Regional integration in a globally networked economy

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Much of the discussion on regional integration is framed in terms of "building blocks" or "stumbling blocks"; will regional economic agreements, such as the European Union or the North American Free Trade Agreement, facilitate the development of an open and liberal international economy, or do they portend the devolution of the world economy into closed, competing economic areas? It is argued here that an open international economy is not an artifact of political processes or of the current distribution of political and economic powers. Rather, the emerging globally integrated world economy is a reflection of fundamental changes in the scale and complexity of technology and the digitalization of international economic transactions. A future of closed regionalism is unlikely, as even the largest economic regions are too small to be viable economically, and there is no reason to believe that regional borders will be any more meaningful than national borders in the face of an electronically networked world economy. Regions are national markets writ large at a time when geography as a basis for the organization of economic activity is in question.

The splitting-up of the world into three great superstates was an event which could be and indeed was foreseen before the middle of the twentieth century. With the absorption of Europe by Russia and the British Empire by the United States, two of the three existing powers, Eurasia and Oceania, were already effectively in being. The third, Eastasia, only emerged as a distinct unit after another decade of confused fighting. The frontiers between the three superstates are in some places arbitrary, and in others they fluctuate according to the fortunes of war, but in general they follow geographical lines. (Orwell, 1949, pp. 152-153).

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At century's end, the world economy presents a paradox of simultaneous integration and fragmentation as both the centripetal and centrifugal forces of globalization and regionalization are evident to even a casual observer. Can they continue to coexist, or will one come to dominate? Will the late 1990s witness progress towards an integrated, open and liberal international economic order or a devolution into relatively closed regional blocks, the economic analogs of George Orwell's "three superstates"?

On the one hand, we appear to be in the midst of a transition from an international world economy rooted firmly in national markets to integrated global systems of production and technology. Internationalized production has replaced trade as the "glue" binding international economic transactions: by the early 1990s, 37,000 parent firms with worldwide sales of about $4.8 trillion controlled about one third of the world's private-sector productive assets (UNCTAD-DTCI, 1994).

During the late 1980s foreign direct investment (FDI) grew at an average annual rate nearly three times above that of trade and four times above that of world output. Critically, 1990 was the first year in which worldwide sales of foreign affiliates exceeded world exports (United States, Office of Technology Assessment, 1993, p.1). Furthermore, the exponential growth of cross-border strategic alliances or collaborative agreements during the early 1990s may well herald the emergence of a complex networked global economy (Mytelka, 1991).

At the same time, there has been a dramatic increase in regionalization. The European Union and the 1992 Single Market are a reality, as is the enlargement of the European Union to fifteen countries. Further expansion of the European Union with at least some former Central European economies becoming members around the turn of the century is a real possibility. Despite the problems resulting from the crisis in Mexico, the North American Free Trade Agreement (NAFTA) is solidly in place, and prospects for MERCOSUR appear promising. In the Asia-Pacific region, the first steps have been taken towards the removal of all trade barriers, and discussions on regional integration are taking place within at least three sub-regional groups: Asia-Pacific Economic Cooperation (APEC), the Association of South-East Asian Nations (ASEAN) and South-Asian Association for Regional Cooperation (SAARC)). It has been suggested that an Indian Ocean regional economic grouping might even be possible.[1]

[1] Niki Tait, "Indian Ocean grouping faces a big 'maybe' ", *Financial Times*, 14 June 1995, p. 8.

In fact, the General Agreement on Tariffs and Trade (GATT) was notified of 33 regional integration agreements between 1990 and 1994—a 300 per cent increase compared with the entire decade of the 1980s and almost 30 per cent of all international agreements since 1948.[2] Intra-regional trade (expressed as a region's share of the total external trade of its constituent markets) grew substantially in East Asia, North America and Europe during the 1980s.[3]

There is considerable difference of opinion about the resolution of this apparent paradox of regionalism versus multilateralism. Some, such as Robert Z. Lawrence (1995), square the circle by arguing that regional agreements are "building blocks" which will facilitate multilateralism and lead to an integrated and open global economy. Others see regionalization as "stumbling blocks", as a withdrawal towards closure which may lead to a reduction in inter-regional economic activity and inhibit further development of a liberal international economy. Jagdish Bagwati, for example, has argued that "This obsession with free trade areas strikes a blow at the multilateral trading system in ways that are either ill-understood or deliberately discounted, disregarded and distorted by politicians and lobbyists."[4]

The most pessimistic are those who believe that globalization has reached its limits—that the glass is half empty and draining. Paul R. Krugman (1992) argued that we are experiencing the decline of the second global economy, a devolution into competing regional blocks which will inevitably become more restrictive against trade from the outside. The obvious parallel is to the 1930s when what Charles Kindleberger has called "disarticulation"—the containment of trade within block borders—prevented a return to the integrated pre-First World War international economy and plunged the world more deeply into depression.

Two related arguments are presented here. First, the emerging globally integrated economy is not an artifact of the current distribution of political and economic powers or the outcome of a successful negotiating process, but rather reflects very basic, fundamental and secular changes in the scale and complexity of economic and technological activities. Second, regional

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[2] Guy de Jonquières, "WTO's blessing for trade groups", *Financial Times*, 27 April 1995, p. 8.

[3] Between 1980 and 1990, intra-regional trade grew from 33.8 per cent to 38.4 per cent in East Asia, 31.5 per cent to 37.3 per cent in North America and 52.4 per cent to 63.4 per cent in the European Community (Kirkpatrick, 1994).

[4] Jagdish Bagwati, "The high cost of free trade areas", *Financial Times*, 31 May 1995, p. 13.

markets are, at best, national markets writ large. There is no reason to believe a priori that they are large enough to be viable economically, or that regional borders will be any less permeable than national borders in an electronic age. A future restricted or closed regionalization is therefore not a likely scenario for the world economy.

A discussion of regionalization in the context of the increasing scale of economic activity and the digitalization of cross-border transfers is presented first. In answering the question of whether geography remains a meaningful mode for the organization of economic activity, it is suggested that the ambiguity of medieval Europe may well be an appropriate analogy for the post-modern world economy. The conclusion outlines some policy implications for governments.

A world of regions?

A regional scenario is not inconsistent with events. First, *multilateralism appears to have been pushed to its limits.* Although an agreement was reached after nine years of negotiations in the context of the Uruguay Round, the process was tortuous and the outcome far from clear until the very end. That experience did not leave most observers with a great deal of confidence in the success of another multilateral round. What confidence remained was drained further by the battle over the choice of the head of the World Trade Organization (WTO) (GATT's successor), which bogged down in disagreement among the three major regions, and the United States-Japan bilateral auto dispute that threatened to render the WTO's critical new adjudication procedures stillborn. Furthermore, substantial domestic opposition to multilateralism—and particularly its institutions—has surfaced in a number of countries, particularly the United States.

Second, *regionalism is very much a reality.* Despite all of the bumps, detours and delays on the road to achieve integration, the European Union's single market exists, albeit in somewhat incomplete form. Although NAFTA is a less ambitious effort—its objectives do not go much beyond a free trade area—it has been more successful and has presented fewer problems than even its most ardent supporters had hoped for, despite the difficulties raised by the recent Mexican crisis. Furthermore, the eventual expansion of NAFTA to include other countries (Chile is the most likely first candidate) is a distinct possibility; and with MERCOSUR for the first time in decades, economic integration is actually taking place within Latin America.

There is increasing discussion of economic links among APEC members and a formal agreement in principle on the removal of barriers to trade within the region—in twenty-five years—has been reached. Although, to date, economic integration within Asia has been driven by private-sector initiatives—primarily the vertical integration of Japanese transnational corporations (TNCs), there is discussion among South-Asian countries on moving towards the creation of a free trade area.[5]

In short, while the intensity and pace of integration differs considerably in Europe, North America and Asia, regionalization is a reality and, at least in the short run, the future of regional blocks appears consistent with the progress of events.

Third, *regionalization may be more consistent with the structural limitations of the international system than an integrated global economy*. The argument is familiar: the establishment and maintenance of an open, liberal, global economy may require a dominant power or *hegemon* to set the rules and bear the costs of supplying the public goods requisite to the free flows of trade and investment. Given the end of the Cold War, when security issues often overrode economic concerns, and the decline in the *relative* dominance of the United States, an open global economy requires cooperation in a multipolar world comprised of a number of relatively equal powers. That is a difficult task at best. To be clear, cooperation in the absence of a dominant power is not impossible; indeed, there is a large literature in international relations that argues that this is feasible under a number of very plausible conditions. But it cannot be achieved easily, and regionalization is certainly as—if not more—consistent with what theory postulates.[6]

Building blocks or stumbling blocks?

Will regionalization lead to integration or devolution? Optimists such as Robert Z. Lawrence (1995) argued that regional blocks will be "building

[5] The Asia-Pacific Economic Cooperation (APEC) organization was created in 1989 as a forum for regular discussions on regional trade issues and economic cooperation. Its membership comprises 17 economies: Australia, Brunei Darussalam, Canada, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Philippines, Singapore, Taiwan Province of China, Thailand and the United States. In mid-November 1994, the APEC ministers endorsed a set of non-binding investment principles.

[6] The debate about whether cooperation is probable or even possible in the absence of a dominant or hegemonic power plays a central role in the literature of International Political Economy. The idea that a dominant power is necessary to provide order and the "public goods" necessary for the maintenance of an open, liberal international system originated with Charles Kindleberger's work on the Great Depression; for a recent summary of this literature, see Baldwin (1993).

blocks'' paving the way to an open global economy. They note that we may well have reached the limits of multilateralism given the complexity of the issues, the number of actors involved (there were 108 participants in the Uruguay Round), the differences between them and the lack of clear international economic leadership.

As the argument goes, it should be easier to reach agreements maintaining free flows of trade and investment within regions where the issues are less complex, substantial economic exchanges already exist, the number of actors is reduced, and geographic—and perhaps cultural—proximity facilitates the negotiating process. Regionalization or ''minilateralism'' would promote free flows of trade and investment within blocks and, in time, lead to multilateral negotiations between a reduced number of participants (the blocks negotiating as entities) and an open, liberal global economy.

The critical assumptions here are that regional blocks will be trade creating (rather than trade diverting)[7] and would maintain relatively open borders. That is far from assured; the motivation for regional integration is not an overall belief in a liberal world order, but a conviction that regionalization is good for the countries involved. There appears to be no more reason to assume that the borders of regional blocks will be relatively open than to assume they will be relatively closed. ''Fortress Europe, NAFTA or Asia'' may be as plausible a scenario as ''building blocks''. Paul R. Krugman (1992, pp. 12-13) argued strongly that the idea of relatively open blocks is nonsense; that block insiders will always have a stronger voice than outsiders; and that the result will be a world of regions which ''will become more restrictive against trade from the outside''.

Relatively closed regional blocks would have differential impacts on trade and FDI depending on the nature of the commodity or the strategy of firms. Transnational corporations in industries such as processed foods or consumer products in which inter-regional trade in intermediate or finished goods is very limited might suffer only minor disadvantages, or even gain, from ''fortress'' regionalism. Their traditional strategic focus has been the foreign affiliate, and many are only now in the process of a transition to regional strategies and organizational structures. However, TNCs in industries that are relatively integrated globally, in which substantial inter-regional exchanges of goods and technologies are the norm could suffer serious consequences from closed regionalization. Firms in aerospace, electronics, semi-

[7] For a good discussion of this issue, see *The Economist*, ''Building blocks or stumbling blocks'', 31 October 1992, p. 69.

conductors or pharmaceuticals in which the scale of technology requires inter-regional markets to afford a competitive research-and-development budget would find closed regionalization catastrophic.

A forecast of devolution into regional blocks assumes that the degree of multilateral cooperation necessary to sustain a relatively open global economy is not possible in a multi-actor, multipolar world. Regional integration represents a compromise: an area small enough for multilateral negotiations to be tractable, but large enough to provide for gains from trade and scale economies. Whether regionalization is taken as a positive or negative development *vis-à-vis* an open global economy depends on the assumptions about the motivation for, and character of, the blocks.

Regionalization is not the answer

Much of the current discussion on regionalization is framed either explicitly or implicitly in a context more appropriate to the 1930s than the 1990s. The motivation for the current attempts towards regional integration differs considerably from that which drove ''disarticulation'' during the Great Depression. In fact, the very term *block* entails atavistic assumptions. Although protectionist sentiments still abound, the primary motivations for present-day integration are efficiency and scale rather than containment and protectionism.

Regional economic integration in the 1990s should not be seen in isolation; it is the latest step in a century-long process of geographic expansion of markets from local, to national and now to international. In fact, a global world economy has been defined in terms of the cross-border integration of national economic spaces (UNCTAD-DTCI, 1994). The expansion of markets in geographic space has been driven by efficiency considerations. The process began in earnest in the mid-nineteenth century with the revolution in manufacturing technologies and the application of science and technology to industry. Larger markets allowed gains from specialization (division of labour), differences in resource endowments, and from scale economies in manufacturing and technology. There is no reason whatsoever to assume that consolidation of markets at the regional level represents the final step of this process.

Those who argue that the world economy is devolving into three relatively closed regional blocks make the following assumptions:

- Regional markets are large enough to be viable economically.

- Regional borders are meaningful and economic transactions across them can be controlled.
- Economic activity can and should be organized in terms of discrete geography.

It is argued here that these assumptions are becoming questionable. First, even regional markets may not be large enough to support efficient production or competitive research-and-development efforts. Second, borders are losing meaning in an electronic age. And last, geography is becoming less relevant as *the* basis for organizing and controlling economic activity. Why should the borders of geographically defined regional markets be any less problematic than the borders of national markets in the face of an electronically networked global economy?

Regional markets are too small

A large number of strategic industries is characterized by rapidly escalating research-and-development costs combined with shortened product life cycles. For example, development costs for semiconductors increased tenfold, from $100 million for a one-megabyte chip in 1985 to an estimated $1 billion for a 256-megabyte chip in 1999. And the cost of bringing a single new prescription drug to the market is now about $300 million.[8] In these industries, technological development cannot be sustained by any single national market. Firms need to have a global market—or at least be TNCs—in order to afford a competitive research-and-development budget. Furthermore, it is far from clear that even the largest global firms can continue to absorb the costs and risks of technological development on their own. There has been an exponential increase in strategic alliances (international collaborative agreements) between TNCs from the major industrial countries during the past decade, and many of these are clearly technologically driven. According to one estimate, high-technology strategic alliances' compound annual growth rate over the 1980s was 31 per cent.[9] International collaboration is becoming the norm even in defence-related industries in which national security has traditionally been seen as far more important than efficiency, and military capability has taken precedence over economics.

[8] See Daniel Green, "Takeover fever: the wave of acquisitions and mergers in the drugs sector is set to continue", *Financial Times*, 22 August 1995, p. 10.

[9] For data on the growth of alliances, see Gomes-Casseres (1993) and Mytelka (1991). The growth figure was cited by Lewis Platt, Chief Executive Officer of Hewlett Packard at the Wharton School, University of Pennsylvania, on 12 September 1993.

The costs and risks of technology are one reason for the emergence of strategic alliances. A recent analysis of over 4,000 strategic alliances found that the primary motive for cooperation is the need to cope with the complexity and interrelatedness of different fields of technology (Hagedoorn, 1993). The range of technologies that must be brought to bear on product and/or process development is increasingly beyond the core competencies of even the largest and most global firms. Technologies have become so complex and change so rapidly that even industry leaders cannot master them internally: cross-firm collaboration is mandated.

If the largest national markets are too small to support competitive development efforts given the costs, risks and complexities of technologies in strategic industries, are regional blocks large and diverse enough to accomplish these objectives? It is argued here that they are not, and that the critical reason is probably complexity rather than cost and risk considerations. Both, however, are relevant and important.

While the three major regions are not by any means homogeneous, North America, Europe and East Asia have developed different approaches to capitalism and have different strengths when it comes to research, development and the introduction of new products. Harnessing these inter-regional differences may well provide a competitive advantage given the complexity of technology and the fast pace of its development. While hard data on alliances are still difficult to come by, there is a general agreement that almost all involve companies from the United States, Europe and Japan, and that close to half entail inter-block (i.e., United States-European) arrangements (United States, Office of Technology Assessment, 1993, p. 119). An executive of a major Japanese pharmaceutical company argued recently that the advantages of inter-regional collaboration are a significant motivation for maintaining research laboratories in Japan, London and Boston; his company must utilize the different approaches to problem solving of professional staff in each region to succeed.[10] Similarly, a study of semi-conductors and biotechnology (Kogut, Walker, Shan and Kim, 1994) concluded that the inter-regional distribution of technological capabilities is an important determinant of emerging global networks.

In fact, "outward pressure" exists in all regional markets. In the European Union, widening appears to have taken precedence over deepening; Austria and two Nordic countries have joined and active negotiations are

[10] Speech by Yamamoto of Eisai Co., Ltd at the "Strategic Management Society" annual meeting at HEC, Jouy-en-Josas, France, 22 September 1994.

underway with a number of Central European economies. There is a real possibility of expanding NAFTA to include Chile (and later other Latin American countries). The Asia-Pacific region is very broadly defined to include virtually every country touching the Pacific Rim.

The emerging integrated global economy is not an artifact of political relationships. It is dependent neither on the way political and economic powers are distributed among States nor on any successful outcome of negotiations designed to enhance economic efficiency through multilateral co-operation. At least in the longer run, it is not conditional on any given political-economic process. The integrated global economy is a manifestation of fundamental and irreversible changes in industry structure; it reflects the scale (cost and risk) and complexity of technologies in strategic industries (semiconductors, aerospace, telecommunications and pharmaceuticals). These industries *cannot* be organized on a uninational basis and remain technologically competitive at the same time. It can be argued that even intra-regional organization is problematic. These industries are inherently global in nature.

Putting aside blatant technological determinism (i.e., firms in strategic industries either collaborate transnationally or forego competitive development), the question here—which is certainly debatable—is whether regional blocks such as the European Union, the Americas or Asia-Pacific represent markets of sufficient diversity and size to allow firms to deal with the scale and complexity of technologies within their borders. Looking at the existing pattern of strategic alliances in electronics, semiconductors, aerospace, etc., one would think not. In this context, "Fortress Europe" may mean no more than the "walling in" of obsolete technology.

Can regional borders be closed?

In a world of tangible flows in which raw, intermediate and finished goods are traded through arm's-length transactions and in which currencies are physically transported from one market to another, controlling cross-border transactions is difficult, but possible. Borders are less meaningful as economic constructs when production is international; when affiliate sales are higher than exports; and a large proportion of existing flows are intra-firm rather than arm's-length. One has to ask if borders will have any meaning in a world in which the most important international flows are knowledge transmitted instantaneously across worldwide electronic webs. A world in which, in Nicholas Negroponte's (1995) words, "trade in atoms" has been replaced by "trade in bits".

Borders are almost entirely irrelevant in international financial markets where $1 trillion worth of foreign exchange is traded on an average day. There are severe limits on any government's ability to ''defend its currency'' in the face of huge flows of electronic transactions which are consummated in the blink of an eye regardless of the distance involved.[11] In industries in which the critical flows of knowledge, technology, information or capital take place electronically, national borders are rapidly losing meaning as economic constructs or as frontiers across which economically valuable flows can be monitored and controlled. The problematic nature of borders will only be exacerbated as the world moves into the age of wireless data communications: cellular modems linked worldwide through satellite networks such as Iridium, Globalstar or Immarsat.

A world of closed regional blocks with limited exchanges between them assumes that cross-border transactions can be controlled. The critical question here is why should borders around a region be more meaningful (or less permeable) than those surrounding a national market? Does it matter to a satellite whether an impulse is transmitted from New York to Minneapolis or to Melbourne? If anything, regional borders, comprising a series of national borders that are joined imperfectly, could be compromised more easily.

The increasing permeability of borders is symptomatic of a more general question. Both the modern State system and the very idea of a market—whether local, national or regional—are inherently territorial constructs.[12] One must ask whether the modern, geographically based modes of economic and political organizations are still viable in the face of emerging global electronic networks.

Is geography still relevant?

Unambiguous, mutually exclusive territorial jurisdictions separated by discrete and meaningful borders have been characteristic of the modern era from the mid-seventeenth to the late twentieth century; indeed, territoriality defines political modernity (Ruggie, 1993). Regional integration, even at its extreme of political union, merely extends territorially based modes of economic and political organizations in geographic space—albeit not always contiguously. Geographically defined national markets and nation-States,

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[11] For a recent discussion of the problems of regulation in an electronic global economy, see Herring and Litan (1995).

[12] See Ruggie (1993) and Cooper (1986) for further discussions on this point.

however, are but one of a number of historical modes of organizing economic and political authority, and a relatively recent one at that. It is reasonable to ask whether the very idea of a geographically organized market will continue to be relevant in the emerging post-modern, electronically networked world of the twenty-first century.

The international financial world provides an example and, perhaps, a metaphor. If one is asked to name the three international financial centres, the immediate reply is London, Tokyo and New York. No one would say the United Kingdom, Japan or the United States. The reason is obvious: in this context, the three countries are not relevant as geographically based centres of political and economic authority. The international financial world is organized electronically rather than geographically; it consists of hundreds of thousands of computer screens located worldwide. Communication among them is more rapid than in a small village market: information is shared instantly across the globe. When transactions, of a magnitude not even imaginable a quarter of a century ago, consist of electronic impulses transmitted at the speed of light, geography and borders lose meaning as organizational constructs.

In the post-war period, TNCs replaced trade as the primary means of organizing international economic transactions; production has become internationalized. In more technical terms, firms' administrative hierarchies have replaced the market as the mode of international economic organization. The increased importance of collaborative agreements or strategic alliances, especially in high-technology industries, compared with equity-based FDI by TNCs, represents a further evolution in the primary mode of international economic organization. Cross-border strategic alliances represent the internationalization of network forms of economic organizations.

Many large international firms now are enmeshed in complex webs of multiple and polygamous alliances and cooperative agreements (Dicken, 1994). In a number of industries—automobile assembly is an excellent example—large vertically integrated chains of production have been disassembled and put back together as networks linking parts of organizations; a business unit or plant with a research unit or a supplier. These networked links, which are often cross-border, are completely dependent on integration though electronic information systems and satellite telecommunications.

Does the geographic organization of economic authority still retain any meaning either nationally or regionally? Do the concepts of home and host country apply to an IBM-Toshiba-Siemens alliance for developing the next generation of semiconductors? If it is successful who gets to control the technology? If the Boeing-Airbus collaboration to develop a super jumbo jet were to be successful and if, as it is claimed, the world market really can only support one manufacturer, which jurisdiction should have responsibility for the control of the resulting global natural monopoly?[13] Again the same question must be asked: why should geography remain viable as a mode of economic organization simply because the market area has increased from national to regional?

At century's end we face an asymmetry between the modes of economic and political organization. Economic systems are increasingly global in scope and electronically, rather than geographically, organized. (To be clear, it is not argued that national markets have lost all meaning; rather, they are no longer the basic building blocks of the world economy.) Political authority, on the other hand, is local and organized geographically in terms of territorial nation-States. The viability of regional integration, and the likelihood of the devolution of the world economy into rather closed regional blocks, must be considered in that context.

Regional blocks are not the solution

Regional integration represents the extension of national economic and, perhaps, political organizations and structures over a larger geographical area. There is no question that regional integration can provide benefits to the countries involved in terms of specialization (gains from trade) and scale and scope economies. The North American Free Trade Agreement encourages a more efficient production on a continent-wide basis, and the European Union allows for scale economies both in manufacturing and research and development. The questions at hand, however, are whether or not the region represents the limit of an open, liberal economic system and whether or not the global economy is devolving into three relatively closed regional blocks. The answers to both questions are no. First, in many strategic industries the immense costs and risks of technology development, and particularly its rapidly increasing complexity, mandate cross-regional integration. Second, regional blocks represent an extension of the modern form of territorially based economic structures in geographic space. Although regional blocks may represent the limit of our ability at present to cooperate internationally,

[13] At this point, the collaboration appears to be on "hold" due to disputes over the viability of the market.

they do not resolve the emerging asymmetry between economic and political geography; they are a linear solution in a world of increasing complexity and ambiguity.

There is no reason why a larger market area should make discrete borders more meaningful or territorial control of economic activity more effective in an electronically networked world economy. Regionalization is a modern solution to a post-modern problem. Moats and drawbridges did not provide a meaningful defence against the cannon, and regional borders will not inhibit cellular transmissions of data and information. Economic activity can no longer be contained geographically at the country or regional levels.

Back to the future?

Almost twenty years ago, Hedley Bull (1977) argued that the emergence of a modern and secular counterpart of Western Christendom, with its characteristic overlapping authority and multiple loyalties, was within the realm of possibility. The post-modern future may well resemble more closely the medieval past—at least metaphorically—than the more immediate, geographically organized world of national markets and nation-States to which regional blocks clearly belong. Although medieval ''states'' occupied geographic space, politics were not organized in terms of unambiguous geography. Political authority took the form of hierarchical, personal relationships of often overlapping and intertwined mutual obligations and rights. Borders were diffuse, representing a momentary projection of power rather than the limit of sovereignty (Ruggie, 1993).

While the medieval analogy has very obvious limits, the past may well contain applicable lessons for the future. A neat, unambiguous, mutually exclusive geographic ordering of economic and political authorities may no longer be the norm. Borders are diffuse and permeable, compromised by transnational integration and global telecommunications. Relationships are increasingly networked rather than hierarchical, with both individuals and organizations enmeshed in complex worldwide webs. Multiple and competing loyalties result.

Both public policy makers and private-sector managers must deal with competing systems for the organization of economic and political authority: sovereign and non-sovereign actors; geographic and electronic markets; local politics and global economies; fragmenting States and regional blocks; and bilateralism and multilateralism. States experience increasing constraints on internal autonomy and find territoriality a problematic basis for exercising economic and political control. Transnational corporations find themselves caught between conflicting jurisdictions, each of which believes it has the right to exercise economic authority.

A world in transition

Much of the discussion of globalism versus regionalism implies an assumption of cyclicality: the ebb and flow of integration and devolution of the world economy. As ''disarticulation'' of the first globally integrated economy was a cause for the Great Depression, the breakdown of the world economy into regional blocks portends the decline of the second. Is it possible, however, that the uncertainty and instability now being experienced in the international economy may be a reflection of secular rather than cyclical changes; of the initial stages of a systemic transformation of the organization of economic, and perhaps political, authority—a transformation perhaps comparable to the transition from a medieval to a modern state system in Europe during the sixteenth and seventeenth centuries.

In many industries, economic and technical systems are inherently global and transcending geography, being reorganized as worldwide electronic networks. On the other hand, politics remain geographic and local, firmly rooted in sovereign, territorial-based nation-States. For the foreseeable future the world will be torn by an asymmetry between the scope and mode of economic and political structures, by ambiguity of jurisdiction and by conflicting pulls on loyalty. That tension was reflected clearly in much of the debate in the United States surrounding both NAFTA and the ratification of the new GATT agreement. The main concern was the potential loss of local control and United States sovereignty, a concern that reflected the fear that national values and preferences in areas as diverse as workers' rights, the environment and lifestyles will become meaningless in a world in which sovereignty is transferred to some distant, ill-defined regional or international authority. In industries such as pharmaceuticals, aerospace and semiconductors, however, further integration or devolution of the global economy is not in the hands of the United States Congress, the European Parliament or the Japanese Diet. A global world economy is not dependent on the particular constellation of political forces at the moment. The emergence of an integrated global economy during the past decade reflects basic structural change: dramatic increases in the scale of technology, global electronic information systems and the corresponding development of network forms of organization.

In many strategic industries globalization presents a discrete rather than a marginal calculus. The issue is not one of a choice between autonomy and increased efficiency or gains from trade; of a trade-off between local production and the affordability of goods. Unless it is possible to call a halt to technological innovation—to forego the next generation of memory chips, pharmaceuticals, global cellular communications or super jumbo jets—transnational integration, increasingly taking the form of transregional alliances, is here to stay. The question is how it can be effectively dealt with and what it means in terms of "national competitiveness" and the ability to achieve national goals.

Current trends towards regionalization must be seen in this context. To ask whether regional blocks are "stumbling blocks" or "building blocks" assumes that global integration is a political process and that it depends on the effectiveness of multilateral negotiations. Although the character and depth of integration differs dramatically across all three major regions, each represents an attempt to extend markets geographically to exploit the gains from trade and deal with the scale of technology. While drawing a border around a region always implies the possibility of exclusion, protection is not the primary motive of the European Union, NAFTA or APEC. Regional integration is neither a building nor a stumbling block; it is a process taking place within the larger context of an integrated and transregional world economy.

To argue that global integration is a technical or economic rather than a political process is not to argue that all roads leading to Rome (another neo-medieval metaphor?) are equidistant, equally efficient, or equally comfortable. There are a number of policy implications for easing the transition:

- ***Encourage "open" regional agreements.*** Regionalization should facilitate free flows of trade and investment within regions without diverting existing external trade. Local content regulations, for example, should reflect a balance between promotion of intra-regional integration and the maintenance of global sourcing arrangements. Regionalization should enhance, rather than detract from, the trend towards liberalization of conditions for entry (and operation) of FDI now present in most developed and developing countries.

- ***Encourage "widening" rather than "deepening".*** Regional integration should aim at extending regional agreements to include all countries which will "play by the rules" rather than at the deepening of existing agreements, to encompass monetary integration, for example.

While this is not the place to debate issues such as the single European currency, the "deepening" of a wide variety of transnational linkages of production, finance and technology is taking place daily. At this point, it is more important that existing regional blocks be extended as widely as possible to obtain and maintain commitment to an open economy than it is to try to create larger ersatz "national" markets through the creation of deeper bloc-wide institutions. This should be taken as a statement of priorities and not as an argument against further European economic and political integration.

- ***Regional integration must deal with both investment and trade.*** As noted above, in 1990 the value of foreign affiliate sales was higher than that of world trade. In fact, it is increasingly difficult to separate trade and investment: they are two sides of the same coin. Regional agreements must facilitate free flows of FDI and trade as well as facilitate the cross-border integration of production and technology. Again, at this point what is required is the elimination of barriers rather than the creation of new institutions; efforts such as the recent OECD negotiations on multilateral investment rules should be encouraged (Witherell, 1995).

- ***Harmonize national and regional legislation and encourage multilateral organizations.*** Problems resulting from the asymmetry of economic and political organizations and structures will increase rapidly in the future; dealing with the anti-trust implications of global national monopolies is but one example. As networked alliances increase in importance, mechanisms for dealing with both trade and FDI may become irrelevant. While the resolution of national differences through international organizations raises difficult issues, experiences with standard setting indicate that the harmonization of national (and regional) legislation is possible. The experience of the European Union, for example, shows that harmonization can be a means to effect integration and, at the multilateral level, it may be the only possible medium-term solution.

- ***Develop formal mechanisms to encourage inter-regional cooperation.*** The United States plays a pivotal role in this regard as it is a member of both NAFTA, APEC and the Atlantic community. It is important that inter-regional agreements be encouraged and undertaken as a step towards multilateralism rather than the marshaling of forces to increase the competitiveness of existing blocks. The formation of institutionalized mechanisms to insure inter-regional cooperation and communication should be encouraged, perhaps through an inter-regional "summit" accompanied by ongoing interaction at the ministerial level. Thus, the broad definition of APEC to encompass virtually every country touching on the Pacific rim should be encouraged. Similarly, increased trans-Atlantic economic integration should be seen as a positive step as long as it is inclusive rather than exclusive and in accord with multilateralism and the World Trade Organization.

The current round of regionalization represents both the evolutionary extension of the scope of markets across national borders and, perhaps, a final attempt to organize markets (and technology) geographically. In the longer run, how regionalization is dealt with will not affect the emergence of an integrated global economy. It will affect the distribution of benefits and costs resulting from that transition, as well as the "competitive" position of individual economies and the welfare of individual countries. ■

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