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**ZHANG ZUQIAN**

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# Revival of Regional Economic Integration – Challenge for the Asian Pacific Region\*

ZHANG ZUQIAN\*\*

## Introduction

Since the mid-1980s it has been noticed by people from the academic world, business community as well as governments that a revival of regional economic integration (REI) has swept Western Europe, North America and the economies in the Asian Pacific region. At first glance in this trend, a few conspicuous and far-reaching events could be singled out: the Single Market Act in the EC, the North America Free Trade Agreement (NAFTA) and the annual conference of Asian Pacific Economic Cooperation (APEC). International economic relations are assumed to be increasingly conducted between trading blocs rather than between countries.<sup>1</sup>

This renaissance of regionalization in the world economy could be regarded as a development initially caused by the resistance of many advanced industrial economies to structural adjustment and dissolution of the liberal international trade and financial order.<sup>2</sup> And it has

\* This paper is written under Professor Susan Strange's supervision. Thanks should also be extended to the Italian Foreign Ministry which provided me with a grant for study in Italy.

\*\* Shanghai Institute for International Studies, Deputy Director of Department for Comprehensive Studies; Political and Social Sciences Department, EUI 1989-91.

<sup>1</sup> Peter Drucker, *The Economist*, October 21, 1989.

<sup>2</sup> Robert Gilpin, *The Political Economy of International Relations*, Princeton Univ. Press, 1987, p. 397; Detlef Lorenz, "Regionalisation versus Regionalism – Problems of Change in the World Economy", *Intereconomics*, January/February, 1991, pp. 3-10; Jeffrey J. Schott, "Trading Blocs and the World Trading System", *The World Economy*, vol. 14, no. 1, 1991, pp. 1-17.

further gained strength from the fact that with the end of the Cold War the United States would sooner or later release itself from the role of the benevolent hegemon which has opened its domestic market and provided capital and technology to its allies and the Third World in order to obtain political and security benefits.<sup>3</sup>

As far as the Asian Pacific region is concerned, in recent decades economic ties among economies there have been greatly expanded. Especially in Northeast Asia, with Japan as the primary catalyst, a spreading and deepening network of economic ties has been built up.<sup>4</sup> One of the driving forces for economic integration in the Asian-Pacific region is the fast-growing trade within this region. In the 1980s the average annual trade flows among the 12 countries on the Pacific rim grew by more than 10% – roughly equal to the growth in trade across the Pacific and much faster than that among West European countries. Moreover, this trade has been gathering pace in recent years.<sup>5</sup> The trade within Asia is growing even faster. It was predicted that this trade would surpass the region's \$250 billion two-way trade with the US by 1991 and by 1995 the US market would be marginal for Asian economies.<sup>6</sup> Asian economies have also been increasingly dependent upon Japan and the four Asian Newly Industrializing Economies (NIEs; South Korea, Taiwan, Hong Kong and Singapore) for investment and technology as these more advanced economies are investing much more in this region than anywhere. Therefore, this region is sometimes considered to be the most nearly self-sufficient one in comparison with North America and Western Europe.<sup>7</sup>

Against such a background, some observers are highly optimistic about the Asian Pacific Region in terms of regionalization in the world economy. It seems to them that the current trend of REI would eventually create the only non-European economic bloc in the Asian Pacific

<sup>3</sup> Lawrence Krause, "Trade Policy in the 1990s I: Good-bye Bipolarity, Hello Regions", *The World Today*, vol. 46, no. 5, May 1990.

<sup>4</sup> Robert A. Scalapino, *Major Power Relations in Northeast Asia*, American Univ. Press, 1987, p. 4.

<sup>5</sup> *South*, July 1989.

<sup>6</sup> *BusinessWeek*, March 20, 1989.

<sup>7</sup> Robert Gilpin, *The Political Economy of International Economy*, Princeton Univ. Press, 1987, p. 398.

region.<sup>8</sup> Several more or less bold proposals have been put forth in academic and government circles.

Shortly before the 7 December breakdown of the Uruguay Round of GATT, the prime minister of Malaysia Mr. Datuk Seri Mahathir Mohamad proposed to build up a regional trade bloc in case of failure to reach an agreement among negotiators in Brussels. According to his proposal, this grouping would include six countries of ASEAN, three countries in Indochina, as well as Burma, China, Hong Kong, Taiwan and South Korea. Japan would be asked to take the lead in its formation. But other industrial countries around the Pacific rim, namely, the United States and Australia, would be excluded. Before it was accepted at an ASEAN-summit in Kuala Lumpur, Mahathir's scheme was fundamentally revised as to establish ASEAN as a free-trade area (called AFTA) within 15 years.<sup>9</sup>

As activities of economic exchange among China, Taiwan, Hong Kong as well as Macao have greatly expanded since China adopted the policies of economic reform and opening to the outside world, keen interest in the setting-up of an actual economic association of these Chinese-speaking peoples has been aroused. Various informal proposals and schemes, from the Pan-China Economic Community to the Chinese-speaking Economic zone, are raised from time to time.<sup>10</sup>

Recently Taiwan's authorities have seemed prepared to relax policies towards economic exchanges across the Taiwan Strait to such an extent that its economics minister Mr. Vincent Siew was reported to propose linking Taiwan, China and Hong Kong in a Single Economic Bloc to make the Chinese-speaking community "an industrial zone second to none in the world". At an academic seminar discussing global economic trends, Mr. Siew said that technology and capital from Taiwan and

<sup>8</sup> Lawrence Krause, "Trade Policy in the 1990s I: Good-bye Bipolarity, Hello Regions", *World Today*, vol. 46, no. 5, May 1990.

<sup>9</sup> *Far Eastern Economic Review*, October 24, 1991, pp. 64-65.

<sup>10</sup> "Towards Pan-China Economic Circle", *World Economic Herald* published by Shanghai Research Association of World Economy, March 1988; Huang Zhilian, "On Development of Chinese Economic Community", *The Courier*, Hong Kong, March 20, 1989; Xu Jiuling, "On Regional Development Around The Pacific Rim by 2000", *National Policy*, Taiwan, Starting Issue, 1989; Lin Qiyang, "Chinese Culture and Future of Asia", *Quarterly Journal* published by Shanghai Academy of Social Sciences, no. 2, 1990; Dr. Zheng Cheyan, "Pan-China Economic Area", *Ming Pao Monthly*, Hong Kong, vol. 25, no. 11, 1990.

Hong Kong would complement China's vast natural resources and man power in competition for global markets.<sup>11</sup>

Despite promising development in the direction of REI, black clouds still remain on the horizon in the Asia-Pacific region. This paper intends to explore the prospects for REI there through a study of the major structural factors and strategic approaches which have been pursued so far.

### Heterogeneity in Structural Factors

Many students of REI have noticed the role of major economic, political and social characteristics of the countries concerned in the process of REI. A number of efforts have been made to give an account of *background conditions* which would be favourable to REI either in providing possible motives or in helping to reach the goal of REI.

Although David Mitrany takes into account the role of *environmental conditions* in the success of his functionalist strategy, Karl Deutsch is considered to be one of the pioneers who produced the earliest analyses of *favourable conditions* for integration.<sup>12</sup> In efforts which were made to enlarge and improve upon Deutsch's framework of analysis, comes into being the term of *structural properties*, which include political, social and economic characteristics of the embryonic regional community and would-be member countries.

In Roy Pryce's argument, it is desirable that a group of countries wishing to embark on the process of integration should possess a number of *structural factors* in terms of geography, politics, economics, society as well as culture. A favourable background for integration could consist of such structural factors as a roughly comparable stage of economic development, a similar set of economic and political values, compatible political and ideological institutions and a common cultural background.<sup>13</sup>

Jeffrey J. Schott also argues that successful trading blocs which hold together over time and increase the welfare of their members, usually exhibit *four basic characteristics*: a similar level of per capita GNP, geographic proximity, similar or compatible trading regimes and political commitment to regional organization. In his view, integration between

<sup>11</sup> *International Herald Tribune*, November 14, 1991.

<sup>12</sup> R.J. Harrison, *Europe in Question*, George Allen & Unwin Ltd, 1974, p. 95.

<sup>13</sup> Roy Pryce, *The Politics of European Community*, Butterworths, 1973, pp. 30-1.

countries with diversity in these four basic characteristics would pose enormous physical and adjustment problems.<sup>14</sup>

Table 1 Basic Figures for Some Asian Pacific Economies

	Area (1,000km <sup>2</sup> )	Population in millions	GDP (’88, US \$b)	Per capita income (’88, US \$b)	% avg. GDP Growth ’84-’88
Australia	7,682	16.8	271	11,570	4.1
Brunei	5.8	0.3	2.9	12,772	n.a.
China	9,561	1,103.9	354	283	11.6
Fiji	18.3	0.8	0.95	1,274.8	1.7
Hong Kong	1.071	5.7	54.78	9,643	8.4
Indonesia	1,948	184.6	64.15	403.7	11.9
Japan	377.8	123.2	2,864.1	15,400	4.52
N. Korea	122.3	22.5	20.8	1,114	2
S. Korea	99.2	43.1	171.5	4,040	17.0
Macao	0.017	0.4	2.6	5,970	16.2
Malaysia	330.4	17.4	24.54	1,875	2.95
New Zealand	268.7	3.4	39.1	10,413.8	2.2
Philippines	300	64.9	39.19	667.35	2.92
Singapore	0.625	2.7	24.5	8,162	n.a.
Taiwan	36	20	128.8	5,520	9.71
Thailand	514	55.6	56.1	1,038	11
Vietnam	329.6	66.8	n.a.	100-150	n.a.

Source: Asia 1990 Yearbook, *Far East Economic Review*.

In a word, as far as REI is concerned, the less heterogeneous in their structural factors, the more probably their efforts towards REI would turn out to be successful. In the most successful case of REI, namely, the EC, this argument seems to be tenable. A roughly comparable stage of development (all of the EC members are classified to be advanced industrial economies) has so far provided enough room to expand intra-

<sup>14</sup> Jeffrey J. Schott, "Trading Blocs and the World Trading System", *The World Economy*, vol. 14, no. 1, 1991, pp. 1-17.

industry trade between themselves. Many empirical studies (e.g. Grubel, 1974) have proved that since the end of World War II intra-industry trade has contributed the majority of increment in World trade as well as intra-EC trade.<sup>15</sup>

But in the Asian Pacific region things are much more complicated than in Western Europe. There is a larger regional grouping with only one advanced economy (Japan), several middle-income ones (four Asian NIEs, that is, Hong Kong, Singapore, South Korea and Taiwan) and the majority of developing economies. For developing countries in similar stages of economic development, benefits to be derived from increased intra-area trade as the result of REI schemes are expected to be small because the trade conditions among them are often widely different from those postulated in the customs union theory developed by Viner and his successors. Very often the trade among developing countries is only a small fraction of the total trade of these countries, while the bulk of their trade is with the rest of the world, usually developed countries.<sup>16</sup>

Similarity or compatibility in domestic political and ideological institutions is also considered to play an important role in the success of the EC. The remarkable resilience of the EC institutions and their sustained policy output could be attributed to shared political values and norms.<sup>17</sup> In contrast, with the end of the Cold War and sweeping and profound change in 1989-90, the Council for Mutual Economic Assistance (CMEA) fell to pieces and was eventually disbanded because the former communist political and economic systems in member countries which had bound them previously had been overthrown.

However, it is surely impossible to find another region in the world with such obvious heterogeneity in structural factors as the countries in the Asian Pacific. Whether in politics and economics or in social and cultural background, a whole spectrum of variants exists. In this region, there are market and centrally planned economies, highly advanced industrial economies and the underdeveloped countries with their per capita GNP around US\$300, liberal democracies and Leninist regimes, as well as those with Confucianism and Islam as the authorized religion. There is no Asian Pacific community in a linguistic, religious, cultural,

<sup>15</sup> See Herbert G. Grubel and P.J. Lloyd, *Intra-Industry Trade: The Theory and Measurement of International Trade in Differentiated Products*, Macmillan, 1975, p. 9.

<sup>16</sup> Jan Ter Wengel, *Allocation of Industry in the Andean Common Market*, Martinus Nijhoff Publishers, 1980, p. 3.

<sup>17</sup> Helen Wallace, "The Europe That Came in from the Cold", *International Affairs*, vol. 67, no. 4, 1991, p. 654.

political, or ideological sense; nor historically is there much evidence of regional consciousness.<sup>18</sup>

When considering possibilities for REI, some observers have noticed that because of the rigid central control of enterprises in socialist countries there is the nearly insurmountable difficulty of linking centrally planned economies with market ones on the way towards REI. However, two recent developments in this region, that is, economic reforms in socialist countries and so-called authoritarian pluralist systems winning favour, could narrow the gap between countries there in terms of economics and politics.

The programme of economic reform and opening to the outside world launched more than ten years ago has not only enabled China to achieve the fastest economic development in its history but also has integrated China's economy, especially the part along its coast, with prosperous East Asian economies. In Guangdong, one of China's southern provinces bordering Hong Kong, 60,000 enterprises, either wholly or partly owned by foreigners and overseas-Chinese, employ more than 5 million workers and produce manufactured goods, around 60% of which are exported via Hong Kong. With its annual growth rate over 10% for years, Guangdong is considered to be a new "small economic tiger" alongside South Korea, Taiwan, Hong Kong and Singapore.<sup>19</sup> At the same time, the economy of Fujian, one of China's south-east provinces has been closely linked with Taiwan just across the Strait. The Xiamen Special Economic Zone, which is one of China's five Special Economic Zones and located in this province, has alone received £500 million of investment from Taiwan.<sup>20</sup>

With irreversible economic reform going on, an increasingly expanding part of the Chinese economy, for the moment mainly comprising private-owned and foreign-owned enterprises which are generating little less than half of GNP, has begun to operate on the basis of market principles of supply and demand rather than central planning. It seems that some kind of compromise between central government and reform-minded local leaders has been kept so far, because the majority of the state's revenue is coming from this part of the economy. For the foreseeable future, China's economy is turning out to be market in

<sup>18</sup> Richard A. Higgott, et al., "Asia-Pacific Economic Cooperation: An Evolving Case-Study in Leadership and Co-operation Building", *International Journal*, vol. XLV, Autumn 1990, p. 827.

<sup>19</sup> See *South*, April 1989, p. 37.

<sup>20</sup> See *The Independent*, February 8, 1991.

nature but with a socialist face. Along a similar line, Communist-dominated Vietnam, Laos and Cambodia have also begun to pursue economic reform of their own. Even the rigid North Korean regime tries to show limited flexibility in terms of economic policies.

Given China's abundant manpower, natural resources, its immense potential market which would be emancipated by economic reform and the fact that an isolated China would pose a much more dangerous threat to neighbouring countries; among governments and academics in this region a consensus is taking shape that China should be integrated into the Asian-Pacific region.<sup>21</sup> Largely due to this consideration, China as well as Taiwan and Hong Kong were invited to participate in the Conference on Asia Pacific Economic Cooperation in 1990.

In regional politics, quiet but profound changes have also taken place. As some other parts of the world are struggling to set up Western-styled liberal democracy, more and more Asian states are inclined to take Japan as the model to follow. Japan's economic success, which is claimed to be based on political and social stability, orderliness, a low crime rate, negligible drug-taking and strong communitarian values, has impressive attractiveness for other Asian governments and peoples as well. In the Japanese polity, the outcomes of major political struggles, including the succession of leadership, are decided before regularly-held elections, a system of consensus is promoted so that a dominant faction in the Liberal Democratic Party remains in office to provide stability, while various opposition parties which are unlikely to win overwhelming public support, are allowed to contest the polls. Similar systems have been taking root in South Korea, Taiwan, Malaysia, Singapore and Indonesia. Even Chinese leaders have an inclination for this. When the most senior political leader Mr. Deng Xiaoping spoke in favour of neo-authoritarianism, he might have had this kind of system in mind. In Robert A. Scalapino's argument, this system is classified as "authoritarian pluralism".<sup>22</sup>

With these two developments there is an optimistic view that traditional statecraft based on ideology and geo-politics has become obsolete and that so-called geo-economics will prevail.<sup>23</sup> But in this region some serious conflicts and uncertainties still remain. One of the most difficult obstacles, for instance, the painful conversion of large state-owned

<sup>21</sup> John Wong, "Integration of China into Asian-Pacific Region", *The World Economy*, vol. 11, no. 3, pp. 327-354.

<sup>22</sup> See *International Herald Tribune*, November 9-10, 1991.

<sup>23</sup> See *The Guardian*, December 6, 1991.

enterprises to private-owned or joint-stock ones, is yet to be overcome in the process of China's economic reform. Leadership successions are outstanding not only in Communist-dominated states but also in Singapore and Taiwan. Faced with upsurging demands for democracy, the governments there will find it increasingly difficult to keep the balance between economic prosperity and political suppression.

### Unfavourable International Structural Factors

The political and strategic environment, both regional and global, could be considered as one of the international structural factors for REI. The history of REI tells us that the occurrence of integration is to a considerable extent defined for the individual member actors by their international environment. The countries wishing to integrate themselves economically submit, more or less, to the logic of regional and global developments which govern the relations between them, narrow down the range of choices available, and permit, encourage or discourage integration.<sup>24</sup>

In the initial stage of European integration in post World War II years, political and strategic considerations generated by the immediate history and the prevailing international situation played a much more important role than economic ones did. In thirty years of the Twentieth Century, the traditional strife for power among European countries pushed Europe into two bloody wars and nearly destroyed European civilization. Thus, the revulsion against war between European countries provided a psychological impetus for statesmen of the Six to agree upon linking together their steel and coal industries which had the most important military potential in economic sectors at that time. Similarly, from political and strategic considerations under the circumstances of the Cold War, the United States supported and tolerated the process of European integration by opening its domestic market to European goods and by treating the European Common Market as an exception to the GATT regime. In this sense, R.J. Harrison describes the process of European integration as a logical outcome of the changes which took place in world politics.<sup>25</sup>

In recent years Western Europe fortunately found that the end of the Cold War gave a tremendous impetus to the process of integration,

<sup>24</sup> R.J. Harrison, *Europe in Question*, George Allen & Unwin Ltd., 1974, p. 132.

<sup>25</sup> *Ibid.*, p. 133.

both economically and politically, to such an extent that more and more non-EC countries are expected to be involved in the Community. But in the Asian Pacific region, on the contrary, not only have some of the formidable obstacles to REI remained, but there are also divisive issues which were previously overshadowed by East-West conflicts and which may now emerge with the winding down of Cold War.

The world's last two divided countries, China and Korea, are located in the Asian Pacific region. With its bitter hostility towards South Korea and all Western countries and its dangerous ambition to possess nuclear weapons, North Korea under a rigid Stalinist regime is reasonably considered to pose the most formidable potential threat to the stability and economic prosperity of this region. Although some kind of confidence-building agreement has been reached recently between North and South Korea, North Korea's real intention remains in doubt until significant and consistent changes have taken place in both its internal and external policies.

Superficially, the tension between the Chinese mainland and Taiwan has been gradually eased in recent years. But underneath the rapid expansion of economic exchanges across the Taiwan Strait, there still exists the latent hostility nurtured by the bloody wars between the Communist Party and the Nationalists (KMT). Legal representativeness of the whole of China is claimed by the authorities on both sides of the Strait. This hostility can erupt into a large-scale crisis. It is one of the most possible developments; with the KMT's control in the island weakening, the local people's demand for formal independence will grow to an extent which is intolerable to the leaders in Beijing. Beijing has threatened a thousand times to launch some kind of military action, the most possible being a naval blockade against Taiwan should it claim independence. If this possibility becomes a reality, all the efforts towards regional economic cooperation and REI will evaporate.

Three of the divisive issues need to be solved before any significant progress can be made in the direction of REI, especially in terms of establishing formal supranational institutions. The first is how to reassure the Asian Pacific nations of Japan's peaceful future development. Because of its expansionist policies and atrocities during the Second World War, nearly all of the nations in this region have a deep distrust and dislike for Japan's possible role of dominance in any future regional grouping. Every time that Japan tries to increase its expenditures on defense and promote its overseas military role, protests and complaints are heard across this region. Although these nations have already been heavily dependent on Japanese capital, technology and market, all of them have tried their best not to be Japan's satellites.

Diversification-oriented foreign economic policies have been adopted as prudent in these states. As long as this distrust and dislike of Japan exists, there will be no smooth process of economic integration.

The second divisive issue is over territory. There is the Sino-Japanese dispute over the Senkaku Islands (or "Fishing Islands" in the Chinese language) in the East China Sea; and the disputes between China and some of the Southeast Asian countries over the Spratly Islands in the South China Sea. It is reported that a maritime arms race between Asian countries has been generated by these territorial disputes.<sup>26</sup>

The third divisive issue is how to manage the Sino-Japanese relationship. It is obvious that the Asian Pacific region's future is largely decided by the relationship between China and Japan. These two countries are strikingly different. Japan has already become the second largest economic power in the world, and its economy will thrive further in the foreseeable future. There is a common perception that Japan has been striving to get rid of its historical humiliation as a defeated nation in the Second World War and seek a role in international affairs in accordance with its ever growing economic power. China, on the contrary, is a peculiar developing country with tremendous potential for economic development and the largest military machine in Asia. China is also the only nuclear power in this region.<sup>27</sup> Moreover, Chinese leaders are deliberately taking advantage of nuclear weapons to maintain China's position in the international community. For the moment, both China and Japan are rationally cautious not to offend each other. But in the long term some kind of conflict between these two countries will probably occur, especially when one of them tries to take a leading role. Therefore, it is hardly possible that China and Japan will make joint efforts to promote the process of REI as France and the Federal Republic of Germany have performed in the process of European integration.

### **Complementarity Versus Competitiveness**

The history of REI, either between advanced industrial economies (i.e. the EC and EFTA) or between developing economies (ANDEAN, ASEAN, CARICOM, etc.), shows that dynamic economic complementa-

<sup>26</sup> See *International Herald Tribune*, December 19, 1990.

<sup>27</sup> India has shunned so far to declare that it has the nuclear ability for military purposes.

rity generated by rapidly expanding intra-industry trade between advanced industrial economies provides much more room for the process of REI than does the static complementarity which is decided by natural endowments and in turn is the basis for inter-industry trade. Many attempts towards REI in the Third World have failed or are stagnant largely because members of the group found that they were competitors with each other rather than partners of mutual cooperation.

Take for example the Asian Pacific region, comprising economies which are dramatically uneven in terms of stages of economic development. The average per capita income in Japan exceeds \$20,000, while the same figure in China is reported to be around \$300. (It is also said that this figure should be around \$800-1,000 at least for the coastal area of China if the low expenditure for basic needs is taken into account.)

As most of the economies there are export-oriented ones, the question should be answered as to whether the scheme of REI would provide enough economic complementarity for them, rather than the impetus of competition for export markets, capital and technology. Some efforts have been made by academics to explore the would-be benefits generated by REI.

The theory of intra-industry trade used to be based on empirical studies of trade between developed countries. Later, Tharakan and Balassa found that intra-industry trade in manufactured products between advanced and developing countries is not negligible, and that the empirical hypothesis of intra-industry trade determinants, which were believed to be generally applicable to trade between advanced countries, can also be applied to trade between advanced and developing countries. But Tharakan dealt only with industry characteristics while Balassa dealt only with country characteristics.<sup>28</sup>

When exploring the potential for intra-industry trade between economies around the Pacific rim, Young Sun Lee combined country and industry characteristics in his study. He found that RND coefficients (denoting the degree of vertical product differentiation) is as significant as that of PD (denoting the degree of horizontal product differentiation) as far as intra-trade was concerned. It is his conclusion that the main theoretical framework which was generally believed to be applicable to trade between advanced countries is also applicable to trade between newly industrializing, underdeveloped and advanced

<sup>28</sup> P.K. Tharakan, "Intra-Industry Trade between the Industrial Countries and Developing World", *European Economic Review*, vol. 26, pp. 213-227, 1984; Bela Balassa, "Interest of Developing Countries in the Uruguay Round", *The World Economy*, vol. 11, no. 1, pp. 39-54, March, 1988.

countries of the Pacific Basin. Significant potential could thus be assumed for the expansion of intra-regional trade, much of which would be intra-trade in nature, between economies at different stages of economic development.<sup>29</sup>

As for the pattern of economic integration in this region, the metaphor of "a flock of flying geese" is very often cited, but from different perspectives. The former Japanese foreign minister Saburo Okita (1985) resorts to this term in the context of the theory of international division of labour. In his view, developed economies, e.g. the US and Japan would continue to export technology-intensive and capital-intensive products to developing economies in this region, while the latter continue to export raw industrial materials and other primary products to the former. The four Asian NIEs, that is, South Korea, Hong Kong, Taiwan and Singapore, are supposed to play the mediate role: exporting labour-intensive products to developed economies on the one hand and exporting some capital and technology to the less developed economies on the other.<sup>30</sup> The intention of Saburo Okita's suggestion is reasonably perceived to maintain the existing regional pattern of international division of labour. As nearly all the countries in this region have been striving hard to realize industrialization of their economies and to climb up the ladder of international division of labour, Saburo Okita's scheme seems to be unacceptable.

Yung Chul Park (1989) contemplates the prospects for REI in the Asian Pacific (in his view the US, Canada, Australia and New Zealand are excluded) from a broader perspective and in more detail. Obviously applying the theory of product cycle to his study, Park envisages a pattern of economic integration which is also similar to a flock of flying geese. He divides Asian Pacific economies into four groups in line with comparative advantage. With her comparative advantage in high-technology industries, Japan is the most advanced economy in this region and flies as the leading goose. Closely following Japan, there is a second group of geese consisting of the four Asian NIEs. The third group consists of the two upper middle-income economies of the Association of South East Asian Nations (ASEAN), namely, Thailand

<sup>29</sup> Young Sun Lee, "A Study of the Determinants of Intra-Industry Trade Among the Pacific Basin Countries", *Weltwirtschaftliches Archiv*, vol. 125, no. 2, 1989, pp. 346-356.

<sup>30</sup> Suburo Okita, "Pacific Development and Its Implications for World Economy", in James W. Morley, ed., *The Pacific Basin: New Challenges for the US*, Proceedings of Academy of Political Science, 1986, pp. 23-35.

and Malaysia; and the fourth group is made up of the two lower middle-income economies of ASEAN, Indonesia and the Philippines. China, with her size, population, natural resources and industrial diversity, including a wide range of industries from some of the high-technologies and many low-cost labour-intensive industries, would not belong to any of the above-mentioned groups. As a huge bird flying alongside the flock of geese, China would be friendly as a potential big importer but aggressive as an emerging competitive exporter. In this metaphor, each economy would pick up industries given up by the economies ahead of it. In this sense, structural adjustment and upgrading of industries would be completed in the context of competition and cooperation.<sup>31</sup>

Whatever pattern of economic cooperation takes shape, a key question will be which country will play the role of "core area" by providing the major outlet for exports and sources of capital and technology to other partners. This is because nearly all the economies in this region have pursued export-promotion strategies for economic development to modernize their industries. There is little doubt that Japan is assumed to play this role.

Japanese trade and investment in East Asia has grown dramatically over the past decade, but so has Japanese trade and investment in North America and the EC.<sup>32</sup> Japanese trade with East Asia since 1985 has increased twice as fast as trade with North America (and three times as fast since 1987). Since the first quarter of 1988, however, this trend has been significantly weakened. Japanese imports from East Asia have grown at about the same rate as its total trade. Japanese trade with North America thus remained much larger and grew faster than trade with the East Asian economies (excluding China) during the 1980s. Japanese trade with East Asia rose from 25% to 29% of its total trade during the 1980s, while its trade with North America rose from 24% to 32% (after peaking at 34.8% in 1987). In addition, the EC share in total Japanese trade nearly doubled from 9.1% to 17.3% during the same period.

Japanese foreign direct investment (FDI) in East Asia has shown similar growth in recent years. In East Asia, Japanese FDI quadrupled from the relatively low base of \$2 billion to \$8.2 billion during the fiscal

<sup>31</sup> Yung Chul Park, "The Little Dragons and Structural Change in Pacific Asia", *The World Economy*, vol. 12, no. 2, June, 1989, pp. 125-161.

<sup>32</sup> See Jeffrey J. Schott, "Trading Blocs and the World Trading System", *The World Economy*, vol. 14, no. 1, 1991, pp. 11.

years of 1985 to 1988, the share in total Japanese FDI rising from 16.4% to 17.4%. At the same time, the shares of North America and the EC rose respectively from 45.1% to 47.4% and from 15.6% to 19.4%. Much more money was invested in North America and the EC than in East Asia.<sup>33</sup> Therefore, as Gerald Segal argues, the nature of Japan's economy is essentially non-regional.<sup>34</sup>

Table 2 Direction of Japan's Trade

	export, US\$m	% of Total	import, US\$m	% of Total
<b>1980 total</b>	<b>130,441</b>		<b>141,296</b>	
US & Canada	34,359	26.3	29,319	20.8
Australia & N.Zealand	4,087	3.1	7,825	5.6
Asia	31,518	24.2	34,693	24.6
<b>1985 total</b>	<b>177,164</b>		<b>130,488</b>	
US & Canada	71,243	40.2	30,901	23.7
Australia & N.Zealand	6,512	3.7	8,426	6.5
Asia	41,757	23.6	34,093	26.1
<b>1990 total</b>	<b>287,678</b>		<b>235,307</b>	
US & Canada	97,858	34.0	61,408	26.1
Australia & N. Zealand	8,136	2.8	14,085	6.0
Asia	90,146	31.3	68,074	28.9

Source: Direction of Trade, IMF.

In the above-mentioned integration pattern of a flock of flying geese, Japan, as the leading bird, should transfer her capital and technology to other Asian Pacific economies and absorb exports from them on a scale large enough to sustain healthy economic development in this region. In the sense of the theory of product cycle, Japan, the original innovator country, would become a net importer in the end. It is really Japanese capital and technology that account for, to a certain extent,

<sup>33</sup> Ibid., p. 11

<sup>34</sup> Gerald Segal, "North-East Asia: Common Security or à la Carte?" *International Affairs*, vol. 67, no. 4, October 1991, p. 759.

booming industries for exports in the economies there; but much of these exports go to the United States or elsewhere, not to Japan. Japan's market accounts for only about one-fourth of all exports from the four Asian NIEs as well as China. In addition, nearly all the economies in the region run a trade deficit with Japan. At the same time, the United States takes up between one-third to 50% of exports from the Asian Pacific economies, and an increasing number of economies run a trade surplus with the United States.

The history of REI also shows that if "core areas" in a regional grouping could not provide a special pay-off to smaller partners, bleak prospects could be predicted. This has already been shown from the role of the USSR in CMEA and the role of Argentina, Brazil and Mexico in the Latin American Free Trade Association (LAFTA).<sup>35</sup>

Moreover, economic complementarity is limited among developing countries which are the majority of economies in the Asian Pacific region. Very often these economies find themselves in competition with each other rather than partners in mutual regional cooperation. In the case of ASEAN which is usually regarded as the most successful attempt towards REI in the Third World, the promotion of economic cooperation has been its biggest failure. Intra-ASEAN trade has never exceeded 20% and is now around 10%. Existing preferential trading arrangements (PTAs) among ASEAN members which allow for cuts in tariffs on selected products have never been extended to sectors of real significance such as cars and textiles. Items covered by the schemes are either not produced in ASEAN states – snow ploughs being a famous example – or already enjoy a zero tariff rating. In 1986, of 12,000 separate items covered by the PTA scheme, only 5% were actively traded by members. The agreement, reached at a summit-meeting in October 1991, aimed at building ASEAN as a free-trade area within 15 years, is burdened with so many qualifications that serious doubts are likely to be raised as to whether the rhetoric will be matched by reality.<sup>36</sup>

Superficially, intra-regional Asian Pacific trade for most of the economies in the region is around 50% of their total trade. But if trade with the US is excluded, this share would be dramatically reduced to 20% or even less. At the same time, an equivalent figure in the EC is

<sup>35</sup> Ernst B. Haas, "The Study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing", in Leon N. Lendberg and Stuart A. Scheingold, eds., *Regional Integration: Theory and Research*, Harvard University Press, 1971, p. 11.

<sup>36</sup> See *Far East Economic Review*, October 24, 1991, pp. 64-65.

much more than 50%. Heavy dependence on the outside world for trade and investment would surely constrain developing economies' political commitment to REI schemes.

Given the fact that most Asian Pacific economies depend heavily on the US market for exports as well, the US, especially its West Coast, has been increasingly involved in the booming economic development along the Pacific rim. The US is considered by some analysts to be an important participant in bloc-building in this region. But this consideration would cause much complexity.

First, with the size of its economy and its role in the world economic order, the US would be well advised to refrain from entering into intercontinental trade bloc building. Because such intercontinental trade bloc building with the US as an important participant would transcend even regionalism and reduce the present virtual tripolarity of the world economy (i.e. the US, Japan and Western Europe) to a dangerously unbalanced bipolarity: the Pacific *versus* Western Europe. Such a development in the world economy would not be in the American interest, for the US has also an important stake in the economic prosperity of Western Europe. Up to now, the hold-up of liberal principles of international trade and finance has remained the priority for US foreign economic policies.

Second, a US shift of preference in favour of the Pacific would inevitably weaken its commitment to South America and hence reinforce the marginalization of this sub-continent in terms of the world economy.<sup>37</sup>

So far the wind has blown in the other direction. The US-Canada Free Trade Act signed in January 1988 may soon be expanded to include Mexico. A further development is that other Southern countries beyond Mexico may also join this trend of REI. In the spirit of the Caribbean Basin Initiative, the countries in the sub-continent seem to enjoy a preference over those across the Pacific in the agenda of America efforts towards REI. Because, despite the disparity in the level of economic development between northern and southern partners, the would-be North America trading bloc has most of the structural factors for REI: geographic proximity, diminishing difference in political and social systems (largely thanks to the end of the Cold War and democratization in the sub-continent) and compatible trading regimes as well as a strong commitment to regionalization.

<sup>37</sup> P.M. Wijkman, "The Effect of New Free Trade Areas on EFTA", in Detlef Lorenz, "Regionalisation versus Regionalism - Problems of Change in the World Economy", *Intereconomics*, January/February 1991, p. 7.

Third, it would be unimaginably difficult to pull apart the trade bloc which has two "core areas", that is, Japan and the US, which are deeply involved in economic disputes.

As for the question to which embryo trading bloc the US would belong, contradictory answers can be heard. Some prominent Asian politicians do not think that the US is one of the Asian Pacific club members. For instance, with trade disputes between Japan and the US deteriorating, there is a real worry that "a new East-West conflict" would be in the making. It seems to former prime minister Lee Kuan Yew of Singapore that in this conflict smaller Asian economies would be forced to gather around Japan and confront the US and its European allies.<sup>38</sup>

### Difficult Strategy for REI

In his works on regional integration, Deutsch pointed out that different structural factors deserve different strategies of integration.<sup>39</sup> Although to a certain extent weakness in some aspects of structural factors for REI could be balanced by alternative strategic approaches, in the case of the Asian Pacific region it is unimaginably difficult to find appropriate pathways to skirt the obstacles on the way towards REI.

A gradual process of regionally-based economic cooperation dates from the early 1960s. The years between 1960 and 1967 are regarded as the first phase in this cooperation, in which a tentative proposal was raised in response to the creation of the European Economic Community and the EFTA and with a growing Japanese recognition of the importance of the Asian Pacific region to its economic performance. According to this proposal, a Pacific Free Trade Area would include Japan, Australia, New Zealand, Canada and the United States.

The creation of the Association of South-East Asian Nations (ASEAN) and of the Pacific Basin Economic Committee (PBEC) marked the beginning of the second phase. Although its publicly claimed objective is to promote intra-bloc economic ties, ASEAN made little progress in terms of REI and showed its reluctance to ideas of wider Asian Pacific economic cooperation for the next decade and a half. Meanwhile, PBEC, which is a private business-oriented organiza-

<sup>38</sup> See *International Herald Tribune*, March 15, 1990.

<sup>39</sup> Karl Deutsch, *Political Community at the International Level*, New York, Doubleday, 1954, p. 64.

tion centering on Australian-Japanese cooperation on commercial issues, has achieved few concrete results to its name, except creating a personal and information network.

The third phase of Asian Pacific economic cooperation is largely marked with the activities of the Pacific Economic Cooperation Conference (PECC), which was set up in 1980 following a meeting between Australian prime minister Malcolm Fraser, and his Japanese counterpart, Masayoshi Ohira. PECC, which aims to promote regional economic cooperation with joint efforts from government, the business community and academics, was regarded to be the major element of attempts towards REI until the 1989 ministerial meeting of Asian Pacific Economic Cooperation (APEC). Under its auspices, an informal series of consultative meetings and purpose-specific task forces were organized. It is of great importance that the formation of PECC and its activities help to develop a *pacific perspective* on trade and development issues and to facilitate communication and networking on regional economic issues.

To a certain extent, PECC takes on some characteristics of the OECD. For instance, it publishes *Pacific Economic Outlook* which is somewhat similar to the *OECD Outlook*. But PECC does not have any centralized bureaucratic institution such as that on multilateral surveillance which is one of the principle elements of the OECD.

As Richard A. Higgott and others have noticed, the major feature of all three historical phases of co-operation in the Asia-Pacific region is the weak effort put into the development of formal institutional frameworks for regional cooperation.<sup>40</sup> In the case of the EC, the resilience of its established supranational institutions and bureaucracy has been indispensable to its success.

The November 1989 meeting of Asian Pacific Economic Cooperation (APEC) is the culmination of efforts towards regional economic cooperation or trade-bloc-building in the 1980s. So far three meetings have been convened. In comparison with preceding efforts, the importance of the APEC meeting is conspicuous, not only because it is the annual ministerial-level forum but also because it has laid the foundation for continued integrative efforts through the 1990s.

As far as the process of REI is concerned, however, three issues have remained unresolved. First, the ultimate institutional structure of APEC is still unclear. Over the short and medium term, meetings of economic

<sup>40</sup> See Richard A. Higgott, et. al, "Asia-Pacific Economic Cooperation: An Evolving Case-Study in Leadership and Co-operation Building", *International Journal*, vol. XLV, Autumn 1990, pp. 839-840.

ministers or higher-level officials seem to be further used as the major institutional form in which the designated host state shoulders most responsibility for arranging the agenda of the meeting and directing consultations. Of course, this type of informal approach has some advantages. For instance, smaller members may feel that they can play a somewhat equal role to that of the larger members. But it has yet to be seen whether this type of informal approach can cope with fluid developments in global and regional economy and the unexpected eruption of severe economic conflicts. Up to now, direct bilateral diplomacy between national governments has still enjoyed a major role in resolving regional economic issues.

Second, in the context of the Asian Pacific region with the great disparity in the size of member states, it seems that the would-be core area, Japan, will inevitably take on the role of leadership. But up to now it has been Australia, not Japan, which has played the role of quasi-leader: former Australian prime minister Hawke initiated the idea of APEC and hosted the first meeting in November 1989 in Canberra. Australia, however, is unlikely to be the leading player, or even one of the important players in bloc-building for a long time. Over the last decades, Australia's economic performance has flagged and its position both in global and regional economy has significantly shrunk. Japan, however, has shunned taking on the leading role largely for historical reasons. Therefore, the situation remains contingent as far as leadership is concerned.

Third, the political commitment of many of the states in the region to bloc-building is either weak or ambiguous. Members of ASEAN, probably with the exception of Malaysia, still prefer their much smaller regional grouping to the Asian Pacific one, in which their role might be diminished and their interests infringed. The United States has remained suspicious of the future development of bloc-building in this region. For instance, at the 1991 meeting in Seoul, the Secretary of State Mr. James Baker warned his South Korean counterpart to be "cautious" with Malaysia's proposal for a free trade area. As mentioned above, no matter what its real intention is, Japan has kept a low profile in regional economic affairs and has repeatedly confirmed its commitment to a liberal international trade and financial order. As for most of the other states in this region, it seems that they are wise to avoid expressing unequivocally their commitment to regional bloc-building from various considerations.

## Conclusion

Most Asian Pacific economies, that is, Japan, the four Asian NIEs (Taiwan, Hong Kong, South Korea and Singapore) and some of the other Asian countries, have so far gained more benefits from the liberal international trade and financial order than any other part of the world. In view of the continual expansion of their exports which is indispensable for their economic development, it would be the Asian Pacific economies' best option to maintain this open, liberal international economic regime. But with the irreversible developments towards REI both in North America and Western Europe, Asian Pacific economies have to consider some alternative foreign economic strategies in case of a complete breakdown of the existing international economic order embodied by the GATT and IMF. In the most likely case that the Uruguay Round of GATT achieves only limited results and that the shaky multilateral world trading system remains in place, so-called *open regionalism* seems to be the second-best option for Asian Pacific economies.

Some analysts (e.g. D. Lorenz and J. Schott) also suggest that from the point of view of the world economy, attention should be focused on the openness of regional arrangements and on the quality of inter-regional cooperation. In Lorenz's view, the recent regionalism has been accompanied by the extensive globalization of many world markets, therefore both inter-regional and intra-regional trade continue to flourish, although at different speeds.

For a long time regionalism has been identified with the formation of economic blocs at different stages – free trade area, customs union, economic union and so on. The common characteristic of these economic blocs is to eliminate all or some internal barriers to economic flows between member states, but to maintain existing barriers or to erect additional barriers against outsiders. But the recent wave of regionalism has swept states which are different in political, social and economic systems as well as in stages of economic development. These states can not reach any agreement about issues concerning “high politics”.

Moreover, as mentioned above, most Asian Pacific economies rely more heavily on extra-regional than intra-regional trade. These economies therefore prefer regionalism which is *open* rather than *exclusive* towards the rest of the world, namely, the would-be economic bloc will not pursue geographically discriminatory arrangements while eliminating internal barriers, but make their regional arrangement a complement to the existing multilateral trading system.

Table 3 Trend of EC trade Direction

	Export, ecu, m	% of Total Export	Import, ecu, m	% of Total Import
<b>1983 year</b>	<b>671,884</b>		<b>707,694</b>	
Intra-EC 12	366,885	54.6	365,256	51.6
Extra-EC 12	300,621	44.7	341,699	48.3
US & Canada	57,733	8.6	65,324	9.2
Selected Asian Countries	26,430	3.9	43,594	6.2
<b>1985 year</b>	<b>849,936</b>		<b>874,675</b>	
Intra-EC 12	466,594	54.9	466,742	53.4
Extra-EC 12	378,650	44.6	406,417	46.5
US & Canada	95,438	11.2	76,511	8.7
Selected Asian Countries	37,176	4.4	55,067	6.3
<b>1989 year</b>	<b>1,043,289</b>		<b>1,073,552</b>	
Intra-EC 12	625,722	60.0	624,488	58.2
Extra-EC 12	413,010	39.6	446,716	41.6
US & Canada	88,675	8.5	93,472	8.7
Selected Asian Countries	59,072	5.7	93,303	8.7

Source: Eurosta.

Note: Selected Asian Countries include six members of ASEAN, China, Japan, South Korea, Taiwan and Hong Kong only.

Some observers, e.g. Richard Rosecrance and Singapore's deputy prime minister and minister for trade and industry Lee Hsien Loong, consider that even a United States-dominated NAFTA (North America Free Trade Area Agreement) could not satisfy American demand for export markets, technology, foreign investment, energy and raw material. This is because both US trans-Pacific and trans-Atlantic trade are much bigger than any trade the US could generate with Canada, Mexico and other Central and South America countries for many years to come.<sup>41</sup>

<sup>41</sup> Richard Rosecrance, "Regionalism and Post-Cold War Era", *International Journal*, vol. XVI, Summer, 1991, p. 387; see *International Herald Tribune*, January 27, 1992.

In addition, several decades of economic development under a liberal international trade and financial order has greatly enhanced economic interdependence both between countries and would-be trading blocs. Each country or bloc has a big stake in other countries' and blocs' economic prosperity. In this sense, beggar-your-neighbour policies would not be as effective as before.

Therefore, the Pacific Economic Cooperation Conference (PECC) in 1988 introduced the term "*open regionalism*" to its discussion. At this conference two interpretations of "*open regionalism*" were given: (a) the PECC is not a geographically discriminatory free trade area like the EC; (b) the economies in this region are willing to promote mutual economic flows with the rest of the world on the basis of reciprocity. Later, ministerial-level Asian Pacific Economic Cooperation (APEC) meetings also repeatedly stressed that APEC's activities would complement, not detract from, the principles of GATT and all the participants agreed to advance the Uruguay Round negotiation. If regionalization in the world economy evolves in the direction of *open regionalism*, the Asian Pacific economies would have much more room for their economic development and prosperity.





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