like APEC and the EAEG, a response to the growing uncertainty surrounding the multilateral trading system. 180 It was also a response to the establishment of APEC and in particular the fear that APEC might undermine ASEAN. 181 Yet the establishment of AFTA lessened these concerns and thus made some ASEAN member countries more willing to support the consolidation of APEC. 182

179 See Australian Financial Review 14-2-94, pp.1, 12: 'Pacific trade war looms'; Sydney Morning Herald 14-9-94, p.15: 'Japan defies sanctions talk as US economic war looms'. The US administration had been pressuring Japan to accept numerical targets for US imports in terms of sales and market share and it was feared that Japan might decide to meet these targets by giving preference to US goods over goods from the other regional economies. Australia was particularly concerned by the prospect of managed trade between the US and Japan. See Australian Financial Review 27-4-93, p.3: 'PM must try to capture Miyazawa'. In return for a pledge that Australia would not be part of any pact that was detrimental to the interests of Japan, Keating was given assurances by Japan's Foreign Minister Watanabe 'that in any third party arrangement to diminish trade imbalances in Japan's favour, Australia was not a casualty.' See Australian 22-9-92, p.1: 'Keating wins Tokyo to APEC plan'.

180 Pangestu 1995, p.41. With the outcome of the Uruguay Round still in doubt and with the formation of free trade areas in both Europe and the Western Hemisphere, the ASEAN countries saw the need to form a free trade area of their own to strengthen their bargaining position vis-à-vis the other areas and to maintain and enhance their attractiveness as a production location in the eyes of foreign investors. By giving APEC a much needed economic dimension, AFTA, they believed, would increase the relevance of ASEAN both to its members and to the outside world. It would also increase the cohesiveness of ASEAN by strengthening the economic bonds between the member states. According to the AFTA Reader (ASEAN Secretariat 1993, p.1), the objective of AFTA is to increase ASEAN's competitive edge as a production base geared for the world market. According to Nibhat Pukanasut of the Thai Fiscal Policy Office, in a world environment where there is increasing competition for market access and foreign investment, if each ASEAN country were to attempt to go it alone it would be at the expense of its friends. (See Nation, 1-10-91). ASEAN policymakers such as Bajr Isarasema, Permanent Secretary of the Thai Commerce Ministry, had detected a shift in the investment strategies by Japan, Taiwan, Hong Kong and South Korea away from developing countries to industrialised ones. They attributed this shift to the desire of producers in these countries to maintain their market share in the markets of developed countries, which, they feared, were becoming increasingly closed to imports. See Nation 15-12-91.

181 Soesastro 1994b, p.342; Pangestu 1995, p.41. The concerns held by the ASEAN countries about the future relevance and cohesiveness of ASEAN had led them to oppose proposals at the 1989 and 1990 APEC ministerial level meetings to institutionalise APEC and to use it as a vehicle for regional trade liberalisation negotiations. See above this chapter, fn 62, 151. A virtuous circle of trade liberalisation was created with liberalisation in APEC spurring liberalisation in AFTA and vice versa. Thus, according to Pangestu, the slow pace of the Uruguay Round and moves to consolidate APEC led the ASEAN economic ministers to decide in September 1994 to reduce the period for the implementation of AFTA from 15 to 10 years. They agreed to reduce all tariffs above 20 per cent to a maximum of 5 per cent by 2000.

182 This was particularly true of Indonesia and the Philippines. Malaysia remained opposed to any moves to consolidate APEC. Thailand also voiced some opposition to the proposal for APEC-wide free trade, again reflecting divisions within the Thai bureaucracy on the question of trade and investment liberalisation. At a meeting of ASEAN economic ministers in September 1994, the Thai Deputy Prime Minister Supachai Panitchpakdi warned that an APEC FTA might dilute AFTA and divert attention from the Uruguay Round commitments.
agreement by ASEAN member countries to liberalise trade and investment among themselves under AFTA also made it easier for the ASEAN countries to contemplate the adoption of trade and investment liberalisation at the APEC level. This was particularly true of Indonesia, which having made the commitment to open its market to its ASEAN partners was less concerned about opening it even further to the other APEC members.183

In sum, the consolidation of APEC that has occurred since 1989 is partly the result of concerns that were already present at its inception and that have become more compelling as a result of recent economic and political developments at a national, regional and global level. It is also partly the consequence of the establishment of AFTA which has made the ASEAN countries less fearful of the negative effects of APEC on the cohesion and collective bargaining power of ASEAN. Yet despite the commitment made by the APEC leaders at Bogor to regional free trade by 2020 several obstacles must be overcome before that goal can be attained. It is to these obstacles and the efforts to overcome them that we now turn.

The remaining obstacles to the attainment of APEC-wide free trade

The first of these obstacles relates to the nature of the commitment itself. The fact that the commitment to free trade at Bogor was non-binding and not, as in the case of the Single European Act, the US-Canada FTA and NAFTA, a legally binding and formalised agreement may have facilitated the signing of the declaration but it also might make it

and the establishment of the World Trade Organisation. (See Australian Financial Review 26-9-94: 'No common ground found on APEC'). Responding to the US proposal for an APEC leaders summit in Seattle in 1993, Supachai had expressed concern at the evolution of APEC. He wanted APEC to remain an informal dialogue process rather than become a body that negotiates formal agreements. (See Australian 13-7-93, p.2: 'APEC calls for fancy footwork'). Given the size of the Indonesian market in relation to the markets of the other ASEAN countries, Indonesia no doubt believed that it stood to gain more in terms of investment and trade from APEC-wide liberalisation than from liberalisation that was confined only to ASEAN. Indonesia's representative on the EPG, Suhadi Mangkusuwondo, has argued that Indonesia's decision to support the AFTA proposal was a crucial turning point. (See Australian 14-11-94, p.3: 'Australia, Asia & APEC: Aiming for consensus'). According to Mangkusuwondo, 'the President's confidence has strengthened, having examined the performance of the Indonesian economy after a series of deregulatory decisions. This has convinced him that it is in Indonesia's own interest to liberalise further.' Thus in an address to a meeting of APEC Trade Ministers in Jakarta in October 1994, President Suharto declared that '(e)xperience so far shows that by individually liberalising trade and investment, we attain higher economic growth compared to the average economic growth in other parts of the world. We are therefore determined to continue and intensify the efforts to facilitate trade whether among ourselves or between ourselves and other parts of the world.' Thus in 1992 and 1994 Indonesia announced new measures to deregulate the economy and ease foreign investment regulations. (See Far Eastern Economic Review 23-7-92, pp.34-35: 'Biting the bullet: Indonesian technocrats urge faster pace of economic reform'; Australian 8-6-94, p.39: 'Suharto's Surprise'). Indonesia was at one stage contemplating giving its support to the 2010 deadline that had been proposed by Australia and Singapore for free trade among the APEC economies. (See Australian Financial Review 26-9-94: 'No common ground found on APEC') Yet, according to Mangkusuwondo (Australian Financial Review 9-11-94, p.16: 'Soeharto to care for weak members'), Suharto's conviction that trade liberalisation would benefit Indonesia was not generally accepted in Indonesia itself.

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easier for the signatories to disregard it afterwards. Both Malaysia and Thailand had insisted on the non-binding nature of their commitment in annexes to the official declaration at Bogor and on the eve of the Osaka APEC leaders summit in November 1995 Malaysia's Minister for Trade Rafidah Aziz confirmed that Malaysia did not consider itself to be bound by the Bogor free trade pledge.

The other obstacles to free trade in the Asia Pacific concern differences of opinion among the APEC member economies over the most appropriate means to attain that goal. The APEC leaders meeting at Bogor was unable to resolve these differences and decided to defer the elaboration of the actual trade liberalisation programme - the Action Agenda - until the next APEC ministerial meeting in Osaka in 1995. The APEC members are

184 Thus US Assistant Secretary of State Winston Lord (Australian 4-11-94, p.4: US confident of trade timetable) was confident that given the non-binding nature of the commitment countries such as China, Malaysia and Japan, which had some reservations about certain aspects of the free trade plan, would still agree to it. The question of whether states are more likely to comply with a binding agreement such as the SEA or NAFTA than a non-binding agreement such as APEC is a complex one. On the one hand, as the actions of de Gaulle in the 1960s with regard to the EC demonstrate, the fact that an agreement is binding may not in itself be enough to guarantee compliance of a state if that state believes the agreement to be no longer in its national interests. On the other hand, it is clear that some states believe that a binding agreement is more likely to guarantee compliance than a non-binding one. Thus in the case of the SEA, the majority of EC member states overruled the UK and insisted on the need for a formal binding agreement to ensure compliance. Similarly, both Canada and Mexico felt that only a formal binding agreement could provide the necessary reassurance to investors and producers that their access to the US market could not be curtailed by a unilateral decision of the US Congress. It could be argued, however, that this preoccupation with 'bindingness' is but another example of Western legalism. See also below this chapter, fn.193. In East Asia, where there is no such tradition of legalism, the relationship between compliance and bindingness may not be the same. Indeed, it is often argued that in East Asia there is a preference for non-binding, informal agreements. The business networks on which much of the East Asian miracle is said to be based are informal. But if this is the case then what guarantee is there that these networks are based on market principles and what is to prevent governments from favouring domestic producers over their foreign rivals? Will Western firms and governments steeped in the legalist tradition be willing to accept such a different approach? Will Western investors be sufficiently reassured by such agreements? Yet this reluctance on the part of some East Asian states to sign a binding APEC FTA may also be due to other non-cultural factors. There may be a reluctance on the part of some states to sign a binding agreement which preserves the unequal status quo in terms of economic development. There may also be a similar reluctance by some states to commit themselves to the pursuit of free trade when they are still uncertain about the effect that free trade will have on internal stability. We thus return to one of the central concerns of states with regard to free trade: will it strengthen or undermine national resilience?

185 Australian 19/19-11-95, p.1: 'Malaysian free trade warning clouds APEC summit'. Although Malaysia would try to meet the free trade deadline, Rafidah declared, it would do so at a pace it was comfortable with. Australia was concerned at the tendency of some APEC members to back away from the target dates specified in the Bogor Declaration and wanted these dates reaffirmed in the Osaka Action Plan. See Australian Financial Review 14-11-95, p.5: 'Australia urges target affirmation'. There had been considerable opposition on the part of China, Thailand and Malaysia to any binding commitment to a liberalisation time-table. (See Australian 26-10-94, p.1: 'China rejects APEC deadline'). Both Malaysia and Thailand issued a separate list of reservations which they wanted annexed to the Bogor Declaration. See Soesastro 1995, pp.3-4. Malaysia stressed that regional liberalisation should not lead to the creation of an exclusive Pacific FTA but should be GATT/WTO consistent and on an unconditional MFN basis; that the target dates should not be binding; that the liberalisation process will be on a best endeavour basis, will take into account the differing levels of economic development of the members and will only cover a substantial portion of Asia Pacific trade and should not go beyond the provisions of GATT/WTO. Thailand maintained that the goal of liberalisation should not be the creation of an FTA and that the liberalisation process must be consonant with the decisions of the Uruguay Round and the WTO; that the time frame should be seen as the target for achieving the goal ; and the 'elimination' of trade and investment barriers in the region should be done on a gradual basis.
divided on three main questions: the question of discrimination, that is, how the benefits of regional liberalisation should be extended to members and non-members; the question of comparability, that is, how to ensure that all APEC economies are making a comparable effort to liberalise; and the question of comprehensiveness, that is, whether trade liberalisation should apply to all sectors at the same time or whether some sensitive sectors such as agriculture might be excluded initially.

In the lead up to the 1995 Ministerial Meeting in Japan the question of whether the benefits of regional liberalisation should be extended to members and non-members conditionally or unconditionally continued to divide APEC members. The US was still opposed to extending the benefits of regional liberalisation to non-members unconditionally while Japan was opposed to any preferential liberalisation.\textsuperscript{186}

The US concerns about free riding also led it to question the automatic extension of the benefits of regional trade liberalisation to all APEC members. The US was intent on reducing its burgeoning trade deficit with China and had been using the annual review of China's trade status that was mandated by the US Congress to put pressure on China.\textsuperscript{187}

\textsuperscript{186} See \textit{Australian} 1-3-95, p.1: 'Cabinet eases free trade stance'. This issue had been the source of considerable debate within the APEC EPG prior to the Bogor meeting. The final position of the EPG had been a compromise between the position of the US representative, Fred Bergsten, that the benefits of APEC trade liberalisation should be extended to non-APEC members on a reciprocal basis only, and that of Japan's representative, Ippei Yamazawa, that these benefits should be extended automatically on an unconditional MFN basis. See \textit{Australian} 29-8-94: 'Key group rules out APEC trade bloc'; \textit{Weekend Australian} 8/9-7-94, p.24: 'What price free trade?' While Bergsten (1994, pp.24-25) agreed that the extension of benefits to non-members on an unconditional MFN basis might be possible on some issues such as competition policy and industrial standards, and in sectors in which APEC members already dominate, he argued in favour of preferential treatment for members as a general rule. This, he maintained, was the accepted practice in all sub-regional trade agreements in the Asia Pacific and would avoid free-riding by other countries and trading entities, in particular the European Union, which would have no incentive to undertake similar liberalisation. According to Bergsten, the US domestic political opinion was particularly sensitive to 'free riding' and any Asia Pacific free trade arrangement that permitted this 'would run afool of domestic political realities in the United States and most other APEC members.' On the other hand, the temporary adoption of a conditional MFN approach to regional trade liberalisation by APEC, Bergsten asserted, would increase APEC's leverage in global trade negotiations and thus ensure maximum global liberalisation.

Those opposing Bergsten did so on the grounds that the adoption of a conditional MFN approach, even on a temporary basis, was against one of the fundamental principles of APEC, that of open regionalism. See Garnaut 1994; and Chapter Three, p.103-06. Garnaut argued that the gains to the liberalising economy from liberalising were greater than those to so-called free-riders. According to Garnaut, '(i)t is a lesson of experience in the Asia Pacific economic community that the main gains accrue to the liberalising economy itself.' In 1995 the issue resurfaced in the form of a proposal by Australia and the US to have the principle of non-discrimination removed from the final communiqué to be adopted at Osaka. The US position was that Osaka should not make a decision on conditionality but should concentrate instead on the actual reduction of tariffs. See \textit{Australian Financial Review} 19-6-95, pp.1,5: 'Push to turn APEC into trade bloc'; \textit{Australian Financial Review} 21-6-95, p.3: 'Aust move to drop principle'; \textit{Australian Financial Review} 28-6-95, p.12: 'Move for APEC action next year'. The ASEAN countries were also divided on this issue, with Singapore favouring liberalisation on a conditional MFN basis, and Malaysia and Indonesia on an unconditional MFN basis. See Soesastro 1994b, p.353.

\textsuperscript{187} According to the APEC EPG (1994, p.26), the NIEs were to achieve the goal over a period of about 15 years. In the lead up to the Bogor APEC meeting the US had originally opposed the setting of an earlier free trade deadline for developed countries than that for developing countries on the grounds that it would enable China to free ride. (See Soesastro 1995, p.4).
China, however, claimed that this review was contrary to APEC’s commitment to the principle of non-discrimination.188

APEC members are also divided on the question of how regional trade liberalisation should be achieved. In the lead up to the Osaka Summit, Japan, the host of the summit, proposed the adoption of a concerted unilateral approach to regional trade liberalisation, whereby individual countries would draw up and implement their own liberalisation programme subject to regular group review and with common finishing dates.189 The US and Canada, however, were in favour of a common or collective approach and had wanted APEC leaders to adopt a series of sector specific liberalisation programmes and targets that all members must adhere to.190 As with the issue of non-discrimination the US was concerned that a voluntary approach to trade liberalisation would leave the way open for other countries to free ride and was therefore not likely to gain Congressional approval.191 The ASEAN countries in particular opposed the collective approach which they feared would require the establishment of a powerful regional bureaucracy to enforce the liberalisation programmes.192 They no doubt saw this approach as a threat to their own sovereignty in terms of economic policymaking.193

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188 See Australian Financial Review 17-11-95, p.26: ‘Ministers thrash out an acceptable compromise’. At Osaka APEC members accepted a compromise solution whereby the principle of non-discrimination, though reaffirmed, was diluted somewhat by the qualification that APEC economies ‘will apply or endeavour to apply’ (emphasis added) it between and among themselves in the process of liberalisation and facilitation of trade and investment. (See The Osaka Action Agenda 1995, p.1). The Action Agenda also reaffirmed that the benefits of regional trade and investment liberalisation would also be extended to non-members but avoided specifying whether that would be on a conditional or unconditional MFN basis. This non-decision prompted a warning from Bergsten that ‘APEC cannot continue to ignore the issue of how to treat non-member economies.’ (See Australian Financial Review 20-11-95, p.5: ‘It's going to be tough getting through 1996’).


191 According to US Under Secretary of Commerce, Jeffrey Garten, the US was rather sceptical about the willingness of the APEC countries to move ‘beyond the rhetorical profession of wanting free trade.’ See Australian Financial Review 26-9-95, p.10: APEC free-trade roadblock. On the eve of the Bogor APEC economic leaders’ summit a trade advisory committee to President Clinton declared that corporate support for APEC would be threatened if APEC failed to deliver immediately on promises to liberalise trade and investment in Asia. See Australian Financial Review 9-11-94, p.14: ‘Doubts surface among Washington insiders’. Paula Stern, a member of the President’s Advisory Committee on Trade Policy and Negotiations and former chair of the US International Trade Commission, was highly critical of the failure of APEC to produce concrete results and called on APEC to adopt the NAFTA extension approach to free trade in the Asia Pacific. This approach had been previously rejected by the EPG. See above this chapter, fn.166. At a press conference immediately after the Bogor summit Clinton attempted to allay US concerns about free riding when he declared that ‘(u)nder this agreement, individual APEC nations will have to tear down trade barriers to reap trade benefits. And, no country will get more benefits than it gives, no free riders.’ See Sydney Morning Herald 19-11-94, p.32: ‘A brave new world’. Nevertheless, scepticism in the US about APEC’s usefulness and its ability to achieve its goal of regional free trade by 2020 is still strong. According to Paula Stern, APEC’s focus on 2020 was diverting attention from more practical and concrete measures to bring about an immediate reduction in trade and investment barriers. See Australian Financial Review 8-11-95, p.14: ‘US think-tank dismisses APEC’s track record’.

192 Australian Financial Review 30-6-95, p.3: ‘APEC urged to abandon trade discrimination’. These fears were reflected in an earlier debate at the 1993 Seattle APEC meeting over an
The third question concerning the comprehensiveness of regional trade liberalisation also divided APEC members in the lead up to the Osaka summit. China, South Korea, Taiwan and Japan wanted some sectors, particularly agriculture, to be excluded at least initially and a more flexible liberalisation timetable while the US, Australia and Singapore wanted all sectors to be liberalised and strict adherence to the 2020 timetable. Both Australia and the US argued that APEC would have little to offer if agriculture was excluded from the liberalisation process. The issue threatened to derail the whole unsuccessful proposal - recommended by the APEC EPG and supported by Australia, South Korea and the United States - to change the name of APEC from Asia Pacific Economic Cooperation to Asia Pacific Economic Community. Some participants had argued that 'Community' was too strongly associated with the European Community. See statement by Rafidah in the Australian 22-11-93, p.13: 'Community focus of controversy'. See also Sydney Morning Herald 20-11-93, p.1: 'Keating rebuffed on trade group'; and Australian Financial Review 23-11-93, p.12: 'Take one step at a time, Keating told'. As a result of the considerable opposition to the suggested name change, the APEC EPG in its second report (1994, pp.34-35) ruled out any such change. It also rejected the name Asia Pacific Free Trade Area because of its association with so-called closed regionalism. The achievement of free trade in the region, it declared, would be in accordance with its credo of 'open regionalism' in that it would aim to 'ratchet up' the expansion of world trade through constant interaction between APEC and the GATT system.

Although the US was willing to accept the concerted unilateral approach it made its acceptance conditional on the adoption of a disciplined and structured consultation and review process. Malaysia and China, however, wanted consultations to be merely information exchanges. (See Australian Financial Review 26-9-95, pp.1, 10: 'APEC roadblock'. Australian 16-11-95, p.55: 'White House happy with fresh veneer'). The US Assistant Secretary of State for East Asian Affairs, Winston Lord, argued that it was crucial 'there be a review process that ensures everyone is making an earnest and fair and equitable attempt to liberalise.' In their Declaration for Action issued at the end of their summit in Osaka the APEC Economic Leaders noted that the success of the concerted liberalisation approach would hinge on their 'own continuing efforts, strong self-discipline, and close consultation.' According to the Osaka Action Agenda, the consultations will be informal and 'will be an on-going collective effort of a confidence-building nature in order to facilitate the exchange of information on progress in the preparation of Action Plans, ensuring transparency and contributing toward attaining the comparability of respective Action Plans.' The APEC Senior Officials Meeting (SOM) will review the overall progress of APEC economies' actions and submit a report to the annual Ministerial Meeting for review.

The differences between the Asian APEC members and the US over the best way to achieve the goal of regional free trade has led some scholars and regional analysts, particularly those from East Asia, to claim that there is a distinct Asian approach to regional trade and investment liberalisation and facilitation. The Indonesian member of the EPG, Suhadi Mangkusuwondo (1994, pp.294-95), has contrasted the evolutionary approach of the Asian countries to the legalistic approach of the US. According to Mangkusuwondo, 'the "Asian" approach is to agree on principles first, then let things evolve and grow gradually, rely on the market to set the pace for economic integration, with minimum government intervention or direction.' The US approach, he maintains, is to start with legally binding commitments. The contention that these different approaches are culturally based would appear to lend support to Mahathir's argument that the EAEC is the more viable regional arrangement. See Australian 17-2-95, p.7: 'Talks fail to end APEC split on trade'; Australian Financial Review 6-7-95, pp.1, 6: 'APEC free trade threat'; Australian Financial Review 11-10-95, p.4: 'APEC free trade plan suffers setback'. Japan had included in the first draft of the Action Agenda a clause that would have permitted members to give special treatment to certain industries. ASEAN was also divided over this issue, with the Philippines and Malaysia supporting Japan and Indonesia, Thailand and Brunei upholding the principle of comprehensiveness. See Australian Financial Review 15-11-95, p.13: 'Divisions emerge again, this time on agricultural front'; Australian 16-11-95, p.35: 'Farming impasse highlights strain on forum's unity'.

See statement by Assistant US Trade Representative Nancy Adams, Australian Financial Review 6-10-95, p.28: 'Long haul ahead for APEC. Australia is reported to have threatened to walk away from the APEC Agenda if agriculture was excluded. See Australian Financial Review 16-10-95, p.1: Australian threat to dump APEC. It is also said to have threatened not
APEC process until Australia managed to convince Japan that there was no need to include a provision for special treatment for specific sectors or industries in the Action Plan since under the concerted unilateralism approach countries could vary the pace of liberalisation for individual sectors or industries.196

Conclusion

This chapter confirms the three preliminary conclusions of the EC, CUSFTA and NAFTA case studies concerning the emergence of institutionalised regional economic integration in the 1980s and early 1990s. First, regionalism in the Asia Pacific was not the result of a single factor but of multiple inter-related and mutually reinforcing factors. Second, these factors were not identical nor were they of equal significance for the countries involved. Finally, although there are factors that are common to the case studies the relative importance of these common factors in each of the cases is not the same.

There are of course many differences both in the nature and the path taken between the institutionalised regional economic integration in the Asia Pacific and that in the EC and North America. Perhaps the most important difference has been the form of the agreement to establish regional free trade. Whereas in the EC and North America the agreement took the form of a formal document which was ratified by the legislatures of the countries concerned, in the case of APEC, the agreement itself is an informal pledge given by the leaders of the APEC economies but without the force of a legally binding document. To some extent this explains why APEC is not as institutionalised as either the EC or NAFTA. In the absence of a legally binding agreement there is no immediate need for a regional mechanism to ensure adherence to the agreement and APEC members have had difficulty in agreeing on a dispute settlement arrangement.

Yet despite these obvious differences, one is struck by the similarity of the factors involved in both the decision in 1989 to establish APEC and the APEC decision five years later to achieve regional free trade with those factors identified in the other case studies. As in the other case studies these factors identified in this chapter also support the five propositions that were advanced at the end of Chapter Three as possible explanations for the (re-)emergence of institutionalised regional economic integration in the 1980s and early 1990s. The factors identified in this chapter provide definite confirmation of the first proposition that institutionalised regional economic integration was a response to the

196 to support Japan’s push for a permanent seat on the UN Security Council. See Australian Financial Review 21-11-95, p.10: ‘Japan’s agriculture stand tested Keating’. Australia’s Prime Minister Keating also warned that the exclusion of agriculture from the free trade process would encourage others to seek to exclude other sectors and could thus paralyse APEC. See Australian Financial Review 6-10-95, p.28: ‘Long haul ahead for APEC’. Australian Financial Review 18/19-11-95, p.4: ‘Secret deal led to breakthrough’. Although the Osaka Agenda enshrined the principle of comprehensiveness, that principle was qualified by the inclusion of the principle of flexibility, which gave APEC economies the right to vary their liberalisation programmes to take into account ‘the different levels of development among the APEC economies and the diverse economic circumstances in each economy’. See The Osaka Action Agenda 1995, pp.1-2. See also Australian Financial Review 15-11-95, p.12: ‘Japan leads the way to agreement’. 
undermining of the liberal international trading regime and the associated rise of protectionism, particularly in the US. We have seen that APEC was partly the result of the desire of the countries of the region to maintain both the economic interdependence and economic dynamism of the region in the face of growing uncertainty regarding the durability of the multilateral trading system and the word-wide trend towards unilateralism, bilateralism and regionalism. Yet whereas the decision of the Mexican and Canadian governments to seek an FTA with the US was clearly an attempt to find an alternative arrangement that would guarantee access to the markets of their most important trading partners, the decision to establish APEC for most the countries involved was more an attempt to maintain and improve the multilateral trading system rather than to create an alternative to it. They hoped that APEC would increase their bargaining position in the Uruguay Round and thus force the EC to compromise further. They also hoped that by including the US in APEC they might be able to exert greater influence over the direction of US trade policy. APEC, they believed, could provide much needed support to the multilateralists in the US in their battle over control of US trade policy with the unilateralists and bilateralists.

It is true that some countries also saw APEC as a fallback position should the Uruguay Round fail and that Australia saw APEC as a vehicle for regional trade liberalisation and later with the US as a possible preferential free trade arrangement. However, most of the East Asian APEC members were initially opposed to regional trade liberalisation, fearing that it would only reinforce the trend to regionalism elsewhere and thus ultimately undermine the multilateral trading system even further. Although they eventually agreed to achieve regional free trade by 2020, there is still considerable opposition to any APEC preferential trade agreement.

The US decision to join with the other Asia Pacific economies in the establishment of APEC, as with its previous decision to create CUSFTA and its subsequent decision to form NAFTA, also reflected a desire to bolster the multilateral trading system. Like the other Asia Pacific economies, the US believed that APEC would increase pressure on the EC in the Uruguay Round negotiations and thus help bring these negotiations to a more successful and rapid conclusion. But it also saw APEC as a means of increasing pressure on some of the East Asian economies to grant US exporters better access to their markets. In this way APEC could, they believed, help reduce the chronic US trade deficit with East Asia and thus weaken support for those within the US who were calling for the strengthening of unilateral trade retaliation instruments such as Super 301.

197 Like the Canadian and Mexican governments, the Hawke government in Australia had seen the maintenance and enhancement of the multilateral trading system as essential to the success of its efforts to increase its manufacturing exports and to attract the foreign investment needed to restructure and modernise its manufacturing base. Yet when that system seemed increasingly threatened, Australia, rather than seeking to ensure its access to the US market through a bilateral free trade agreement like Canada and Mexico, sought a way both to bolster support for that system and to maintain and enhance its access to the fast-growing East Asian markets.
The factors identified in this chapter as having led to the establishment and consolidation of APEC also support the second proposition, that institutionalised regional economic integration is a type of economic alliance that states enter into in order to enhance their economic and political security and more importantly to boost their competitive position in the global economy.

We have seen in this chapter that the APEC economies had come to see APEC as vital to the maintenance and enhancement of their economic and political security. The ASEAN countries in particular felt that the maintenance of strong economic growth was essential to their continued internal political and social stability, to their national resilience. Much of that growth was export-driven and thus largely the consequence of growing regional and international economic interdependence. This economic interdependence, they believed, was underpinned by both the rules-based multilateral trading system that had been established at the end of WWII and the stable regional security environment that was the result of the US military presence in Japan and the Philippines. With the multilateral trading system now being eroded and with the increasing likelihood of a reduction in the US military presence in the region following the end of the Cold War, they perceived that economic interdependence to be under threat. They saw APEC as a way to ensure the continuation of economic interdependence and the resulting regional economic dynamism. They believed that APEC would do this by increasing the bargaining position of those countries who depended most on the multilateral trading system for their economic welfare. It would also ensure that the US remained economically and militarily engaged in the region and thus prevent other regional military and/or economic powers such as Japan and China from dominating the region.

At the same time the smaller Western Pacific economies believed that APEC would enhance their economic security by constraining the political and economic power of the dominant regional powers, Japan and US, and giving them a greater say in decisions affecting their economic welfare. More particularly it would help ensure that Japan and the US did not settle their bilateral dispute at the expense of other regional countries.

The US also recognised the utility of APEC in maintaining its own economic and political security. With the end of the Cold War and the growing economic strength of the East Asian economies the US sensed that its influence in the region was waning. It felt that a multilateral forum such as APEC would enable it to preserve its strategic role as balancer in the region and thus prevent the region from falling under the sway of another power.

Asia Pacific economies also saw APEC as a means of enhancing their competitive position in the global economy countries. Australia, New Zealand, Canada and the US in particular hoped that APEC would help them consolidate their ties with the dynamic East Asian economies and thus ensure that their economies also benefited from that economic dynamism. They were convinced that membership of a regional economic forum such as APEC would enable national firms to boost their competitive position in world markets by
providing them with increased economies of scale, greater opportunities for specialisation, more efficient allocation of resources and increased competition.

APEC was a response to the growing competitive nature of international environment in the 1970s and 1980s and in particular to the idea that institutional regional economic integration could enhance a country's international competitiveness. The establishment and more particularly the consolidation of APEC was partly motivated by the desire to offset the benefits that other countries were said to derive from their membership of regional economic arrangements such as the EC and NAFTA. APEC was also a response to the erosion of the rules-based multilateral trading system and the increasing use of economic and political leverage in trade negotiations. The Asia Pacific economies saw the need to band together to increase their own leverage in international economic fora.

The APEC case study does confirm to some extent the third proposition, that institutionalised regional economic integration is a defensive reaction among rival capitalists and rival states, whereby both firms and states come to see their welfare from a regional rather than a purely national perspective and there is a nascent regional identity and consciousness. Thus we have seen in this chapter, that growing economic interdependence among the countries of the region and the establishment and consolidation of regional trading arrangements in Europe and North America had given rise to the awareness of the region as an entity with its own interests to defend. Nevertheless, as we noted to the beginning of this chapter, unlike in the other case studies, there is considerable disagreement as to what constitutes the region. Is it a region called East Asia composed of Southeast and Northeast Asia? Is it the Western Pacific made up of East Asia and Australia and New Zealand? Or is it the Asia Pacific taking in both rims of the Pacific Ocean?

As we have seen in this chapter, Australia had originally perceived the region to be the Western Pacific. It argued that as a result of the increase in the Western Pacific's share of world trade and world production, the region was under represented in international economic fora. There was a need, Australia argued, for a stronger Western Pacific voice to ensure that the interests of the region were not overshadowed in the Uruguay Round of multilateral trade negotiations by the world's economic giants, the US and the EC. Following the invitation to the US and Canada to join APEC, however, the Asia Pacific soon replaced the Western Pacific in Australian official discourse. More recently there has been a further shift in that discourse with Australia now said to be part of the East Asian Hemisphere as well as the Asia Pacific region. This shift reflects growing Australian concern about its possible exclusion from an East Asian region. Malaysia has steadfastly opposed the attempt to define the region as the Asia Pacific and has advanced its own proposals for an East Asian region. It has been argued that the rapid increase in market-driven economic interdependence in East Asia has led to the emergence of a sense of East Asian identity, consciousness and pride, of an East Asian culture and way of doing things. Part of this shared identity was the result of the desire by other East and Southeast
Asian countries to emulate the economic success of Japan. The adoption of a Japanese model of economic development by these countries has led to the emergence of shared values and practices and of a belief that there is something distinct about East Asia which sets it apart from Europe and North America. More recently, the differences between the Asian APEC members and the US over the best way to achieve the goal of regional free trade has led to the assertion that there is a distinct Asian approach to regional trade and investment liberalisation and facilitation.

The establishment and consolidation of APEC also provides some confirmation of the fourth proposition that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence. However, the establishment and subsequent consolidation of APEC was not the result of a desire by Asia Pacific countries to offset any decline in their ability to regulate their national economies through the joint exercise of certain regulatory powers with other countries at the regional level. It therefore does not support this more specific component of the fourth proposition. As in the two North American case studies, countries saw APEC trade facilitation and liberalisation as a way to hasten the pace of deregulation rather than as a means of reasserting government control of the market. The shift in the economic paradigm from Keynesianism to economic liberalism and the corresponding shift in the direction of economic policy from import substitution to export oriented industrialisation had made governments less concerned with maintaining strong regulatory control of the economy. At the same time as can be seen by the considerable opposition to the institutionalisation of APEC and the adoption of the concerted unilateralism approach to trade liberalisation, some APEC members, in particular the developing countries of ASEAN, were fearful that any formal cession of sovereignty to a regional authority would only increase the ability of Japan and the US to interfere in their affairs. If anything they hoped that by reducing the ability of governments to regulate imports of goods and capital, APEC would limit the increased opportunity that this growing economic interdependence had given the US and Japan to influence their policies. It would also prevent governments from shifting the adjustment costs of growing interdependence - largely the result of shifting comparative advantage - through increased protectionist measures onto their trading partners. Thus the view held by the governments in the Asia Pacific of regionalism is generally more in accordance with that of Hayek and Olson than that of Philip and Erhard. (See Chapter Two, pp.39-44).

As was the case in the other case studies, many governments in the Asia Pacific saw institutionalised regional economic cooperation as a means of maintaining and boosting domestic economic growth and thus increasing their chances of remaining in power. This was particularly important for the ASEAN countries, where economic growth was seen as crucial to both national and regional resilience. Some countries, such as Indonesia, also saw APEC liberalisation agreements as a way of disciplining domestic protectionist forces, which they believed were obstructing economic growth.
The establishment and consolidation of APEC provides further confirmation of the fifth proposition, that institutionalised regional economic integration is the result of cognitive change.

We have seen in this chapter that the shift in the dominant economic paradigm from Keynesianism to economic liberalism and a corresponding shift by regional policymakers in their economic strategy away from import-substitution towards export oriented growth made policymakers more favourably disposed towards institutionalised regional economic integration. This was true not only of the developed countries - Australia, New Zealand, Canada, the United States and Japan - but also of the developing countries of ASEAN, who in the past had been opposed to intergovernmental regional economic cooperation between developed and developing countries. The success of previous experiments with export-oriented growth both at home and elsewhere in East Asia had increased the willingness of governments to listen to the advocates of export-oriented growth and deregulation. At the same time the growing economic problems experienced by countries that continued to pursue import substitution had weakened the influence of the proponents of opposing policies. As a result policymakers became more concerned about maintaining and enhancing their access to export markets. They were thus more willing to accept regional agreements that would limit their ability to regulate the import of goods and capital if as a result of similar actions by other countries their own access to foreign markets and capital was enhanced. Countries have learnt the value of regional economic agreements in reducing economic uncertainty and in increasing national economic security and welfare. They are less inclined than in the past to fear the loss of formal economic sovereignty that such agreements entail. At the same time they have accepted the idea that regional economic agreements can enhance the international competitiveness of their firms by providing them with increased economies of scale, greater opportunities for specialisation, more efficient allocation of resources and increased competition. A larger market, they believed, would also make them more attractive destinations for foreign investment. Thus it would seem that through its close association with liberal economics regionalism has regained favour with the countries of the Asia Pacific.

The APEC case study also supports the argument that institutionalised regional economic integration is the result of the adoption by policymakers of certain ideas favourable to regionalism due to the lobbying and influence of epistemic communities and/or existing regional institutions. We have seen in this chapter that the growing acceptance by countries of the need for APEC, particularly by those who in the past had been most opposed to the idea - the developing countries of ASEAN - can be attributed in part to the growth of a pro-regional cooperation network in the countries concerned and to the increasing ability of that network to influence government policy.
CHAPTER NINE
CONCLUSION

Having reviewed the various theoretical explanations for the emergence of regionalism in Chapters Two and Three and identified the principal causal factors behind the emergence and/or re-emergence of regionalism in the 1980s and early 1990s in three regions - Europe, North America and the Asia Pacific, I will now draw some conclusions regarding the emergence of the new regionalism. Since some preliminary conclusions as to the causes of regionalism in a specific region have already been drawn at the end of each of the case studies, the focus here will be on the comparison of causes across regions and an attempt will be made at an explanation for the emergence of regionalism in the 1980s and early 1990s that fits all three regions.

I revisit first the three possible causal explanations or hypotheses as to the revival of regionalism that were advanced in Chapter One. Then I attempt to answer rather briefly the series of specific empirical and theoretical questions that were also raised in Chapter One concerning the causes of regionalism and which had been categorised by levels of analysis. I then return to the propositions listed at the end of Chapter Three concerning the re-emergence of regionalism in the 1980s and early 1990s. Again the focus here is on a comparison across regions as there has already been an extensive discussion at the end of each of the case studies of the significance of each of the propositions in explaining the emergence of regionalism in that case study. A brief attempt is made to establish the relative importance of each of the propositions in accounting for the emergence or re-emergence of regionalism in each of the regions studied. Since cause is not only about positive forces shifting towards regionalism but also about the negative forces or resistances that must be overcome, there follows an examination - albeit also brief - of several propositions concerning the resistances to the new regionalism. I then reassess some of the specific theories that were identified in Chapters Two and Three, such as customs union theory, interdependence theory and social learning, in the light of the findings of the case studies. At the same time I compare and contrast the causal explanations accounting for the new regionalism of the 1980s and 1990s with those accounting for the regionalism of the 1950s and 1960s. Finally I attempt to construct a theory accounting for the rise of the new regionalism.

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1 See p.15.
2 See pp.9-12.
The broad hypothesis proved or disproved

In Chapter One three possible causal explanations or hypotheses were advanced concerning the revival of regionalism:

First, regionalism in the three case studies may be principally a reaction to developments in the international economic and political systems. Nevertheless, the relative importance of these same developments in bringing about regionalism may differ in each of the regions.

Second, regionalism may principally arise from some sort of interactive chain reaction in that regionalism in one area may provoke an extension of regionalism in another.

Third, it is possible that there are no common causal factors across regions. In this case, the fact that these moves to regions occurred in the 1980s would be coincidental.

From the case studies in this thesis it is clear that the third causal explanation that the moves towards regionalism in the 1980s and early 1990s were coincidental and unrelated cannot be sustained. Although there were some factors that were specific to a particular case study - the desire for political union in the case of the EC or US concerns about the political, economic and social stability of Mexico in the case of NAFTA, there were also many factors that were common to all three regions.

It also apparent from the case studies that neither the first nor the second causal explanation is, by itself, sufficiently robust and that both are necessary to account for the emergence of the new regionalism. In all three regions the move towards regionalism was clearly a reaction to negative developments in the international economic and political systems. It was in part a specific response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US. It was also partly the result of an ideational shift in terms of economic doctrine away from Keynesianism and import substitution industrialisation to economic liberalism and export-oriented economic growth.

Yet it is also apparent from the case studies that the new regionalism was to some extent also the result of a kind of interactive chain reaction, with regionalism in one area provoking an extension of regionalism in another. This was particularly true of both APEC and NAFTA, which were not only both reactions to the EC Single Integrated Market but to each other. The chain reaction, really a spiral of mutual anxiety, is also evident in the argument of the EC Commission that the Single Integrated Market was essential if European firms were to enjoy the same access to a vast market as their American and Japanese competitors. In this way the spiral of anxiety about competitive regionalism resembles in some respects the spiral of competitive security reactions in international relations.

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3 APEC was in part a reaction to CUSFTA, and NAFTA was partly a reaction to APEC.
It is indeed difficult to establish which of these causal explanations is the principal one as it is clear from the case studies that they are in fact mutually reinforcing. Thus the undermining of the GATT and the rise in protectionism increased the importance of securing access to a large market, while concern that secure access to a large regional market was in some way the reason for the increasing international competitiveness of firms led governments to adopt regionalism in order to counter moves to regionalism elsewhere. Concern about competitiveness reinforced the ideational shift to economic liberalism and at the same time that shift made governments more willing to take up the regional option. These ideas were carried to fruition by specific political and intellectual elites in each of the regions so that the role of elites in reaction to these causal circumstances and in forwarding the rise of the new regionalism was crucial.

Answering the specific empirical and theoretical questions posed in the Introduction

I now return to the series of specific empirical and theoretical questions that were raised in Chapter One in the context of the broad causal question posed by this thesis. The answers here will be necessarily brief and often tentative. Many of these questions have been already dealt with at greater length in Chapters Two and Three, while others involve issues which are beyond the purview of this thesis and require a more detailed examination that is not possible here. For these, I have been content to show how the findings of the case studies might illuminate the question and suggest ways in which the question might be further pursued. In re-examining these questions I will retain the categorisation by level of analysis - systemic, inter-regional, region-specific, and intra-state - that was employed in Chapter One.

System-level questions on the causes of regionalism

In Chapter One we asked whether long run historical factors constituted the main cause of the new regionalism and suggested the end of the Cold War and the economic rise of East Asia as two possible long run historical factors at the system-level that might have had an impact on the recent resurgence of the phenomenon of regionalism. The findings of the case studies in this thesis do not appear support the argument that the end of the Cold War was a significant factor in the emergence of the new regionalism at least initially. Thus the initial moves towards regionalism in the 1980s in Europe, North America and the Asia Pacific preceded the end of the Cold War. As we have seen in Chapters Four and Five, attempts by Reagan in the early 1980s to revive the Cold War divisions had brought France and West Germany closer together and thus contributed indirectly to the push for an economically and politically more unified Europe that could exercise a greater, more moderating influence over US foreign policy. It was only later
with the fall of the Berlin Wall and the reunification of Germany that the end of the Cold War became a significant factor in moves towards greater political unity in the EC. The end of the Cold War also played no role in the Canada-US FTA and in the establishment of APEC, except to the extent that it eventually shifted security calculations to more positively involve the US in APEC. Indeed, as we have seen in Chapter Eight many of the ASEAN countries at the time of APEC’s establishment in 1989 were still reluctant to join a regional organisation that might be seen as aligning them to the US camp. However, the end of the Cold War was a factor in the both NAFTA and the consolidation of APEC after 1989. This change made it easier for Mexico to contemplate compromising its position of non-alignment through the signing of an FTA with the US and resulted in a re-ordering of US priorities such that an agreement that might guarantee political, economic and social stability in Mexico became an important foreign policy objective. In the Asia Pacific, the end of the Cold War not only saw increased support from ASEAN countries for APEC as a multilateral framework that could keep the US engaged in Asia but also led to a reappraisal by the US of the importance of such a framework in maintaining its influence in the region.

While the end of the Cold War was not a factor in the initial moves to regionalism in the 1980s, the same cannot be said of the economic rise of East Asia. We have seen in Chapters Four, Five, Six and Seven how the rise of and the economic challenge presented by East Asia to the so-called developed economies was a significant factor in moves in Europe to establish the Single Integrated Market and in moves in North America to establish CUSFTA and NAFTA. We have also seen in Chapter Three and elsewhere how that rise had not only sparked concerns about declining economic competitiveness and rising protectionism but had cast doubts on the fairness of the GATT system and even on the validity of the doctrine of free trade itself. These doubts and concerns were important factors in the moves to regionalism in the 1980s. The economic rise of East Asia was also an important factor in the moves towards regionalism in the Asia Pacific. We saw in Chapter Eight how the growing complementarity of the Asia Pacific economies that was an outcome of East Asian economic growth had increased support, particularly among Western Pacific countries, for a multilateral framework that could preserve the growing economic interdependence of the region against rising protectionism and a trend towards bilateralism, particularly on the part of the US. At the same time the economic rise of East Asia had augmented US fears that growing intra-East Asian economic interdependence might weaken the ability of the US to influence the region through its web of bilateral arrangements and made it more amenable to the establishment of a multilateral economic framework.

Thus this thesis partly confirms the two very broad observations that were made in Chapter One about the causes of the new regionalism. As we have seen in the case studies, the new regionalism was an outcome of a new set of principally economic factors, related
to the rise of Japan and the East Asian economies, and to the global recession in the 1970s and early 1980s, factors that pre-dated the end of the Cold War. Thus states in Europe, North America and the Asia Pacific came to see regionalism as a way of restoring national economic growth that had fallen considerably during the global recession, and of increasing the international competitiveness of their firms to offset the growing challenge from East Asia. The case studies also show how the end of the Cold War and the transformation of the international political system has shifted the new regionalism from being essentially an economic phenomenon to a complex mix of politico-strategic and economic developments. This is particularly evident in the Asia Pacific where APEC was seen as necessary to the maintenance of economic and political security in the region. Political and security considerations were far less significant in the establishment of CUSFTA prior to the end of the Cold War than they were in the US decision to enter into an FTA with Mexico. They were also a less important factor in the establishment of the EC SIM than they were after the end of the Cold War in the signing of the Maastricht Treaty.

The thesis also sheds light on the important neo-realist/neo-liberal question of how is it that states, which are said in realist accounts to generally pursue strategies based on self-help and self-interest, have embarked on a process of cooperation, that implies an actual, if not formal, devolution of sovereignty. It shows how, at a time when economic issues have been placed at the top of the policy agenda of most states, relations among states are increasingly determined by economic as well as security interests. It may be the case, as the neo-liberals have argued, that in dealing with economic issues states are more likely to seek the benefits of cooperation and be willing to sacrifice some elements of national economic sovereignty to achieve these.

Thus in a period when economic issues are accorded a high priority, it is not surprising that cooperation among states, albeit at a regional level, has also increased. States, it would seem, are redefining their national interests as now being found in regional interests. This redefinition, which may or may not be lasting, was the result of an ideational shift in economic policymaking from Keynesianism to economic liberalism and the economic crisis that helped bring it about, and of learning about the beneficial effects of cooperation from past experiences.

Nevertheless, there are two serious qualifications to this. First, this increased cooperation at a regional level is the result of increasing economic competition and conflict at the global level and of an associated rise of economic nationalism at the domestic level. Thus states perceive themselves as being engaged in the struggle for economic survival in the global economy and are willing to enter into strategic economic alliances with other regional states in an effort to boost their national economic competitiveness. Second, in agreeing to the partial loss of formal economic sovereignty that is entailed by membership of a regional trading arrangement, states paradoxically appear to have reinforced their position both at home and internationally. Thus, a state that
is party to a regional agreement may have lost its right to arbitrarily restrict the access of the other signatories to its domestic market but, because the other parties to the agreement have also forsworn this right, the economic security of the state is enhanced. Thus the risk of free riding is diminished and the virtues of economic security are enhanced. Such agreements also reinforce the position of the state both as an important domestic arbiter and as a regional and international player. It determines access to foreign markets and the terms on which its own firms compete with foreign firms in domestic and foreign markets, and it enjoys privileged relations with states of its own region and increased bargaining power in international fora through its membership of a regional economic alliance.

The further neo-realist/neo-liberal question of whether the new regionalism is a consequence of declining US hegemony and the shift to multipolarity has already been discussed extensively in Chapter Three so I will restrict myself here to the further insights into this question provided by the case studies. It is clear that an important causal factor in the new regionalism, in North America and the Asia Pacific in particular, was the erosion of the liberal international economic order and of the confidence of countries in that order. However, as we have seen in Chapter Three, the argument that this erosion was a product of the decline in US hegemony is highly contested, as is the exact nature of the link between hegemony and the liberal international economic order. What is apparent is that the relative decline in US economic superiority vis-à-vis the other economic poles of Europe and East Asia has facilitated the development of the new regionalism, though the situation is somewhat complicated by the dependence of the key economic states of these poles - Germany and Japan - on the US militarily. It is also apparent from the case studies that this relative decline has seriously undermined what many consider to be an essential condition for a liberal international economic order, namely the continued support of the hegemon for liberal ideology generally, and for the liberal international economic order in particular. Faced with the declining competitiveness of many of its industries, the US has supplemented - or even replaced as some would argue - multilateralism with unilateralism, bilateralism and regionalism, in an effort to achieve an international trading order that better reflects its own national interests. However, that relative decline in US economic superiority, together with a decline in the need for US military protection in the eyes of the other states, has made it difficult for the US to persuade the other states to agree to the changes that it wants. In such a situation regionalism provides both a bargaining chip to increase the pressure on others to accept those changes and a fall-back position should that acceptance not be forthcoming. What is paradoxical in all this is that the ideational shift to economic liberalism which on the surface would seem supportive of the liberal international economic order has in fact accentuated the economic rivalry and competition among states that threatens to undermine that order.

As for the question of how this resurgence of regionalism has been affected by changes in the international political economy, such as the breakdown of the Bretton
Woods system of world economic regulation or the oil price rises of the 1970s, this thesis shows that these changes were strongly significant in the rise of the new regionalism. The collapse of the Bretton Woods system of world economic regulation returned to state hands control of the exchange rate. While this provided states with an important means of boosting the international competitiveness of their firms by undervaluing their currencies and hence led to the competitive environment that later saw states turn to regionalism, it also removed what had been previously seen as an important underpinning of the liberal international trading order - the assurance that no state could gain unfair advantage through the manipulation of its exchange rate - and thus was an important factor in the loss of confidence in that order. The oil price rises (and falls) of the 1970s and 1980s were also conducive to the rise of the new regionalism. The rises in the price of oil increased the concern of the developed, oil dependent economies about the declining competitiveness of their firms that was reflected in their growing trade deficits, and encouraged them to resort to devaluations to offset that decline. At the same time rising inflation, growing unemployment and stagnating economic growth led them to question the validity of Keynesian economic policies and to turn to more economic liberal policies that were more compatible with regional free trade. The falls in oil and other commodity prices had similar effects for the oil and commodity producing, developing economies. As we have seen with Mexico and some of the Southeast Asian countries (and even Australia and Canada), the decline in oil and commodity prices led these countries to abandon their previous development strategies of import substitution industrialisation in favour of export-oriented economic growth, a strategy that was ultimately to prove conducive to the new regionalism.

The thesis also sheds some light on the neo-marxist question of whether the resurgence of regionalism is a result of changes in the world capitalist system, themselves reflecting changes in the economic structure, changes in the mode of production and the composition of the historic bloc, or changes in the regime of accumulation and modes of regulation in particular capitalist states. As we saw in the EC case study, the rise of East Asia and particularly Japan as an economic force gave rise to fears within the EC that Europe was being left behind in the new technological revolution. Similar fears were also shared by policymakers in North America and in countries in the Western Pacific who like their counterparts in Europe saw regionalism as a means of shoring up their international competitiveness and maintaining their position in the world economic pecking order. The thesis therefore provides some support for a reading of regionalism à la Wallerstein as a way for states, that are members of the core or semi-periphery and that might otherwise be relegated to the semi-periphery or periphery, to maintain their status as a member of the core.

The thesis could also support an argument that changes in the mode of production and the composition of the historic bloc, or changes in the regime of accumulation and modes of regulation in particular capitalist states, have given rise to the new regionalism. Thus the
rise of East Asia has led to the claim that we are witnessing the development of a new more efficient Asian regime of accumulation or mode of regulation, which has forced the older regimes and modes of North America and Europe to retreat behind regionalist walls.

Yet the new regionalism is not simply a defensive reaction, a way of preventing or at least forestalling what many neo-marxists and regulationists see as the more desirable and inevitable globalisation of the world economy. It is perhaps principally perceived by states to be a means of boosting the international competitiveness of national firms in the global market. As we saw in Chapter Seven, US and Mexican policymakers had attributed Japan's success to the incorporation of the low cost labour of its regional neighbours into production processes or production sharing and believed that the competitiveness of US firms, in both the domestic and global marketplace, would be similarly increased through NAFTA. Thus regionalism here is seen as a new way to organise production and one which is largely state-driven. The thesis confirms that it is states rather than firms that have been at the forefront of the new regionalism, leading to the contention that the new regionalism may be in part a strategy by states to strengthen their position as the key interlocutors both domestically and internationally, a position that many saw as being seriously undermined by the globalisation of markets and finance.

The question of whether the re-emergence of regionalism in the 1980s and 1990s may have been influenced by the challenge to the ideas of the liberal economic orthodoxy of free trade from strategic trade theory and the concept of dynamic comparative advantage has already been discussed in some detail in Chapter Three. From the case studies it is clear that this challenge to the liberal economic orthodoxy of free trade had an indirect role in the rise of new regionalism by further eroding support for the liberal international economic order. By showing that, contrary to the previous belief that protectionism was self-defeating, states could theoretically benefit from practices that went against the liberal economic orthodoxy of free trade, the challenge to the liberal economic orthodoxy of free trade strengthened the position of those, particularly in the United States, who argued that the US should adopt measures such as Super 301 to force other states to abandon these practices. The case studies also show that the theoretical challenges to the liberal economic orthodoxy of free trade had a more direct role in the rise of the new regionalism by reinforcing the belief that, by creating larger markets through regionalism, states can increase the competitiveness of their firms.

Inter-regional level questions on the causes of regionalism

The question of whether the functional economic integration occurring in East Asia spurred the next stage of EC integration, which in turn spurred regionalism in other regions, has already been touched on at the system level. The case studies in this thesis largely confirm the importance of the chain reaction effect. Thus the economic rise of East Asia and Japan in particular was shown to be an important factor in the push for a Single Integrated Market in the EC, and in moves by Canada to form a FTA with the US and by
Mexico and the US to form NAFTA. In Chapter Eight we saw how concern about the growing trend towards regionalism both in the EC and North America was an important factor in the decision to establish APEC, while in Chapter Seven similar concerns about both the EC Single Integrated Market and APEC played an important role in the establishment of NAFTA. In some ways this could be seen as a variant of the beggar-thy-neighbour defensive regionalism of the 1930s. However, as has already been mentioned, the new regionalism is perceived by states as a means to increase the competitiveness of their firms in the global market and the attractiveness of their economies to global investors. Whether these goals are compatible with the closed regions of the EU and NAFTA remains to be seen.

As for the neo-marxist and neo-realist question of whether the rise of the new regionalism has been influenced by growing economic and political competition between the major states of the world, namely Japan, the US and Germany, and their inability to agree on macro-economic policy, this thesis clearly shows the heightened economic rivalry between the major economic powers to have been an important factor in the new regionalism. Because of this growing rivalry and of their inability to reach agreement on global macro-economic policy and on reforms to the GATT, these powers have sought to consolidate their bargaining position and increase their competitive edge by forming strategic trade alliances with other states in their regional hinterland. Of particular significance here is the growing coincidence of national interests among states of the same region and the associated rise of a regional identity.

Intra-regional level questions on the causes of regionalism

The findings of this thesis confirm the argument that the resurgence of regionalism has been due to a move by some or all of the members of an existing regional arrangement to prevent the erosion or collapse of that arrangement. In Chapters Four and Five we saw how the conviction of some EC members that further institutionalised integration was necessary to prevent the unravelling of existing ties played an important role in the establishment of the Single Integrated Market. There was some concern in the EC that regional functional regional integration was stagnating and had not gone far enough. There was a fear that the unravelling of the existing regional arrangement would decrease the bargaining power of the countries involved vis-à-vis the outside world and threaten to revive the intra-regional political enmities of the past. The members of the EC recognised the importance of regional political stability to economic prosperity and were prepared to sacrifice the less certain but possibly greater welfare gains of global free trade for the increased political stability that a reinforcement of existing regional arrangements might bring. In Chapter Eight we saw how some ASEAN members had held similar concerns

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4 The question remains however as to why other states decided to opt for a form of institutionalised regional economic integration in response to what they perceived to be Japan's functional regional economic integration.
about the negative effect that membership of a broader Asia Pacific economic arrangement might have on the cohesiveness of ASEAN itself. Although these concerns were not sufficient to prevent the establishment of APEC, they did slow down its institutionalisation and the adoption by its members of the goal of free and open regional trade. Indeed, it was only after the ASEAN states had consolidated their own regional organisation through the establishment of AFTA that the consolidation of APEC was possible. In North America, the situation was somewhat different to that in Europe and Southeast Asia, as there were no existing comprehensive regional economic arrangements. However, the request by Canada and to a lesser extent by Mexico could be seen as an attempt to preserve and extend the functional economic integration that existed between their economies and that of the US, integration that was being seriously threatened by rising protectionism in the US.

The thesis also confirms the importance of specific historical circumstances within a particular region in the recent resurgence of the phenomenon of regionalism. In Chapter Five we saw how the weakening of the attachment of certain European states to national sovereignty after World War II facilitated the first wave of regionalism in Western Europe on the 1950s and was still a factor in the second wave of the 1980s. The war had served to discredit nationalism and demonstrate how national sovereignty could no longer guarantee, and was perhaps even inimical to, the economic and social welfare of individual states. This was particularly true of West Germany, which saw a dissolution of German sovereignty within a European political union as the only way to reassure its neighbours and gain acceptance for German reunification. France had also seen economic union with West Germany as essential to the post war reconstruction of its economy but had reverted to nationalism under De Gaulle, bringing a halt to the integration process in Europe. However, with the economic gap between West Germany and France continuing to widen and with the failure of Mitterrand's Keynesian economic policies, France came to see its economic and social welfare and its status as a world power as dependent on closer European economic and political integration. This questioning of sovereignty was specific to Western Europe. However, in the Asia Pacific the situation of Japan was in some ways similar to that of West Germany in Europe. As a result of World War Two, Japan too found itself constrained in the pursuit of its foreign policy objectives and like West Germany saw regionalism as a means of achieving these in a way that reassured its neighbours and made them less fearful of Japan's economic revival. At the same time its dependence on the US for its military security has played an important role in determining the geographical scope of regionalism in the Asia Pacific.

In terms of the relationship between the resurgence of regionalism in the 1980s and growing regional functional economic interdependence, it is clear from the three case studies that, although the prior existence of functional regional economic interdependence was a necessary pre-condition for institutionalised regional economic integration, it was
the threat to the continuation of that functional interdependence rather than its continued growth that led to its institutionalisation. As we saw in Chapter Three, the role of the multinational enterprises and their production and investment structures in bringing about institutionalised regionalism is contested and the case studies appear to support the claim that the new regionalism was largely state-driven. Although multinational enterprises have played an important part in the growth of functional regional economic interdependence, their investment decisions have been influenced by government policies to promote regional economic ties and regional economic development. Thus Japanese development aid to Southeast Asia prepared the way for the export of its industry to Asia just as the Autopact between Canada and the US and Mexico's Border Industrialisation Programme gave an impetus to functional regional economic interdependence in North America.

From the discussion above it is apparent that the new regionalism is to a large extent politically driven and can be seen as a confidence building measure designed to lessen the risk of intra-regional conflict. This is obviously the case in Europe where the Single Integrated Market is largely another step in a process designed to lessen the risk of conflict between France and Germany in the EC. It is also the case in the Asia Pacific where APEC is perceived by its supporters as a means of reducing the likelihood of a trade war between the US and Japan and, more recently, as facilitating China's political and economic integration into the region. It is also true even in North America, where the free trade agreement between the US and Mexico can be seen as an attempt to reduce Mexico's traditional animosity towards its northern neighbour. This leads to the question of whether the new regionalism is as much the result of a convergence of economic systems as a coincidence of national interests. Although there is some indication that economic systems may be converging at least among some states in the regions studied here, it is clear that this convergence is far from complete and that the new regionalism may be seen in part as an attempt to promote that convergence. Within the EC the differences that remain over issues such as the adoption of minimum working conditions or a common currency reflect deeper differences in economic ideology. Both Canada and Mexico are still more interventionist in their domestic economies than the United States, while many in the US still see Japan's economic system as incompatible with that of the US.

The case studies also confirm the importance of cross-border elites or epistemic communities in the new regionalism. In Chapters Four and Five an important role was ascribed to the EC institutions and in particular to the EC Commission in both alerting member states to the problem of the EC's declining international competitiveness and in convincing them that further institutionalised integration was the way to solve that problem. In Chapter Eight we highlighted the role of non-governmental bodies such as PECC in increasing support for institutionalised regional economic integration among the political elites of the Asia Pacific. The North American case study stands out from the
others through the absence of a similar organisation with the specific aim of promoting institutionalised regional economic integration. Yet even here, we ascribed an important role to international institutions such as the World Bank and the IMF and to certain academic institutions such as Harvard in facilitating contact between the political and economic elites of the United States, Mexico and Canada and in encouraging the spread of those ideas and economic ideologies that were favourable to institutionalised regional economic integration.

In all the case studies it was apparent that these epistemic communities had facilitated the spread of new ideas and values among regional elites and that these changing elite ideas and values were a significant factor in the rise of the new regionalism. These elites played an important part in the shift from Keynesianism to economic liberalism and from import substitution industrialisation to export-oriented growth that took place in the 1980s, a shift that was to make governments more favourably disposed towards the adoption of regional free trade as a way of increasing economic growth, employment and competition within the domestic economy and of boosting the international competitiveness of domestic firms. By encouraging governments to seek regional solutions to national problems and by facilitating contacts between national elites at a regional level, these epistemic communities may in fact have been instrumental in shifting state-based political cultures towards elements of a region based political culture and in bringing about a nascent regional identity. Nevertheless, it is clear from the case studies that these elites by themselves did not bring about the necessary change in ideas and elite values that led to the new regionalism. This thesis confirms the argument of Peter Haas in Chapter Three that for such a change in ideas to take place there must first be some kind of political and/or economic crisis that causes political elites to reject accepted paradigms and to seek new ones. In this thesis we have seen how the economic and political crises of the 1970s and 1980s and the rising concern about the declining international competitiveness of domestic firms led governments to revise and even reject accepted doctrine and practices that were hostile to regionalism.

Intra-state level questions on the causes of regionalism

From the case studies it is clear that specific historical circumstances within particular states did play a role in the recent resurgence of regionalism. Of particular significance were the changes in government in the United Kingdom, France, Canada, Australia and Mexico. In Chapter Five we saw how the election of the Thatcher government in the UK in 1979 had been an important factor in the establishment of the Single Integrated Market. Previous Labour governments had been steadfastly opposed to further European integration on the grounds that it would reduce their control over the British economy and for this reason it was unlikely that a Labour government would have viewed the Single Integrated Market with much favour. Thatcher, however, saw the Single Integrated Market as a way of getting the other EC member states to adopt economic policies that were
similar to her own, and of making it more difficult for any new Labour government to reinstate the interventionist policies of the past. Chapter Five also showed how the failure of Mitterrand's Keynesian economic policies in the early 1980s led to a shift in France's EC policy in favour of institutional reform and the establishment of the Single Integrated Market. In Chapter Six we saw how the election of the Mulroney government in Canada in 1982, like that of the Thatcher government in the UK, had accelerated the shift from Keynesian to economic liberal policies and had led Canada to request an FTA with the US. In Chapter Eight the coming to power of the Hawke Labor government in 1983 led to a similar shift in economic policies in Australia towards deregulation and export-oriented growth and to the adoption of regionalism as a strategy to ensure Australia's access to the fast growing markets of its region. While there was no change in the party in government in Mexico, the election of Salinas as President in 1988 consolidated the dominant position of the US-trained técnicos within the Mexican Administration, paving the way for the request by Salinas in 1990 for an FTA with the US.

From the discussion above it is clear that domestic interest groups and elites in the individual states played an important role in the emergence of the new regionalism, both directly through their promotion of regionalism as a solution to some of the pressing economic and political problems being faced by their particular state, and indirectly through their advocacy of economic neo-liberal policies that favoured regionalism.

As for the question of whether the phenomenon of regionalism has weakened the state as the site of decision-making (its jurisdiction over its inhabitants) and in terms of its ability to demand and deliver the loyalty of its inhabitants, leading as the neofunctionalists originally predicted to its eventual replacement by a supranational regional authority, or whether it has, as Hoffmann has argued, actually strengthened the state, the case studies in this thesis appear to confirm the latter argument, at least in the short term. In many of the countries studies here regionalism was perceived as a means of boosting economic growth and reducing unemployment, by increasing the international competitiveness of domestic firms and the attractiveness of the country as a destination for foreign investment, and by guaranteeing the access of domestic firms to foreign markets. Although regionalism has diminished the formal sovereignty of individual states by curtailing their ability to take unilateral action, in doing so it has actually enhanced the economic security of all the states involved in what is a variation of regional disarmament. Regionalism has thus, in effect, shored up the domestic legitimacy of the state by enhancing its capacity to perform

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Keohane and Hoffmann (1991, pp.7-8, 17-18) have argued that while the EU member states have surrendered their authority to make decisions in certain areas, that authority has not been transferred to a supranational body but to an interstate body (the EC Council of Ministers), where it is exercised jointly by the states concerned. They have described this practice as the 'pooling' of sovereignty, a qualified form of supranational decision-making without supranational institutions. See Chapter Five, pp.178-81. The question here of course is whether the persons on these bodies are making decisions in accordance with narrow national interests or with broader national interests that reflect the interests of the region as a whole.
domestic tasks. It has further increased that legitimacy by increasing the bargaining position of the state vis-à-vis other states outside the region, thereby increasing its ability to obtain favourable terms of access to their markets. This is true not only of the less powerful states but also of the global economic powers in their struggle to shape the rules of the new global economic order.

In terms of the distribution of power within the state, regionalism has strengthened the position of the executive relative to that of the parliament and important domestic lobby groups, by reducing the ability of the elective representatives to scrutinise, and that of domestic lobby groups to influence, key economic policy decisions, which are often determined in regional meetings of senior government officials, ministers and leaders. While this may weaken the ability of domestic protectionist forces to influence government policy, it nonetheless reduces the legitimacy of the state in the eyes of its citizens by undermining the principle of democratic accountability. Whether or not this will in the longer term lead to demands, as is already the case in the EU, for the election by universal suffrage of a regional parliament to vet the decisions of the regional executive and thus to the undermining of the state remains to be seen. Moreover, the new regionalism has occurred - with the partial exception of the EC - without the formal transfer of decision-making powers to a regional authority. States have simply agreed to waive their ability to exercise regulatory powers in certain areas and allow market forces to rule. It is still not certain whether this is sustainable in the longer term or whether, in the event of a crisis, states may be forced to cede these powers to a regional authority or resume exercising them themselves.

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6 Critics of the present decision-making practices of the EU have argued that the pooling of sovereignty has further increased the power of executive government to the detriment of the parliament within the member states and have called for the granting of increased powers to the European Parliament to remedy this 'democratic deficit'.
**The propositions**

I now return to the propositions listed at the end of Chapter Three concerning the re-emergence of regionalism in the 1980s and 1990s. In the table that follows a comparison is made of the influence - strong, present, weak or not present - of the five propositions in the case studies.

<table>
<thead>
<tr>
<th>Propositions</th>
<th>EC</th>
<th>CUSFTA/NAFTA</th>
<th>APEC</th>
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<tbody>
<tr>
<td>1. retreat &amp; defend</td>
<td>P</td>
<td>S</td>
<td>S</td>
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<tr>
<td>2. advance &amp; compete</td>
<td>S</td>
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<tr>
<td>3. rivals all</td>
<td>S</td>
<td>S</td>
<td>P</td>
</tr>
<tr>
<td>4. domestic &amp; the region</td>
<td>S</td>
<td>W/P</td>
<td>W/P</td>
</tr>
<tr>
<td>5. ideas &amp; learning</td>
<td>S</td>
<td>S</td>
<td>S</td>
</tr>
</tbody>
</table>

*Code: S - strongly influenced; P - present; W - weakly influenced or not present*

From the above table it is clear that all the propositions are supported - with the possible exception of the fourth proposition - by the case studies. It is also clear that the degree of support for some of the propositions varies from case study to case study. This variation is attributable to circumstances specific to a particular region and/or to changes at the system level and intra-regional level that have occurred in the period between one instance of regionalism and the next.

Propositions Two and Five were shown to have been strongly influential in the rise of the new regionalism in all the case studies. The rise of East Asia and the associated shift in comparative advantage, increasing protectionism, the slowing of economic growth and growing unemployment saw states resort to institutionalised regional economic integration in order to enhance the economic and political security and boost their competitive

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7 These propositions in brief are:

- The 'retreat and defend' proposition that the re-emergence of institutionalised regional economic integration is a response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US.
- the 'advance and compete' proposition that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security in relation to members and non-members of the alliance or more particularly to boost their competitive position in the global economy.
- the 'rivals all' proposition that institutionalised regional economic integration is the result of a defensive interaction first among rival capitalists, but also among rival states. In the first place a move to regionalism occurs because increasing competition drives firms into regional arrangements. In the second case, states, seeing the prospect of their rivals advantaged, move to construct their own economic spheres of influence.
- the 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence.
- the 'ideas and learning' proposition that the re-emergence of institutionalised regional economic integration is the result of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism.
position in the global economy. States saw institutionalised regional economic integration as a means of securing and enhancing access to the markets of important trading partners in their region, and of increasing their bargaining position in international fora and thus securing and enhancing their access to markets in other regions. In the more competitive international economic environment of the 1980s states looked more favourably on the claims of integration economists that regional economic integration would increase the efficiency and international competitiveness of domestic firms, increase economic growth and reduce unemployment.

Cognitive change (proposition five) and in particular the shift in the dominant economic paradigm from Keynesianism to economic liberalism was shown in all the case studies to have made policymakers more favourably disposed towards institutionalised regional economic integration. There was a logical coherence between the basic conviction of economic liberals that a return to economic growth would require less government involvement in the economy and a greater reliance on market forces, and the long standing arguments of integration economists that FTAs, by eliminating government regulation of trade between states, would boost economic growth through increasing economies of scale and increasing competition between firms. This shift, together with the patent success of the export-oriented growth strategies in East Asia, reduced concerns held by states about the loss of economic sovereignty that would result from membership of an FTA, and led to the abandonment of the import substitution industrialisation strategy, thereby overcoming two significant obstacles to institutionalised regional economic integration.

The influence of the remaining propositions in the rise of new regionalism varied according to the case study. The retreat and defend proposition (one) strongly influenced the rise of the new regionalism in both the North American and Asia Pacific case studies. It is clear that the new regionalism in these regions was an attempt to maintain and enhance the functional regional economic integration that had occurred under the umbrella of the multilateral trading system but which was now threatened by the inability of the major economic powers to agree on the reforms needed to ensure that system's survival. It was also present in the EC case study but it was somewhat less influential there. Although the new regionalism in the EC was in part due to the concern by member states that the proliferation of non-tariff barriers within the EC would undermine EC economic and political cohesion, that proliferation was more directly associated with the growing economic competition from East Asia than with the erosion of the GATT. Moreover, there was also a fear on the part of some member states that the relevance of the EC to its member states in terms of the preferential access it accorded domestic producers to the EC market, which had already been diminished by the cuts in the common external tariff that had been agreed to in successive GATT rounds, would be even further reduced in a new GATT Round. This ambiguous attitude towards the GATT clearly sets the EC apart from the other instances of regionalism studied here and serves to underline the fact that
regionalism in the EC is as much about forging closer political union as it is about liberalising trade.

The third proposition 'rivals all' was present in all of the case studies. It was strongly influential in the rise of the new regionalism in the EC, where there was considerable concern about the declining international competitiveness of EC firms in relation to their US and Japanese rivals. This is perhaps explained by region-specific circumstances - institutionalised economic regionalism was already well established and there was already some sense of regional interest and identity; and the greater role traditionally accorded to the state in enhancing the international competitiveness of domestic firms. It was not as influential in the Asia Pacific case study. There are several possible explanations for this difference. First, there is the political and cultural heterogeneity of the Asia Pacific region, its relative newness as a regional entity and the uncertainty as to whether the region is in fact the Asia Pacific or East Asia. Second, some states, particularly in the early stages of APEC's development, were reluctant to use it as a vehicle for regional trade liberalisation and saw it instead as simply another means of shoring up the global trading system. Of all the regions studied here, the Asia Pacific is the one whose identity is most artificial, having been created mainly in reaction to the other instances of regionalism.

The third 'rivals all' proposition was more influential in the rise of the new regionalism in North America than in the Asia Pacific but not as strong as in the EC. There is a stronger sense of regional identity and the region is more homogeneous both politically and culturally than the Asia Pacific. This is particularly true of Canada and the US but also of Mexico and the US. In the case studies we saw how Canada, the US and Mexico had come to hold similar views of the trading practices of the EC and Japan. Because NAFTA was established after the EC SIM and APEC, the importance of inter-regional rivalry as a factor for Mexico in the decision to request an FTA with the US was even greater than it had been for Canada. Yet while Mexico and Canada saw the new regionalism principally as a means of maintaining and enhancing functional regional economic integration, for the US it was primarily aimed at increasing its bargaining position in the negotiations to define the new rules of the global trading system.

The 'domestic and the region' proposition (four) is perhaps the most interesting as far as the findings of the case studies are concerned. Those findings point to some significant connections between domestic politics and the rise of the new regionalism, and the more general contention of this proposition - that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence - is clearly supported by the case studies. Yet the link between the new regionalism and domestic politics was not quite what had been first envisaged when this proposition was drawn up, namely that institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability due to increasing economic interdependence. Although this particular
Propositions about the resistances to regionalism

Any study that seeks to explain why change occurs would, however, be incomplete without some analysis of the resistances to that change and how these were overcome. I have already outlined in each of the case studies the various resistances to institutionalised regional economic integration and the way in which these resistances were overcome. I will now attempt briefly to make some general propositions concerning why and under what circumstances states may oppose regionalism. It is clear from the case studies that opposition to institutionalised regional economic integration arises out of two related concerns about the state sovereignty. The first is that institutionalised regional economic integration will lead to a loss of economic sovereignty and a significant increase in the capacity of outside economic powers to determine the economic policies and structure of the state concerned - or what Triffin, Cooper and others have called vulnerability. A second related concern is that this loss of economic sovereignty will lead to a loss of political sovereignty, which in the short term will reduce a state’s political independence in terms of its ability to shape its own foreign and domestic policies, and in the longer term may, in some cases, lead to the loss of separate political and cultural identity through political integration.

In the case studies we saw how these concerns had been heightened by particular circumstances. Thus a combination of past historical experience, in particular that of colonialism, and certain economic ideologies and practices - dependency theory, the poles of development of Myrdal and Hirschman, import substitution industrialisation, Keynesianism - had increased the fears of states, especially developing states, about the loss of economic sovereignty and the increase in vulnerability that institutionalised regional economic integration would entail. At the same time the ideological divisions of the Cold War, the spread of American culture and the theory and practice of regionalism...
in Europe augmented concerns that the loss of economic sovereignty would lead to a loss of political sovereignty.\(^8\)

Changes in these circumstances, however, lessened these concerns to such an extent that the new regionalism was possible. Among these changes were the perceived failure of import substitution industrialisation and Keynesianism, the undermining of dependency and poles of development theory by the success of export-oriented growth in the NIEs and the shift to economic liberalism. At the same time, the rise of East Asia and the resulting increase in international economic competition and protectionism made states more eager to obtain the security of market access and increased competitiveness that regionalism was said to provide, and less concerned about any accompanying loss of political sovereignty. The growing awareness of the importance of economic growth to regime stability and of the importance of secure access to large markets in achieving that growth had a similar effect. The end of the Cold War and the shift from a bipolar world with an emphasis on military power to a multipolar world where economic power is of growing significance also helped to reduce the concern of states about the loss of formal economic sovereignty that institutionalised regional economic integration would entail. At the same time there was a realisation by states that regional agreements, by binding all states to forgo the right to impose barriers to the entry of foreign goods, could actually reduce the increased vulnerability that results from increased economic interdependence where global agreements had failed to do this.

Yet changes in circumstances were in themselves not sufficient to bring about a change in the attitude of states towards regionalism. As is evident from the case studies, that change was a product of the interaction of these changing circumstances with the spread of ideas or intellectual constructs by institutions and epistemic communities. The changing circumstances thus engendered (in the minds of policymakers) the condition of uncertainty that was necessary for economic ideologies that had been the source of the resistances to regionalism to be forsaken for other economic ideologies more propitious to its development.

It is clear at this point that both the answers to the questions and the analysis of the propositions about causes and resistances undertaken here shift the emphasis on the broad hypothesis posed in Chapter One to a more complex and nuanced explanation of regionalism involving not only the systemic factors of international economic change and the rise of East Asia but factors at the intra-regional and intra-state levels.

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\(^8\) In Europe, however, concerns about political sovereignty had been lessened by the experience of WWII to the extent that regionalism was possible there.
The theories revisited

I now turn to an examination of the insights provided by the case studies in this thesis into the theoretical debates outlined in Chapters Two and Three. The debate between Viner and Triffin over the merits of regionalism is of course still raging and there still appears to be no clear answer to the question of whether regionalism is on the whole a negative or a positive development. However, it is clear that Viner's customs union theory has failed to deter states from entering into regional trading arrangements. It would appear that, in the present period of intense international economic competition and growing protectionism, states are more concerned with finding ways to increase their national competitive advantage and hence national economic welfare in the short to medium term, even if this is at the expense of long term global economic welfare. Customs union theory as it was originally conceived by Viner cannot explain the behaviour of states. Viner had hoped to influence the behaviour of states by showing that the economic gains obtained through a customs union were actually less than was commonly assumed. Yet the case studies vindicate the arguments of Triffin and Balassa that the criteria used by Viner to evaluate the merits of regional agreements were too narrow. It is clear from the case studies that the motivations of states in forming customs unions are more political than economic (a point actually conceded by Viner) and thus cast doubt on theories such as customs union theory and neofunctionalism, which, in their accounts of the behaviour of states, elites or individuals, privilege economic welfare and efficiency over other aspirations such as security and stability, quality of life and the realisation of cultural and political identity. The case studies also show that states may engage in customs unions to increase their bargaining power in international fora - another way of increasing national economic welfare that Viner conceded was not included in his own calculations. Viner's calculations also excluded the gains in economic welfare to be derived through the so-called dynamic effects of customs unions, and through the increased stability and economic security that they gave states against sudden unilateral action by other states. He also failed to see that regional trading arrangements are easier to negotiate than global arrangements because of the smaller number and the greater homogeneity of the states involved. Of course it still remains to be seen whether regional trade liberalisation will be, as Triffin has argued, a stepping stone to global trade liberalisation.

The debate concerning the validity of neofunctionalism as a tool for explaining the evolution of regional integration has already been reviewed in the conclusion to Chapter Five so some general observations will be made here. First, the relevance of the theory to the case studies other than the EC is unclear. The theory purports to explain the evolution of regional integration only after the establishment of a supranational regional authority and, thus would not seem relevant to either the North American or Asia Pacific case studies. Even in Europe, where such a body does exists, the theory's ability to explain the establishment of the Single Integrated Market is questionable. Although neofunctionalists may have been right in their prediction that further steps towards regional integration will
be the result of the desire to protect and extend existing benefits of regional economic interdependence, they failed to correctly identify the process by which these steps would come about. Contrary to neofunctionalist predictions, the state political elites were generally more keen than the general population or economic elites to embrace further regional integration. The SIM was not the result of automatic spillover or of a shift in political loyalties from the national to the supranational entity but of changed external and internal circumstances which forced states to see increased regional integration as the best way to achieve their separate national interests. The fact that similar internal and external circumstances were involved in the establishment of institutionalised regional economic integration in the other case studies would appear to question the utility of neofunctionalism as a tool for explaining the emergence of the SIM. It is clear that state elites in Europe were motivated by the concern that existing regional economic functionalism was inadequate to ensure the international competitiveness of European firms and therefore had to be encouraged through state intervention.

The case studies also shed some light on the complex relationship between global economic interdependence and regionalism. It confirms the argument of Cooper (and Triffin) that regionalism is an attempt by states to find a more sustainable form of economic interdependence. It also confirms the argument by Gilpin that regionalism is a neo-mercantilist response by states to the increasing competition among states for markets. With the threats to global economic interdependence already apparent in the late 1960s and early 1970s, however, the question remains as to why regionalism in fact stagnated in the 1960s and 1970s and did not re-emerge until the 1980s. Part of the explanation for this might be that regionalism was in fact impeded by the persistence of the Cold War and the bipolar international security structure - the stagnation in European integration in the 1960s was largely a result of disagreements between France and the other EC members over the stance they should take on security questions - and that the level of international economic competition was still not sufficiently intense.

The thesis confirms the argument by Keohane and Nye concerning the importance of institutions in maintaining cooperation among states. States clearly saw institutionalised regional economic cooperation as necessary to preserve and extend functional regional economic interdependence at a time when institutionalised global economic cooperation in the form of the GATT was being eroded. As was pointed out in Chapter Three, under the conditions outlined by the neo-liberal institutionalists as necessary for the establishment of institutions at the international level, regional institutions are more likely to emerge than global institutions and it is they which are the norm and global regimes the exception. If this is the case, then the more logical question would be not that of why regionalism but that of under what exceptional circumstances are global regimes possible. While there is considerable disagreement over what constitutes the conditions for global institutions and, in particular, for the establishment and maintenance of a liberal international economic
order, this thesis shows that many of the factors that contributed to the undermining of the liberal international economic order of the post-war period - the relative decline in US economic power and the economic rise of East Asia; the decline in support within the US for that order; the end of the Soviet threat and the bipolarised world structure - were also important factors in the rise of the new regionalism.

As for the debate between the neo-institutionalists and realists concerning the importance of relative gains to the survival of institutions - both global and regional - the thesis does provide support for the realist position. Thus it could be argued that the US perception that the GATT regime in the late 1970s was responsible for the relative decline in US economic strength and its worsening trade deficits and was no longer serving its national interests, led the US to embrace regionalism as a means of increasing its relative gains from international trade. The US believed that regionalism would increase its relative gains in two ways. First, it would give its firms preferential treatment in the markets of neighbouring states and enable them to make greater use of production sharing to reduce their production costs relative to those of their foreign competitors. Second, it would increase US bargaining power in negotiations aimed at reforming the GATT system so that it was more amenable to US trading interests. In the EC case study relative gain calculations were also important. Thus the UK support for the SIM came only after the EC member states had agreed to ways of reducing the UK financial contribution to the Common Agricultural Policy. Similarly France and Italy linked the removal of non-tariff barriers to intra-EC trade to the strengthening of the Community's commercial policy instrument. All the EC member states were concerned by the decline in their relative gains from international trade and saw the SIM as a way of improving their position relative the US and Japan. In the North America, both Canada and Mexico saw the FTA with the US as a means of increasing their relative gains by enhancing the access of their firms to the US market. In the Asia Pacific states feared that the emergence of regionalism elsewhere would reduce their relative gains from international trade and saw APEC as a way of preventing this. Thus the realist position that regionalism is state interest (and relative gains) - driven rather than the result of the socialisation of states into cooperation is confirmed by the case studies.

The thesis also confirms the role of new ideas in facilitating cooperation and policy coordination at a regional level. The shift in the dominant economic paradigm from Keynesianism to economic liberalism not only increased the importance of relative gains in the calculation by states of their national interests, it also led states to view more favourably proposals for institutionalised regional economic integration. The thesis also confirms the role - ascribed by both Cox and neo-liberal institutionalists - of international institutions such as the IMF and the World Bank not only in transmitting cognitive change but also in enforcing it. This was particularly apparent in the case of Mexico but no doubt also true of other developing countries in Southeast Asia such as Thailand and
Indonesia. From the North American case study it is also clear that a similar role was also performed by certain national institutions such as Harvard and Yale, particularly because of their international orientation.

The thesis also supports the arguments of Ernst and Peter Haas regarding the role of transnational scientific and intellectual communities - the so-called epistemic communities - both in the transmission of new ideas across borders and in bringing about the convergence of government policies concerning international or regional problems. Thus in the North American, Asia Pacific and EC case studies, policymakers were exposed through their contact with epistemic communities of neo-liberal and neo-mercantilist persuasions to various arguments favourable to institutionalised regional economic integration. The case studies also confirm Peter Haas's contention that exposure to new ideas is, in itself, not sufficient to bring about a change in state behaviour and that such a change will only take place when the power of existing ideas and their backers has been eroded as the result of some shock or crisis. In the case of the rise of the new regionalism, however, the crises may have produced a policy convergence on the necessity to embrace institutionalised regional economic integration but the rationale for doing so was not necessarily the same. Thus an economic crisis situation sparked by the spiralling US trade deficit undermined the traditional dominance of free trade ideology in the US Congress and made it more receptive to new neo-mercantilist ideas that favoured bilateralism and regionalism. At the same time a similar economic crisis weakened the traditional dominance of protectionist ideology in the EC, Canada, Mexico, Australia, New Zealand and ASEAN, making policymakers in these countries more receptive to liberal economic ideas that favoured free trade at a regional level. Thus it would seem that social learning does not matter in the least unless circumstances change and interests are recalculated.

But it also clear that there is no easy convergence between these two contradictory trends of free trade and protectionism. Therefore the economic convergence theories of some economists and socialists may perhaps need some amendment, or a longer time span, to be valid. The triumph of economic rationalism (and 'free trade') may be temporary and the great escalator of convergence theory may be temporarily or permanently stopped at the way station of institutionalised regional economic integration. This is especially true of Europe, where EC regionalism would appear to be at loggerheads with global trade liberalisation. The refusal of Europeans to accept the belief of the global free traders that global free trade will lead to increased political harmony is no doubt due to the bitter experiences of the inter war period when economic depression and social and political unrest were seen as leading to war. Such experiences explain the greater concern in Europe to maintain control of the domestic economy than in the US and Canada. This view of regionalism as helping to ensure against a return of the political problems of the past differentiates it from regionalism elsewhere, though, on closer reflection, more by degree (US concerns about Mexico, Asian concerns about declining US presence). Yet,
whereas in the Asia Pacific and North America the decline in the multilateral trading system was an important factor in moves towards regionalism, in Europe global free trade was seen as undermining the economic solidarity among EC members, which it was felt was a crucial glue and essential to maintaining regional political stability. Hence at least in Europe increased global economic interdependence leads (contra Keohane and Nye) to increased efforts for regional economic AND political integration.

The future of regions: notes on a causal theory of the new regionalism

If, as seems likely, the factors causing the new regionalism of the 1980s and 1990s are highly similar and the kinds of resistances are also remarkably similar, even if played out in different domestic and regional circumstances, then it might be possible to construct a theory accounting for the rise of this new regionalism.

This would not be a 'grand' theory accounting for all occurrences of regionalism (though it might contribute to such a theory). This theory is time specific, that is to the 1980s and early 1990s.

The theory might have the following negative and positive propositions:

Among the negative propositions might be:

1. The weight of the past is not decisive in moves to regionalism directly since all three case studies come out of quite different national and regional historical circumstances. This is not to say that the weight of the past was not decisive for the particular case of euro-regionalism in the 1950s and 1960s.

2. Though the politics in each of these case studies differed, the resistances to the new regionalism were all of the same order. Thus in all three case studies the new regionalism had been opposed by distributional coalitions which were forced to change. In all three cases governments had been fearful of the political upheaval that might follow the economic restructuring engendered by regionalism. In all three there had been considerable concern that regionalism would undermine state sovereignty.

Among the positive propositions might be:

1. That major systemic changes in international relations broadly conceived (change in the structure of the world economy and the end of the Cold War) were decisive in the push to the new regionalism and its extension in the 1980s and early 1990s. The argument of Waltz that the system strongly influences the behaviour of state actors is thus confirmed, at least on the face of the experience of these case studies.

2. That ideological change (essentially on economic policy), itself a consequence of the ideological uncertainty among policymakers brought about by systemic changes, was decisive in the shift to regionalism in the 1980s and early 1990s. (This casts doubt on those theorists that argue for the end of ideology, or the centrality of culture in international relations).\(^9\) The argument of scholars such as Odell and Peter Haas that

changes in the behaviour of states are the result of cognitive change is thus also confirmed. The question remains, however, whether this ideological change in favour of economic liberalism and free trade is a permanent one. As long as it continues to deliver on its promises of economic growth, it is likely to be so (unless, of course, states abandon their pursuit of economic growth). But should economic growth falter, or worse, should it be seen to undermine national economic and political stability, then there may be a return to some form of modified Keynesianism, either at a regional level - in which case regionalism (though perhaps not open regionalism) will be strengthened, or at a national level - in which case regionalism will be considerable weakened.

3. Since the peculiar feature of economic regionalism in the 1980s was the paradox of states giving up some powers to the region (either intergovernmental or supranational) while strengthening their control of the domestic economy and politics (despite the rhetoric of deregulation), then we need to consider a new model of global, regional, intra-state relations. The state is not dead or dying. Paradoxically it becomes more powerful at home, gains power from its regional connection and then is able collectively through that regional connection to impact on other major states in their regional hinterland.

4. The realist position that regionalism is state interest (and relative gains) -driven rather than the result of states being socialised into cooperation is confirmed. However, realists when considering regionalism may need to have a more nuanced analysis than the assertion of straightforward national interests. Traditional realist conceptions of national interests do not hold in the case of regionalism of the 1980s and early 1990s. States were forced by systemic changes and ideological change to redefine their national interests as being now found in regional interest. (This has important implications for the strength of core realist theory). As the case studies show, it was not so much the goals of states that changed but the means by which they believed these goals could be obtained. Thus states were willing to lose some formal economic sovereignty in order to enhance their economic security and increase their power both domestically and internationally.

5. It has always been the case in the international system that states have had to order their foreign policies to take account of the policies of others and in this, bend to the calculus of power. This thesis shows something related to this but with a different consequence. It is that interaction among regions is as powerful and as dynamic as that among great states (and of both a negative and positive nature) and it resembles quite clearly the security seeking behaviour of great states. However, the interaction among the new regions of the 1980s and early 1990s does not, as yet, show the signs of institutionalised cooperation that relations among great states normally exhibit except in times of security crisis. Why this should be so is an interesting question: regionalism is too new for those habits of cooperation to have developed (especially the need to develop coherence among members

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10 For Odell (1982, pp.12, 364), the shift in US monetary policy that took place in the early 1970s was the result of changes in international market conditions and in the international economic power structure (systemic changes), and changes in the ideas or intellectual constructs on which US monetary policy was based (cognitive change).
- see Keohane and Nye) or relations among regions may be (contra Bull, Carr and Hoffmann) of an essentially different nature to those among great states. If this is the case, then traditional realist theory may be facing its biggest adjustment. With respect to the cooperation-conflict argument, the dominant practice and discourse within regions is one of cooperation, among regions the dominant discourse is competition, rivalry and conflict. This is of course predicted by pure trade theorists and by some realists and neomarxists. However, this is not to say that these patterns of inter-regional rivalry will persist over the long run and regional core states may be forced to develop institutions of cooperation precisely to avoid the costs of conflict (see Keohane) but also to secure what are the necessary gains from trade in the global economy. None of these regions is, in the present circumstances of the global economy, a candidate for autarky (with the possible exception of the US and its regional hinterland). If this is right it has two implications:

• that the role of the US as a possible bridge across all three regions may emerge. (Particularly if the recently floated idea of a Trans Atlantic Free Trade Area becomes reality,¹¹ and if the US can sustain its role in APEC). If this happens we are essentially confronted by the possibility of a ‘true’ superpower exerting considerable influence over its three satrapies. Such a situation could not endure for long for the other rivals, Germany and Japan with their hinterlands, will certainly constrain the US, and Hoffmann's Gulliver's troubles would re-emerge.¹²

• On the other hand if a privileged role for the US is unsustainable then the security dimension of inter-regional relations gains higher importance.

6. One may conclude by saying that the structure of the world in the 1990s has a new feature. While great powers want to consolidate the members of their respective regions behind them, they still reserve the right essentially to conduct foreign policy on great power terms (with the possible exception of the EC - but even the EC states are having difficulties constructing an EC foreign policy). This tension between the global and regional interests of great powers may become a central feature of this world order for some time to come.

¹¹ The idea of a Trans Atlantic Free Trade Area (TAFTA) or a Trans-Atlantic Economic Area (TEA) was being discussed by US and EU policymakers in late 1995. See Australian Financial Review 23-11-95, p.15: 'Waves of worry over ripples on pond'.
¹² Hoffmann 1968.
CHAPTER NINE
CONCLUSION

Having reviewed the various theoretical explanations for the emergence of regionalism in Chapters Two and Three and identified the principal causal factors behind the emergence and/or re-emergence of regionalism in the 1980s and early 1990s in three regions - Europe, North America and the Asia Pacific, I will now draw some conclusions regarding the emergence of the new regionalism. Since some preliminary conclusions as to the causes of regionalism in a specific region have already been drawn at the end of each of the case studies, the focus here will be on the comparison of causes across regions and an attempt will be made at an explanation for the emergence of regionalism in the 1980s and early 1990s that fits all three regions.

I revisit first the three possible causal explanations or hypotheses as to the revival of regionalism that were advanced in Chapter One. Then I attempt to answer rather briefly the series of specific empirical and theoretical questions that were also raised in Chapter One concerning the causes of regionalism and which had been categorised by levels of analysis. I then return to the propositions listed at the end of Chapter Three concerning the re-emergence of regionalism in the 1980s and early 1990s. Again the focus here is on a comparison across regions as there has already been an extensive discussion at the end of each of the case studies of the significance of each of the propositions in explaining the emergence of regionalism in that case study. A brief attempt is made to establish the relative importance of each of the propositions in accounting for the emergence or re-emergence of regionalism in each of the regions studied. Since cause is not only about positive forces shifting towards regionalism but also about the negative forces or resistances that must be overcome, there follows an examination - albeit also brief - of several propositions concerning the resistances to the new regionalism. I then reassess some of the specific theories that were identified in Chapters Two and Three, such as customs union theory, interdependence theory and social learning, in the light of the findings of the case studies. At the same time I compare and contrast the causal explanations accounting for the new regionalism of the 1980s and 1990s with those accounting for the regionalism of the 1950s and 1960s. Finally I attempt to construct a theory accounting for the rise of the new regionalism.

1 See p.15.
2 See pp.9-12.
The broad hypothesis proved or disproved

In Chapter One three possible causal explanations or hypotheses were advanced concerning the revival of regionalism:

First, regionalism in the three case studies may be principally a reaction to developments in the international economic and political systems. Nevertheless, the relative importance of these same developments in bringing about regionalism may differ in each of the regions.

Second, regionalism may principally arise from some sort of interactive chain reaction in that regionalism in one area may provoke an extension of regionalism in another.

Third, it is possible that there are no common causal factors across regions. In this case, the fact that these moves to regions occurred in the 1980s would be coincidental.

From the case studies in this thesis it is clear that the third causal explanation that the moves towards regionalism in the 1980s and early 1990s were coincidental and unrelated cannot be sustained. Although there were some factors that were specific to a particular case study - the desire for political union in the case of the EC or US concerns about the political, economic and social stability of Mexico in the case of NAFTA, there were also many factors that were common to all three regions.

It also apparent from the case studies that neither the first nor the second causal explanation is, by itself, sufficiently robust and that both are necessary to account for the emergence of the new regionalism. In all three regions the move towards regionalism was clearly a reaction to negative developments in the international economic and political systems. It was in part a specific response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US. It was also partly the result of an ideational shift in terms of economic doctrine away from Keynesianism and import substitution industrialisation to economic liberalism and export-oriented economic growth.

Yet it is also apparent from the case studies that the new regionalism was to some extent also the result of a kind of interactive chain reaction, with regionalism in one area provoking an extension of regionalism in another. This was particularly true of both APEC and NAFTA, which were not only both reactions to the EC Single Integrated Market but to each other. The chain reaction, really a spiral of mutual anxiety, is also evident in the argument of the EC Commission that the Single Integrated Market was essential if European firms were to enjoy the same access to a vast market as their American and Japanese competitors. In this way the spiral of anxiety about competitive regionalism resembles in some respects the spiral of competitive security reactions in international relations.

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3 APEC was in part a reaction to CUSFTA, and NAFTA was partly a reaction to APEC.
It is indeed difficult to establish which of these causal explanations is the principal one as it is clear from the case studies that they are in fact mutually reinforcing. Thus the undermining of the GATT and the rise in protectionism increased the importance of securing access to a large market, while concern that secure access to a large regional market was in some way the reason for the increasing international competitiveness of firms led governments to adopt regionalism in order to counter moves to regionalism elsewhere. Concern about competitiveness reinforced the ideational shift to economic liberalism and at the same time that shift made governments more willing to take up the regional option. These ideas were carried to fruition by specific political and intellectual elites in each of the regions so that the role of elites in reaction to these causal circumstances and in forwarding the rise of the new regionalism was crucial.

Answering the specific empirical and theoretical questions posed in the Introduction

I now return to the series of specific empirical and theoretical questions that were raised in Chapter One in the context of the broad causal question posed by this thesis. The answers here will be necessarily brief and often tentative. Many of these questions have been already dealt with at greater length in Chapters Two and Three, while others involve issues which are beyond the purview of this thesis and require a more detailed examination that is not possible here. For these, I have been content to show how the findings of the case studies might illuminate the question and suggest ways in which the question might be further pursued. In re-examining these questions I will retain the categorisation by level of analysis - systemic, inter-regional, region-specific, and intra-state - that was employed in Chapter One.

System-level questions on the causes of regionalism

In Chapter One we asked whether long run historical factors constituted the main cause of the new regionalism and suggested the end of the Cold War and the economic rise of East Asia as two possible long run historical factors at the system-level that might have had an impact on the recent resurgence of the phenomenon of regionalism. The findings of the case studies in this thesis do not appear support the argument that the end of the Cold War was a significant factor in the emergence of the new regionalism at least initially. Thus the initial moves towards regionalism in the 1980s in Europe, North America and the Asia Pacific preceded the end of the Cold War. As we have seen in Chapters Four and Five, attempts by Reagan in the early 1980s to revive the Cold War divisions had brought France and West Germany closer together and thus contributed indirectly to the push for an economically and politically more unified Europe that could exercise a greater, more moderating influence over US foreign policy. It was only later
with the fall of the Berlin Wall and the reunification of Germany that the end of the Cold War became a significant factor in moves towards greater political unity in the EC. The end of the Cold War also played no role in the Canada-US FTA and in the establishment of APEC, except to the extent that it eventually shifted security calculations to more positively involve the US in APEC. Indeed, as we have seen in Chapter Eight many of the ASEAN countries at the time of APEC's establishment in 1989 were still reluctant to join a regional organisation that might be seen as aligning them to the US camp. However, the end of the Cold War was a factor in the both NAFTA and the consolidation of APEC after 1989. This change made it easier for Mexico to contemplate compromising its position of non-alignment through the signing of an FTA with the US and resulted in a re-ordering of US priorities such that an agreement that might guarantee political, economic and social stability in Mexico became an important foreign policy objective. In the Asia Pacific, the end of the Cold War not only saw increased support from ASEAN countries for APEC as a multilateral framework that could keep the US engaged in Asia but also led to a reappraisal by the US of the importance of such a framework in maintaining its influence in the region.

While the end of the Cold War was not a factor in the initial moves to regionalism in the 1980s, the same cannot be said of the economic rise of East Asia. We have seen in Chapters Four, Five, Six and Seven how the rise of and the economic challenge presented by East Asia to the so-called developed economies was a significant factor in moves in Europe to establish the Single Integrated Market and in moves in North America to establish CUSFTA and NAFTA. We have also seen in Chapter Three and elsewhere how that rise had not only sparked concerns about declining economic competitiveness and rising protectionism but had cast doubts on the fairness of the GATT system and even on the validity of the doctrine of free trade itself. These doubts and concerns were important factors in the moves to regionalism in the 1980s. The economic rise of East Asia was also an important factor in the moves towards regionalism in the Asia Pacific. We saw in Chapter Eight how the growing complementarity of the Asia Pacific economies that was an outcome of East Asian economic growth had increased support, particularly among Western Pacific countries, for a multilateral framework that could preserve the growing economic interdependence of the region against rising protectionism and a trend towards bilateralism, particularly on the part of the US. At the same time the economic rise of East Asia had augmented US fears that growing intra-East Asian economic interdependence might weaken the ability of the US to influence the region through its web of bilateral arrangements and made it more amenable to the establishment of a multilateral economic framework.

Thus this thesis partly confirms the two very broad observations that were made in Chapter One about the causes of the new regionalism. As we have seen in the case studies, the new regionalism was an outcome of a new set of principally economic factors, related
to the rise of Japan and the East Asian economies, and to the global recession in the 1970s and early 1980s, factors that pre-dated the end of the Cold War. Thus states in Europe, North America and the Asia Pacific came to see regionalism as a way of restoring national economic growth that had fallen considerably during the global recession, and of increasing the international competitiveness of their firms to offset the growing challenge from East Asia. The case studies also show how the end of the Cold War and the transformation of the international political system has shifted the new regionalism from being essentially an economic phenomenon to a complex mix of politico-strategic and economic developments. This is particularly evident in the Asia Pacific where APEC was seen as necessary to the maintenance of economic and political security in the region. Political and security considerations were far less significant in the establishment of CUSFTA prior to the end of the Cold War than they were in the US decision to enter into an FTA with Mexico. They were also a less important factor in the establishment of the EC SIM than they were after the end of the Cold War in the signing of the Maastricht Treaty.

The thesis also sheds light on the important neo-realist/neo-liberal question of how is it that states, which are said in realist accounts to generally pursue strategies based on self-help and self-interest, have embarked on a process of cooperation, that implies an actual, if not formal, devolution of sovereignty. It shows how, at a time when economic issues have been placed at the top of the policy agenda of most states, relations among states are increasingly determined by economic as well as security interests. It may be the case, as the neo-liberals have argued, that in dealing with economic issues states are more likely to seek the benefits of cooperation and be willing to sacrifice some elements of national economic sovereignty to achieve these.

Thus in a period when economic issues are accorded a high priority, it is not surprising that cooperation among states, albeit at a regional level, has also increased. States, it would seem, are redefining their national interests as now being found in regional interests. This redefinition, which may or may not be lasting, was the result of an ideational shift in economic policymaking from Keynesianism to economic liberalism and the economic crisis that helped bring it about, and of learning about the beneficial effects of cooperation from past experiences.

Nevertheless, there are two serious qualifications to this. First, this increased cooperation at a regional level is the result of increasing economic competition and conflict at the global level and of an associated rise of economic nationalism at the domestic level. Thus states perceive themselves as being engaged in the struggle for economic survival in the global economy and are willing to enter into strategic economic alliances with other regional states in an effort to boost their national economic competitiveness. Second, in agreeing to the partial loss of formal economic sovereignty that is entailed by membership of a regional trading arrangement, states paradoxically appear to have reinforced their position both at home and internationally. Thus, a state that
is party to a regional agreement may have lost its right to arbitrarily restrict the access of the other signatories to its domestic market but, because the other parties to the agreement have also forsworn this right, the economic security of the state is enhanced. Thus the risk of free riding is diminished and the virtues of economic security are enhanced. Such agreements also reinforce the position of the state both as an important domestic arbiter and as a regional and international player. It determines access to foreign markets and the terms on which its own firms compete with foreign firms in domestic and foreign markets, and it enjoys privileged relations with states of its own region and increased bargaining power in international fora through its membership of a regional economic alliance.

The further neo-realist/neo-liberal question of whether the new regionalism is a consequence of declining US hegemony and the shift to multipolarity has already been discussed extensively in Chapter Three so I will restrict myself here to the further insights into this question provided by the case studies. It is clear that an important causal factor in the new regionalism, in North America and the Asia Pacific in particular, was the erosion of the liberal international economic order and of the confidence of countries in that order. However, as we have seen in Chapter Three, the argument that this erosion was a product of the decline in US hegemony is highly contested, as is the exact nature of the link between hegemony and the liberal international economic order. What is apparent is that the relative decline in US economic superiority vis-à-vis the other economic poles of Europe and East Asia has facilitated the development of the new regionalism, though the situation is somewhat complicated by the dependence of the key economic states of these poles - Germany and Japan - on the US militarily. It is also apparent from the case studies that this relative decline has seriously undermined what many consider to be an essential condition for a liberal international economic order, namely the continued support of the hegemon for liberal ideology generally, and for the liberal international economic order in particular. Faced with the declining competitiveness of many of its industries, the US has supplemented - or even replaced as some would argue - multilateralism with unilateralism, bilateralism and regionalism, in an effort to achieve an international trading order that better reflects its own national interests. However, that relative decline in US economic superiority, together with a decline in the need for US military protection in the eyes of the other states, has made it difficult for the US to persuade the other states to agree to the changes that it wants. In such a situation regionalism provides both a bargaining chip to increase the pressure on others to accept those changes and a fall-back position should that acceptance not be forthcoming. What is paradoxical in all this is that the ideational shift to economic liberalism which on the surface would seem supportive of the liberal international economic order has in fact accentuated the economic rivalry and competition among states that threatens to undermine that order.

As for the question of how this resurgence of regionalism has been affected by changes in the international political economy, such as the breakdown of the Bretton
Woods system of world economic regulation or the oil price rises of the 1970s, this thesis shows that these changes were strongly significant in the rise of the new regionalism. The collapse of the Bretton Woods system of world economic regulation returned to state hands control of the exchange rate. While this provided states with an important means of boosting the international competitiveness of their firms by undervaluing their currencies and hence led to the competitive environment that later saw states turn to regionalism, it also removed what had been previously seen as an important underpinning of the liberal international trading order - the assurance that no state could gain unfair advantage through the manipulation of its exchange rate - and thus was an important factor in the loss of confidence in that order. The oil price rises (and falls) of the 1970s and 1980s were also conducive to the rise of the new regionalism. The rises in the price of oil increased the concern of the developed, oil dependent economies about the declining competitiveness of their firms that was reflected in their growing trade deficits, and encouraged them to resort to devaluations to offset that decline. At the same time rising inflation, growing unemployment and stagnating economic growth led them to question the validity of Keynesian economic policies and to turn to more economic liberal policies that were more compatible with regional free trade. The falls in oil and other commodity prices had similar effects for the oil and commodity producing, developing economies. As we have seen with Mexico and some of the Southeast Asian countries (and even Australia and Canada), the decline in oil and commodity prices led these countries to abandon their previous development strategies of import substitution industrialisation in favour of export-oriented economic growth, a strategy that was ultimately to prove conducive to the new regionalism.

The thesis also sheds some light on the neo-marxist question of whether the resurgence of regionalism is a result of changes in the world capitalist system, themselves reflecting changes in the economic structure, changes in the mode of production and the composition of the historic bloc, or changes in the regime of accumulation and modes of regulation in particular capitalist states. As we saw in the EC case study, the rise of East Asia and particularly Japan as an economic force gave rise to fears within the EC that Europe was being left behind in the new technological revolution. Similar fears were also shared by policymakers in North America and in countries in the Western Pacific who like their counterparts in Europe saw regionalism as a means of shoring up their international competitiveness and maintaining their position in the world economic pecking order. The thesis therefore provides some support for a reading of regionalism à la Wallerstein as a way for states, that are members of the core or semi-periphery and that might otherwise be relegated to the semi-periphery or periphery, to maintain their status as a member of the core.

The thesis could also support an argument that changes in the mode of production and the composition of the historic bloc, or changes in the regime of accumulation and modes of regulation in particular capitalist states, have given rise to the new regionalism. Thus the
rise of East Asia has led to the claim that we are witnessing the development of a new more efficient Asian regime of accumulation or mode of regulation, which has forced the older regimes and modes of North America and Europe to retreat behind regionalist walls.

Yet the new regionalism is not simply a defensive reaction, a way of preventing or at least forestalling what many neo-marxists and regulationists see as the more desirable and inevitable globalisation of the world economy. It is perhaps principally perceived by states to be a means of boosting the international competitiveness of national firms in the global market. As we saw in Chapter Seven, US and Mexican policymakers had attributed Japan’s success to the incorporation of the low cost labour of its regional neighbours into production processes or production sharing and believed that the competitiveness of US firms, in both the domestic and global marketplace, would be similarly increased through NAFTA. Thus regionalism here is seen as a new way to organise production and one which is largely state-driven. The thesis confirms that it is states rather than firms that have been at the forefront of the new regionalism, leading to the contention that the new regionalism may be in part a strategy by states to strengthen their position as the key interlocutors both domestically and internationally, a position that many saw as being seriously undermined by the globalisation of markets and finance.

The question of whether the re-emergence of regionalism in the 1980s and 1990s may have been influenced by the challenge to the ideas of the liberal economic orthodoxy of free trade from strategic trade theory and the concept of dynamic comparative advantage has already been discussed in some detail in Chapter Three. From the case studies it is clear that this challenge to the liberal economic orthodoxy of free trade had an indirect role in the rise of new regionalism by further eroding support for the liberal international economic order. By showing that, contrary to the previous belief that protectionism was self-defeating, states could theoretically benefit from practices that went against the liberal economic orthodoxy of free trade, the challenge to the liberal economic orthodoxy of free trade strengthened the position of those, particularly in the United States, who argued that the US should adopt measures such as Super 301 to force other states to abandon these practices. The case studies also show that the theoretical challenges to the liberal economic orthodoxy of free trade had a more direct role in the rise of the new regionalism by reinforcing the belief that, by creating larger markets through regionalism, states can increase the competitiveness of their firms.

Inter-regional level questions on the causes of regionalism

The question of whether the functional economic integration occurring in East Asia spurred the next stage of EC integration, which in turn spurred regionalism in other regions, has already been touched on at the system level. The case studies in this thesis largely confirm the importance of the chain reaction effect. Thus the economic rise of East Asia and Japan in particular was shown to be an important factor in the push for a Single Integrated Market in the EC, and in moves by Canada to form a FTA with the US and by
Mexico and the US to form NAFTA. In Chapter Eight we saw how concern about the growing trend towards regionalism both in the EC and North America was an important factor in the decision to establish APEC, while in Chapter Seven similar concerns about both the EC Single Integrated Market and APEC played an important role in the establishment of NAFTA. In some ways this could be seen as a variant of the beggar-thy-neighbour defensive regionalism of the 1930s. However, as has already been mentioned, the new regionalism is perceived by states as a means to increase the competitiveness of their firms in the global market and the attractiveness of their economies to global investors. Whether these goals are compatible with the closed regions of the EU and NAFTA remains to be seen.

As for the neo-marxist and neo-realist question of whether the rise of the new regionalism has been influenced by growing economic and political competition between the major states of the world, namely Japan, the US and Germany, and their inability to agree on macro-economic policy, this thesis clearly shows the heightened economic rivalry between the major economic powers to have been an important factor in the new regionalism. Because of this growing rivalry and of their inability to reach agreement on global macro-economic policy and on reforms to the GATT, these powers have sought to consolidate their bargaining position and increase their competitive edge by forming strategic trade alliances with other states in their regional hinterland. Of particular significance here is the growing coincidence of national interests among states of the same region and the associated rise of a regional identity.

Intra-regional level questions on the causes of regionalism

The findings of this thesis confirm the argument that the resurgence of regionalism has been due to a move by some or all of the members of an existing regional arrangement to prevent the erosion or collapse of that arrangement. In Chapters Four and Five we saw how the conviction of some EC members that further institutionalised integration was necessary to prevent the unravelling of existing ties played an important role in the establishment of the Single Integrated Market. There was some concern in the EC that regional functional regional integration was stagnating and had not gone far enough. There was a fear that the unravelling of the existing regional arrangement would decrease the bargaining power of the countries involved vis-à-vis the outside world and threaten to revive the intra-regional political enmities of the past. The members of the EC recognised the importance of regional political stability to economic prosperity and were prepared to sacrifice the less certain but possibly greater welfare gains of global free trade for the increased political stability that a reinforcement of existing regional arrangements might bring. In Chapter Eight we saw how some ASEAN members had held similar concerns

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4 The question remains however as to why other states decided to opt for a form of institutionalised regional economic integration in response to what they perceived to be Japan's functional regional economic integration.
about the negative effect that membership of a broader Asia Pacific economic arrangement might have on the cohesiveness of ASEAN itself. Although these concerns were not sufficient to prevent the establishment of APEC, they did slow down its institutionalisation and the adoption by its members of the goal of free and open regional trade. Indeed, it was only after the ASEAN states had consolidated their own regional organisation through the establishment of AFTA that the consolidation of APEC was possible. In North America, the situation was somewhat different to that in Europe and Southeast Asia, as there were no existing comprehensive regional economic arrangements. However, the request by Canada and to a lesser extent by Mexico could be seen as an attempt to preserve and extend the functional economic integration that existed between their economies and that of the US, integration that was being seriously threatened by rising protectionism in the US.

The thesis also confirms the importance of specific historical circumstances within a particular region in the recent resurgence of the phenomenon of regionalism. In Chapter Five we saw how the weakening of the attachment of certain European states to national sovereignty after World War II facilitated the first wave of regionalism in Western Europe on the 1950s and was still a factor in the second wave of the 1980s. The war had served to discredit nationalism and demonstrate how national sovereignty could no longer guarantee, and was perhaps even inimical to, the economic and social welfare of individual states. This was particularly true of West Germany, which saw a dissolution of German sovereignty within a European political union as the only way to reassure its neighbours and gain acceptance for German reunification. France had also seen economic union with West Germany as essential to the post war reconstruction of its economy but had reverted to nationalism under De Gaulle, bringing a halt to the integration process in Europe. However, with the economic gap between West Germany and France continuing to widen and with the failure of Mitterrand's Keynesian economic policies, France came to see its economic and social welfare and its status as a world power as dependent on closer European economic and political integration. This questioning of sovereignty was specific to Western Europe. However, in the Asia Pacific the situation of Japan was in some ways similar to that of West Germany in Europe. As a result of World War Two, Japan too found itself constrained in the pursuit of its foreign policy objectives and like West Germany saw regionalism as a means of achieving these in a way that reassured its neighbours and made them less fearful of Japan's economic revival. At the same time its dependence on the US for its military security has played an important role in determining the geographical scope of regionalism in the Asia Pacific.

In terms of the relationship between the resurgence of regionalism in the 1980s and growing regional functional economic interdependence, it is clear from the three case studies that, although the prior existence of functional regional economic interdependence was a necessary pre-condition for institutionalised regional economic integration, it was
the threat to the continuation of that functional interdependence rather than its continued growth that led to its institutionalisation. As we saw in Chapter Three, the role of the multinational enterprises and their production and investment structures in bringing about institutionalised regionalism is contested and the case studies appear to support the claim that the new regionalism was largely state-driven. Although multinational enterprises have played an important part in the growth of functional regional economic interdependence, their investment decisions have been influenced by government policies to promote regional economic ties and regional economic development. Thus Japanese development aid to Southeast Asia prepared the way for the export of its industry to Asia just as the Autopact between Canada and the US and Mexico's Border Industrialisation Programme gave an impetus to functional regional economic interdependence in North America.

From the discussion above it is apparent that the new regionalism is to a large extent politically driven and can be seen as a confidence building measure designed to lessen the risk of intra-regional conflict. This is obviously the case in Europe where the Single Integrated Market is largely another step in a process designed to lessen the risk of conflict between France and Germany in the EC. It is also the case in the Asia Pacific where APEC is perceived by its supporters as a means of reducing the likelihood of a trade war between the US and Japan and, more recently, as facilitating China's political and economic integration into the region. It is also true even in North America, where the free trade agreement between the US and Mexico can be seen as an attempt to reduce Mexico's traditional animosity towards its northern neighbour. This leads to the question of whether the new regionalism is as much the result of a convergence of economic systems as a coincidence of national interests. Although there is some indication that economic systems may be converging at least among some states in the regions studied here, it is clear that this convergence is far from complete and that the new regionalism may be seen in part as an attempt to promote that convergence. Within the EC the differences that remain over issues such as the adoption of minimum working conditions or a common currency reflect deeper differences in economic ideology. Both Canada and Mexico are still more interventionist in their domestic economies than the United States, while many in the US still see Japan's economic system as incompatible with that of the US.

The case studies also confirm the importance of cross-border elites or epistemic communities in the new regionalism. In Chapters Four and Five an important role was ascribed to the EC institutions and in particular to the EC Commission in both alerting member states to the problem of the EC's declining international competitiveness and in convincing them that further institutionalised integration was the way to solve that problem. In Chapter Eight we highlighted the role of non-governmental bodies such as PECC in increasing support for institutionalised regional economic integration among the political elites of the Asia Pacific. The North American case study stands out from the
others through the absence of a similar organisation with the specific aim of promoting institutionalised regional economic integration. Yet even here, we ascribed an important role to international institutions such as the World Bank and the IMF and to certain academic institutions such as Harvard in facilitating contact between the political and economic elites of the United States, Mexico and Canada and in encouraging the spread of those ideas and economic ideologies that were favourable to institutionalised regional economic integration.

In all the case studies it was apparent that these epistemic communities had facilitated the spread of new ideas and values among regional elites and that these changing elite ideas and values were a significant factor in the rise of the new regionalism. These elites played an important part in the shift from Keynesianism to economic liberalism and from import substitution industrialisation to export-oriented growth that took place in the 1980s, a shift that was to make governments more favourably disposed towards the adoption of regional free trade as a way of increasing economic growth, employment and competition within the domestic economy and of boosting the international competitiveness of domestic firms. By encouraging governments to seek regional solutions to national problems and by facilitating contacts between national elites at a regional level, these epistemic communities may in fact have been instrumental in shifting state-based political cultures towards elements of a region based political culture and in bringing about a nascent regional identity. Nevertheless, it is clear from the case studies that these elites by themselves did not bring about the necessary change in ideas and elite values that led to the new regionalism. This thesis confirms the argument of Peter Haas in Chapter Three that for such a change in ideas to take place there must first be some kind of political and/or economic crisis that causes political elites to reject accepted paradigms and to seek new ones. In this thesis we have seen how the economic and political crises of the 1970s and 1980s and the rising concern about the declining international competitiveness of domestic firms led governments to revise and even reject accepted doctrine and practices that were hostile to regionalism.

**Intra-state level questions on the causes of regionalism**

From the case studies it is clear that specific historical circumstances within particular states did play a role in the recent resurgence of regionalism. Of particular significance were the changes in government in the United Kingdom, France, Canada, Australia and Mexico. In Chapter Five we saw how the election of the Thatcher government in the UK in 1979 had been an important factor in the establishment of the Single Integrated Market. Previous Labour governments had been steadfastly opposed to further European integration on the grounds that it would reduce their control over the British economy and for this reason it was unlikely that a Labour government would have viewed the Single Integrated Market with much favour. Thatcher, however, saw the Single Integrated Market as a way of getting the other EC member states to adopt economic policies that were
similar to her own, and of making it more difficult for any new Labour government to reinstate the interventionist policies of the past. Chapter Five also showed how the failure of Mitterrand's Keynesian economic policies in the early 1980s led to a shift in France's EC policy in favour of institutional reform and the establishment of the Single Integrated Market. In Chapter Six we saw how the election of the Mulroney government in Canada in 1982, like that of the Thatcher government in the UK, had accelerated the shift from Keynesian to economic liberal policies and had led Canada to request an FTA with the US. In Chapter Eight the coming to power of the Hawke Labor government in 1983 led to a similar shift in economic policies in Australia towards deregulation and export-oriented growth and to the adoption of regionalism as a strategy to ensure Australia's access to the fast growing markets of its region. While there was no change in the party in government in Mexico, the election of Salinas as President in 1988 consolidated the dominant position of the US-trained técnicos within the Mexican Administration, paving the way for the request by Salinas in 1990 for an FTA with the US.

From the discussion above it is clear that domestic interest groups and elites in the individual states played an important role in the emergence of the new regionalism, both directly through their promotion of regionalism as a solution to some of the pressing economic and political problems being faced by their particular state, and indirectly through their advocacy of economic neo-liberal policies that favoured regionalism.

As for the question of whether the phenomenon of regionalism has weakened the state as the site of decision-making (its jurisdiction over its inhabitants) and in terms of its ability to demand and deliver the loyalty of its inhabitants, leading as the neofunctionalists originally predicted to its eventual replacement by a supranational regional authority, or whether it has, as Hoffmann has argued, actually strengthened the state, the case studies in this thesis appear to confirm the latter argument, at least in the short term.5 In many of the countries studies here regionalism was perceived as a means of boosting economic growth and reducing unemployment, by increasing the international competitiveness of domestic firms and the attractiveness of the country as a destination for foreign investment, and by guaranteeing the access of domestic firms to foreign markets. Although regionalism has diminished the formal sovereignty of individual states by curtailing their ability to take unilateral action, in doing so it has actually enhanced the economic security of all the states involved in what is a variation of regional disarmament. Regionalism has thus, in effect, shored up the domestic legitimacy of the state by enhancing its capacity to perform

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5 Keohane and Hoffmann (1991, pp.7-8, 17-18) have argued that while the EU member states have surrendered their authority to make decisions in certain areas, that authority has not been transferred to a supranational body but to an interstate body (the EC Council of Ministers), where it is exercised jointly by the states concerned. They have described this practice as the 'pooling' of sovereignty, a qualified form of supranational decision-making without supranational institutions. See Chapter Five, pp.178-81. The question here of course is whether the persons on these bodies are making decisions in accordance with narrow national interests or with broader national interests that reflect the interests of the region as a whole.
domestic tasks. It has further increased that legitimacy by increasing the bargaining position of the state *vis-à-vis* other states outside the region, thereby increasing its ability to obtain favourable terms of access to their markets. This is true not only of the less powerful states but also of the global economic powers in their struggle to shape the rules of the new global economic order.

In terms of the distribution of power within the state, regionalism has strengthened the position of the executive relative to that of the parliament and important domestic lobby groups, by reducing the ability of the elective representatives to scrutinise, and that of domestic lobby groups to influence, key economic policy decisions, which are often determined in regional meetings of senior government officials, ministers and leaders. While this may weaken the ability of domestic protectionist forces to influence government policy, it nonetheless reduces the legitimacy of the state in the eyes of its citizens by undermining the principle of democratic accountability. Whether or not this will in the longer term lead to demands, as is already the case in the EU, for the election by universal suffrage of a regional parliament to vet the decisions of the regional executive and thus to the undermining of the state remains to be seen. Moreover, the new regionalism has occurred - with the partial exception of the EC - without the formal transfer of decision-making powers to a regional authority. States have simply agreed to waive their ability to exercise regulatory powers in certain areas and allow market forces to rule. It is still not certain whether this is sustainable in the longer term or whether, in the event of a crisis, states may be forced to cede these powers to a regional authority or resume exercising them themselves.

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6 Critics of the present decision-making practices of the EU have argued that the pooling of sovereignty has further increased the power of executive government to the detriment of the parliament within the member states and have called for the granting of increased powers to the European Parliament to remedy this 'democratic deficit'.
The propositions

I now return to the propositions listed at the end of Chapter Three concerning the re-emergence of regionalism in the 1980s and 1990s. In the table that follows a comparison is made of the influence - strong, present, weak or not present - of the five propositions in the case studies.

<table>
<thead>
<tr>
<th>Propositions</th>
<th>EC</th>
<th>CUSFTA/NAFTA</th>
<th>APEC</th>
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<tbody>
<tr>
<td>1. retreat &amp; defend</td>
<td>P</td>
<td>S</td>
<td>S</td>
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<tr>
<td>2. advance &amp; compete</td>
<td>S</td>
<td>S</td>
<td>S</td>
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<tr>
<td>3. rivals all</td>
<td>S</td>
<td>S</td>
<td>P</td>
</tr>
<tr>
<td>4. domestic &amp; the region</td>
<td>S</td>
<td>W/P</td>
<td>W/P</td>
</tr>
<tr>
<td>5. ideas &amp; learning</td>
<td>S</td>
<td>S</td>
<td>S</td>
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</tbody>
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*Code: S - strongly influenced; P - present; W - weakly influenced or not present*

From the above table it is clear that all the propositions are supported - with the possible exception of the fourth proposition - by the case studies. It is also clear that the degree of support for some of the propositions varies from case study to case study. This variation is attributable to circumstances specific to a particular region and/or to changes at the system level and intra-regional level that have occurred in the period between one instance of regionalism and the next.

Propositions Two and Five were shown to have been strongly influential in the rise of the new regionalism in all the case studies. The rise of East Asia and the associated shift in comparative advantage, increasing protectionism, the slowing of economic growth and growing unemployment saw states resort to institutionalised regional economic integration in order to enhance the economic and political security and boost their competitive

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These propositions in brief are:

- The 'retreat and defend' proposition that the re-emergence of institutionalised regional economic integration is a response to the undermining of the liberal international trading regime and the associated rise in protectionism, particularly in the US.
- The 'advance and compete' proposition that institutionalised regional economic integration is a type of economic alliance that states enter into to enhance their economic and political security in relation to members and non-members of the alliance or more particularly to boost their competitive position in the global economy.
- The 'rivals all' proposition that institutionalised regional economic integration is the result of a defensive interaction first among rival capitalists, but also among rival states. In the first place a move to regionalism occurs because increasing competition drives firms into regional arrangements. In the second case, states, seeing the prospect of their rivals advantaged, move to construct their own economic spheres of influence.
- The 'domestic and the region' proposition that the re-emergence of institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability as a result of increasing economic interdependence.
- The 'ideas and learning' proposition that the re-emergence of institutionalised regional economic integration is the result of cognitive change, that is, changes in the ideas and beliefs of policymakers and elites that have made them more favourably disposed towards regionalism.
position in the global economy. States saw institutionalised regional economic integration as a means of securing and enhancing access to the markets of important trading partners in their region, and of increasing their bargaining position in international fora and thus securing and enhancing their access to markets in other regions. In the more competitive international economic environment of the 1980s states looked more favourably on the claims of integration economists that regional economic integration would increase the efficiency and international competitiveness of domestic firms, increase economic growth and reduce unemployment.

Cognitive change (proposition five) and in particular the shift in the dominant economic paradigm from Keynesianism to economic liberalism was shown in all the case studies to have made policymakers more favourably disposed towards institutionalised regional economic integration. There was a logical coherence between the basic conviction of economic liberals that a return to economic growth would require less government involvement in the economy and a greater reliance on market forces, and the long standing arguments of integration economists that FTAs, by eliminating government regulation of trade between states, would boost economic growth through increasing economies of scale and increasing competition between firms. This shift, together with the patent success of the export-oriented growth strategies in East Asia, reduced concerns held by states about the loss of economic sovereignty that would result from membership of an FTA, and led to the abandonment of the import substitution industrialisation strategy, thereby overcoming two significant obstacles to institutionalised regional economic integration.

The influence of the remaining propositions in the rise of new regionalism varied according to the case study. The retreat and defend proposition (one) strongly influenced the rise of the new regionalism in both the North American and Asia Pacific case studies. It is clear that the new regionalism in these regions was an attempt to maintain and enhance the functional regional economic integration that had occurred under the umbrella of the multilateral trading system but which was now threatened by the inability of the major economic powers to agree on the reforms needed to ensure that system's survival. It was also present in the EC case study but it was somewhat less influential there. Although the new regionalism in the EC was in part due to the concern by member states that the proliferation of non-tariff barriers within the EC would undermine EC economic and political cohesion, that proliferation was more directly associated with the growing economic competition from East Asia than with the erosion of the GATT. Moreover, there was also a fear on the part of some member states that the relevance of the EC to its member states in terms of the preferential access it accorded domestic producers to the EC market, which had already been diminished by the cuts in the common external tariff that had been agreed to in successive GATT rounds, would be even further reduced in a new GATT Round. This ambiguous attitude towards the GATT clearly sets the EC apart from the other instances of regionalism studied here and serves to underline the fact that
regionalism in the EC is as much about forging closer political union as it is about liberalising trade.

The third proposition 'rivals all' was present in all of the case studies. It was strongly influential in the rise of the new regionalism in the EC, where there was considerable concern about the declining international competitiveness of EC firms in relation to their US and Japanese rivals. This is perhaps explained by region-specific circumstances - institutionalised economic regionalism was already well established and there was already some sense of regional interest and identity; and the greater role traditionally accorded to the state in enhancing the international competitiveness of domestic firms. It was not as influential in the Asia Pacific case study. There are several possible explanations for this difference. First, there is the political and cultural heterogeneity of the Asia Pacific region, its relative newness as a regional entity and the uncertainty as to whether the region is in fact the Asia Pacific or East Asia. Second, some states, particularly in the early stages of APEC's development, were reluctant to use it as a vehicle for regional trade liberalisation and saw it instead as simply another means of shoring up the global trading system. Of all the regions studied here, the Asia Pacific is the one whose identity is most artificial, having been created mainly in reaction to the other instances of regionalism.

The third 'rivals all' proposition was more influential in the rise of the new regionalism in North America than in the Asia Pacific but not as strong as in the EC. There is a stronger sense of regional identity and the region is more homogeneous both politically and culturally than the Asia Pacific. This is particularly true of Canada and the US but also of Mexico and the US. In the case studies we saw how Canada, the US and Mexico had come to hold similar views of the trading practices of the EC and Japan. Because NAFTA was established after the EC SIM and APEC, the importance of inter-regional rivalry as a factor for Mexico in the decision to request an FTA with the US was even greater than it had been for Canada. Yet while Mexico and Canada saw the new regionalism principally as a means of maintaining and enhancing functional regional economic integration, for the US it was primarily aimed at increasing its bargaining position in the negotiations to define the new rules of the global trading system.

The 'domestic and the region' proposition (four) is perhaps the most interesting as far as the findings of the case studies are concerned. Those findings point to some significant connections between domestic politics and the rise of the new regionalism, and the more general contention of this proposition - that institutionalised regional economic integration is a reaction to the costs of increasing economic interdependence - is clearly supported by the case studies. Yet the link between the new regionalism and domestic politics was not quite what had been first envisaged when this proposition was drawn up, namely that institutionalised regional economic integration is the result of efforts by states to offset the decline in their ability to regulate the economy and ensure domestic political control and social stability due to increasing economic interdependence. Although this particular
reading of the fourth proposition was confirmed in the EC SIM case study - it was a significant factor in the French decision to support the SIM - it was totally absent from the other case studies. On the contrary, in the Asia Pacific and North America, governments saw the new regionalism as a way of relinquishing certain regulatory powers and ensuring that no future government could regain them. This view of regionalism was also present in the EC case study where the desire to entrench deregulation both at home and within the region was a significant factor in the decision by the Thatcher government in the UK to support the EC SIM. The findings of the case studies show that though there are conflicting views as to the purpose of institutionalised regional economic integration, it is the view of Hayek and Olson that has been the dominant one in the rise of the new regionalism.

**Propositions about the resistances to regionalism**

Any study that seeks to explain why change occurs would, however, be incomplete without some analysis of the resistances to that change and how these were overcome. I have already outlined in each of the case studies the various resistances to institutionalised regional economic integration and the way in which these resistances were overcome. I will now attempt briefly to make some general propositions concerning why and under what circumstances states may oppose regionalism. It is clear from the case studies that opposition to institutionalised regional economic integration arises out of two related concerns about the state sovereignty. The first is that institutionalised regional economic integration will lead to a loss of economic sovereignty and a significant increase in the capacity of outside economic powers to determine the economic policies and structure of the state concerned - or what Triffin, Cooper and others have called vulnerability. A second related concern is that this loss of economic sovereignty will lead to a loss of political sovereignty, which in the short term will reduce a state’s political independence in terms of its ability to shape its own foreign and domestic policies, and in the longer term may, in some cases, lead to the loss of separate political and cultural identity through political integration.

In the case studies we saw how these concerns had been heightened by particular circumstances. Thus a combination of past historical experience, in particular that of colonialism, and certain economic ideologies and practices - dependency theory, the poles of development of Myrdal and Hirschman, import substitution industrialisation, Keynesianism - had increased the fears of states, especially developing states, about the loss of economic sovereignty and the increase in vulnerability that institutionalised regional economic integration would entail. At the same time the ideological divisions of the Cold War, the spread of American culture and the theory and practice of regionalism
in Europe augmented concerns that the loss of economic sovereignty would lead to a loss of political sovereignty.\(^8\)

Changes in these circumstances, however, lessened these concerns to such an extent that the new regionalism was possible. Among these changes were the perceived failure of import substitution industrialisation and Keynesianism, the undermining of dependency and poles of development theory by the success of export-oriented growth in the NIEs and the shift to economic liberalism. At the same time, the rise of East Asia and the resulting increase in international economic competition and protectionism made states more eager to obtain the security of market access and increased competitiveness that regionalism was said to provide, and less concerned about any accompanying loss of political sovereignty. The growing awareness of the importance of economic growth to regime stability and of the importance of secure access to large markets in achieving that growth had a similar effect. The end of the Cold War and the shift from a bipolar world with an emphasis on military power to a multipolar world where economic power is of growing significance also helped to reduce the concern of states about the loss of formal economic sovereignty that institutionalised regional economic integration would entail. At the same time there was a realisation by states that regional agreements, by binding all states to forgo the right to impose barriers to the entry of foreign goods, could actually reduce the increased vulnerability that results from increased economic interdependence where global agreements had failed to do this.

Yet changes in circumstances were in themselves not sufficient to bring about a change in the attitude of states towards regionalism. As is evident from the case studies, that change was a product of the interaction of these changing circumstances with the spread of ideas or intellectual constructs by institutions and epistemic communities. The changing circumstances thus engendered (in the minds of policymakers) the condition of uncertainty that was necessary for economic ideologies that had been the source of the resistances to regionalism to be forsaken for other economic ideologies more propitious to its development.

It is clear at this point that both the answers to the questions and the analysis of the propositions about causes and resistances undertaken here shift the emphasis on the broad hypothesis posed in Chapter One to a more complex and nuanced explanation of regionalism involving not only the systemic factors of international economic change and the rise of East Asia but factors at the intra-regional and intra-state levels.

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\(^8\) In Europe, however, concerns about political sovereignty had been lessened by the experience of WWII to the extent that regionalism was possible there.
The theories revisited

I now turn to an examination of the insights provided by the case studies in this thesis into the theoretical debates outlined in Chapters Two and Three. The debate between Viner and Triffin over the merits of regionalism is of course still raging and there still appears to be no clear answer to the question of whether regionalism is on the whole a negative or a positive development. However, it is clear that Viner's customs union theory has failed to deter states from entering into regional trading arrangements. It would appear that, in the present period of intense international economic competition and growing protectionism, states are more concerned with finding ways to increase their national competitive advantage and hence national economic welfare in the short to medium term, even if this is at the expense of long term global economic welfare. Customs union theory as it was originally conceived by Viner cannot explain the behaviour of states. Viner had hoped to influence the behaviour of states by showing that the economic gains obtained through a customs union were actually less than was commonly assumed. Yet the case studies vindicate the arguments of Triffin and Balassa that the criteria used by Viner to evaluate the merits of regional agreements were too narrow. It is clear from the case studies that the motivations of states in forming customs unions are more political than economic (a point actually conceded by Viner) and thus cast doubt on theories such as customs union theory and neofunctionalism, which, in their accounts of the behaviour of states, elites or individuals, privilege economic welfare and efficiency over other aspirations such as security and stability, quality of life and the realisation of cultural and political identity. The case studies also show that states may engage in customs unions to increase their bargaining power in international fora - another way of increasing national economic welfare that Viner conceded was not included in his own calculations. Viner's calculations also excluded the gains in economic welfare to be derived through the so-called dynamic effects of customs unions, and through the increased stability and economic security that they gave states against sudden unilateral action by other states. He also failed to see that regional trading arrangements are easier to negotiate than global arrangements because of the smaller number and the greater homogeneity of the states involved. Of course it still remains to be seen whether regional trade liberalisation will be, as Triffin has argued, a stepping stone to global trade liberalisation.

The debate concerning the validity of neofunctionalism as a tool for explaining the evolution of regional integration has already been reviewed in the conclusion to Chapter Five so some general observations will be made here. First, the relevance of the theory to the case studies other than the EC is unclear. The theory purports to explain the evolution of regional integration only after the establishment of a supranational regional authority and, thus would not seem relevant to either the North American or Asia Pacific case studies. Even in Europe, where such a body does exists, the theory's ability to explain the establishment of the Single Integrated Market is questionable. Although neofunctionalists may have been right in their prediction that further steps towards regional integration will
be the result of the desire to protect and extend existing benefits of regional economic interdependence, they failed to correctly identify the process by which these steps would come about. Contrary to neofunctionalist predictions, the state political elites were generally more keen than the general population or economic elites to embrace further regional integration. The SIM was not the result of automatic spillover or of a shift in political loyalties from the national to the supranational entity but of changed external and internal circumstances which forced states to see increased regional integration as the best way to achieve their separate national interests. The fact that similar internal and external circumstances were involved in the establishment of institutionalised regional economic integration in the other case studies would appear to question the utility of neofunctionalism as a tool for explaining the emergence of the SIM. It is clear that state elites in Europe were motivated by the concern that existing regional economic functionalism was inadequate to ensure the international competitiveness of European firms and therefore had to be encouraged through state intervention.

The case studies also shed some light on the complex relationship between global economic interdependence and regionalism. It confirms the argument of Cooper (and Triffin) that regionalism is an attempt by states to find a more sustainable form of economic interdependence. It also confirms the argument by Gilpin that regionalism is a neo-mercantilist response by states to the increasing competition among states for markets. With the threats to global economic interdependence already apparent in the late 1960s and early 1970s, however, the question remains as to why regionalism in fact stagnated in the 1960s and 1970s and did not re-emerge until the 1980s. Part of the explanation for this might be that regionalism was in fact impeded by the persistence of the Cold War and the bipolar international security structure - the stagnation in European integration in the 1960s was largely a result of disagreements between France and the other EC members over the stance they should take on security questions - and that the level of international economic competition was still not sufficiently intense.

The thesis confirms the argument by Keohane and Nye concerning the importance of institutions in maintaining cooperation among states. States clearly saw institutionalised regional economic cooperation as necessary to preserve and extend functional regional economic interdependence at a time when institutionalised global economic cooperation in the form of the GATT was being eroded. As was pointed out in Chapter Three, under the conditions outlined by the neo-liberal institutionalists as necessary for the establishment of institutions at the international level, regional institutions are more likely to emerge than global institutions and it is they which are the norm and global regimes the exception. If this is the case, then the more logical question would be not that of why regionalism but that of under what exceptional circumstances are global regimes possible. While there is considerable disagreement over what constitutes the conditions for global institutions and, in particular, for the establishment and maintenance of a liberal international economic
order, this thesis shows that many of the factors that contributed to the undermining of the liberal international economic order of the post-war period - the relative decline in US economic power and the economic rise of East Asia; the decline in support within the US for that order; the end of the Soviet threat and the bipolarised world structure - were also important factors in the rise of the new regionalism.

As for the debate between the neo-institutionalists and realists concerning the importance of relative gains to the survival of institutions - both global and regional - the thesis does provide support for the realist position. Thus it could be argued that the US perception that the GATT regime in the late 1970s was responsible for the relative decline in US economic strength and its worsening trade deficits and was no longer serving its national interests, led the US to embrace regionalism as a means of increasing its relative gains from international trade. The US believed that regionalism would increase its relative gains in two ways. First, it would give its firms preferential treatment in the markets of neighbouring states and enable them to make greater use of production sharing to reduce their production costs relative to those of their foreign competitors. Second, it would increase US bargaining power in negotiations aimed at reforming the GATT system so that it was more amenable to US trading interests. In the EC case study relative gain calculations were also important. Thus the UK support for the SIM came only after the EC member states had agreed to ways of reducing the UK financial contribution to the Common Agricultural Policy. Similarly France and Italy linked the removal of non-tariff barriers to intra-EC trade to the strengthening of the Community's commercial policy instrument. All the EC member states were concerned by the decline in their relative gains from international trade and saw the SIM as a way of improving their position relative the US and Japan. In the North America, both Canada and Mexico saw the FTA with the US as a means of increasing their relative gains by enhancing the access of their firms to the US market. In the Asia Pacific states feared that the emergence of regionalism elsewhere would reduce their relative gains from international trade and saw APEC as a way of preventing this. Thus the realist position that regionalism is state interest (and relative gains) - driven rather than the result of the socialisation of states into cooperation is confirmed by the case studies.

The thesis also confirms the role of new ideas in facilitating cooperation and policy coordination at a regional level. The shift in the dominant economic paradigm from Keynesianism to economic liberalism not only increased the importance of relative gains in the calculation by states of their national interests, it also led states to view more favourably proposals for institutionalised regional economic integration. The thesis also confirms the role - ascribed by both Cox and neo-liberal institutionalists - of international institutions such as the IMF and the World Bank not only in transmitting cognitive change but also in enforcing it. This was particularly apparent in the case of Mexico but no doubt also true of other developing countries in Southeast Asia such as Thailand and
Indonesia. From the North American case study it is also clear that a similar role was also performed by certain national institutions such as Harvard and Yale, particularly because of their international orientation.

The thesis also supports the arguments of Ernst and Peter Haas regarding the role of transnational scientific and intellectual communities - the so-called epistemic communities - both in the transmission of new ideas across borders and in bringing about the convergence of government policies concerning international or regional problems. Thus in the North American, Asia Pacific and EC case studies, policymakers were exposed through their contact with epistemic communities of neo-liberal and neo-mercantilist persuasions to various arguments favourable to institutionalised regional economic integration. The case studies also confirm Peter Haas's contention that exposure to new ideas is, in itself, not sufficient to bring about a change in state behaviour and that such a change will only take place when the power of existing ideas and their backers has been eroded as the result of some shock or crisis. In the case of the rise of the new regionalism, however, the crises may have produced a policy convergence on the necessity to embrace institutionalised regional economic integration but the rationale for doing so was not necessarily the same. Thus an economic crisis situation sparked by the spiralling US trade deficit undermined the traditional dominance of free trade ideology in the US Congress and made it more receptive to new neo-mercantilist ideas that favoured bilateralism and regionalism. At the same time a similar economic crisis weakened the traditional dominance of protectionist ideology in the EC, Canada, Mexico, Australia, New Zealand and ASEAN, making policymakers in these countries more receptive to liberal economic ideas that favoured free trade at a regional level. Thus it would seem that social learning does not matter in the least unless circumstances change and interests are recalculated.

But it also clear that there is no easy convergence between these two contradictory trends of free trade and protectionism. Therefore the economic convergence theories of some economists and socialists may perhaps need some amendment, or a longer time span, to be valid. The triumph of economic rationalism (and 'free trade') may be temporary and the great escalator of convergence theory may be temporarily or permanently stopped at the way station of institutionalised regional economic integration. This is especially true of Europe, where EC regionalism would appear to be at loggerheads with global trade liberalisation. The refusal of Europeans to accept the belief of the global free traders that global free trade will lead to increased political harmony is no doubt due to the bitter experiences of the inter war period when economic depression and social and political unrest were seen as leading to war. Such experiences explain the greater concern in Europe to maintain control of the domestic economy than in the US and Canada. This view of regionalism as helping to ensure against a return of the political problems of the past differentiates it from regionalism elsewhere, though, on closer reflection, more by degree (US concerns about Mexico, Asian concerns about declining US presence). Yet,
whereas in the Asia Pacific and North America the decline in the multilateral trading system was an important factor in moves towards regionalism, in Europe global free trade was seen as undermining the economic solidarity among EC members, which it was felt was a crucial glue and essential to maintaining regional political stability. Hence at least in Europe increased global economic interdependence leads (contra Keohane and Nye) to increased efforts for regional economic AND political integration.

The future of regions: notes on a causal theory of the new regionalism

If, as seems likely, the factors causing the new regionalism of the 1980s and 1990s are highly similar and the kinds of resistances are also remarkably similar, even if played out in different domestic and regional circumstances, then it might be possible to construct a theory accounting for the rise of this new regionalism.

This would not be a 'grand' theory accounting for all occurrences of regionalism (though it might contribute to such a theory). This theory is time specific, that is to the 1980s and early 1990s.

The theory might have the following negative and positive propositions:

Among the negative propositions might be:

1. The weight of the past is not decisive in moves to regionalism directly since all three case studies come out of quite different national and regional historical circumstances. This is not to say that the weight of the past was not decisive for the particular case of euro-regionalism in the 1950s and 1960s.
2. Though the politics in each of these case studies differed, the resistances to the new regionalism were all of the same order. Thus in all three case studies the new regionalism had been opposed by distributional coalitions which were forced to change. In all three cases governments had been fearful of the political upheaval that might follow the economic restructuring engendered by regionalism. In all three there had been considerable concern that regionalism would undermine state sovereignty.

Among the positive propositions might be:

1. That major systemic changes in international relations broadly conceived (change in the structure of the world economy and the end of the Cold War) were decisive in the push to the new regionalism and its extension in the 1980s and early 1990s. The argument of Waltz that the system strongly influences the behaviour of state actors is thus confirmed, at least on the face of the experience of these case studies.
2. That ideological change (essentially on economic policy), itself a consequence of the ideological uncertainty among policymakers brought about by systemic changes, was decisive in the shift to regionalism in the 1980s and early 1990s. (This casts doubt on those theorists that argue for the end of ideology, or the centrality of culture in international relations). The argument of scholars such as Odell and Peter Haas that

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changes in the behaviour of states are the result of cognitive change is thus also confirmed. The question remains, however, whether this ideological change in favour of economic liberalism and free trade is a permanent one. As long as it continues to deliver on its promises of economic growth, it is likely to be so (unless, of course, states abandon their pursuit of economic growth). But should economic growth falter, or worse, should it be seen to undermine national economic and political stability, then there may be a return to some form of modified Keynesianism, either at a regional level - in which case regionalism (though perhaps not open regionalism) will be strengthened, or at a national level - in which case regionalism will be considerable weakened.

3. Since the peculiar feature of economic regionalism in the 1980s was the paradox of states giving up some powers to the region (either intergovernmental or supranational) while strengthening their control of the domestic economy and politics (despite the rhetoric of deregulation), then we need to consider a new model of global, regional, intra-state relations. The state is not dead or dying. Paradoxically it becomes more powerful at home, gains power from its regional connection and then is able collectively through that regional connection to impact on other major states in their regional hinterland.

4. The realist position that regionalism is state interest (and relative gains) -driven rather than the result of states being socialised into cooperation is confirmed. However, realists when considering regionalism may need to have a more nuanced analysis than the assertion of straightforward national interests. Traditional realist conceptions of national interests do not hold in the case of regionalism of the 1980s and early 1990s. States were forced by systemic changes and ideological change to redefine their national interests as being now found in regional interest. (This has important implications for the strength of core realist theory). As the case studies show, it was not so much the goals of states that changed but the means by which they believed these goals could be obtained. Thus states were willing to lose some formal economic sovereignty in order to enhance their economic security and increase their power both domestically and internationally.

5. It has always been the case in the international system that states have had to order their foreign policies to take account of the policies of others and in this, bend to the calculus of power. This thesis shows something related to this but with a different consequence. It is that interaction among regions is as powerful and as dynamic as that among great states (and of both a negative and positive nature) and it resembles quite clearly the security seeking behaviour of great states. However, the interaction among the new regions of the 1980s and early 1990s does not, as yet, show the signs of institutionalised cooperation that relations among great states normally exhibit except in times of security crisis. Why this should be so is an interesting question: regionalism is too new for those habits of cooperation to have developed (especially the need to develop coherence among members

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10 For Odell (1982, pp.12, 364), the shift in US monetary policy that took place in the early 1970s was the result of changes in international market conditions and in the international economic power structure (systemic changes), and changes in the ideas or intellectual constructs on which US monetary policy was based (cognitive change).
- see Keohane and Nye) or relations among regions may be (contra Bull, Carr and Hoffmann) of an essentially different nature to those among great states. If this is the case, then traditional realist theory may be facing its biggest adjustment. With respect to the cooperation-conflict argument, the dominant practice and discourse within regions is one of cooperation, among regions the dominant discourse is competition, rivalry and conflict. This is of course predicted by pure trade theorists and by some realists and neo-marxists. However, this is not to say that these patterns of inter-regional rivalry will persist over the long run and regional core states may be forced to develop institutions of cooperation precisely to avoid the costs of conflict (see Keohane) but also to secure what are the necessary gains from trade in the global economy. None of these regions is, in the present circumstances of the global economy, a candidate for autarky (with the possible exception of the US and its regional hinterland). If this is right it has two implications:

• that the role of the US as a possible bridge across all three regions may emerge. (Particularly if the recently floated idea of a Trans Atlantic Free Trade Area becomes reality,11 and if the US can sustain its role in APEC). If this happens we are essentially confronted by the possibility of a ‘true’ superpower exerting considerable influence over its three satrapies. Such a situation could not endure for long for the other rivals, Germany and Japan with their hinterlands, will certainly constrain the US, and Hoffmann's Gulliver's troubles would re-emerge.12

• On the other hand if a privileged role for the US is unsustainable then the security dimension of inter-regional relations gains higher importance.

6. One may conclude by saying that the structure of the world in the 1990s has a new feature. While great powers want to consolidate the members of their respective regions behind them, they still reserve the right essentially to conduct foreign policy on great power terms (with the possible exception of the EC - but even the EC states are having difficulties constructing an EC foreign policy). This tension between the global and regional interests of great powers may become a central feature of this world order for some time to come.

11 The idea of a Trans Atlantic Free Trade Area (TAFTA) or a Trans-Atlantic Economic Area (TEA) was being discussed by US and EU policymakers in late 1995. See Australian Financial Review 23-11-95, p.15: 'Waves of worry over ripples on pond'.

12 Hoffmann 1968.