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Regional Integration and Domestic Institutional Compatibility: A Comparative Analysis of Regional Integration in Central Africa, the Americas, Pacific Asia and Western Europe*

YI FENG AND GASPARE M. GENNA

*School of Politics and Economics
Claremont Graduate University*

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Yi Feng and Gaspare M. Genna
School of Politics and Economics
Claremont Graduate University
Claremont, CA 91711 USA

ABSTRACT

This work argues that the ultimate success of regional integration requires that the convergence of domestic economic institutions and the process of regional integration reinforce each other. A Granger causality test is performed on five cases of regional integration in Africa, the Americas, Asia, and Europe for the period of 1975 through 1995. The statistical result confirms our thesis. The most successful case of integration does evince a pattern of positive interaction between the two variables, while less successful cases are lacking in this mechanism of mutual influence. We further discuss several regional groups that have recently emerged and provide theoretical implications for their development.

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I INTRODUCTION

Regional economic integration involves various steps. The first step is a free trade area in which tariffs are eliminated among the member states. The second step is a customs union, which establishes a common policy of protection for the members with other countries. The customs union, which is also a free trade area, is difficult to form because each nation has its own industries that face international competition. A further step in regional integration is a common market, which is a customs union without restriction on the movement of labor and capital across member states. A final stage of regional economic integration will be an economic union, with member states sharing a common currency.

The benefits of regional integration include an improvement of efficiency and an increase in economic welfare. However, national sovereignty and governance by the domestic political elite will be eroded by economic integration. As argued elsewhere in the paper, political leaders benefit from the process of integration that increases national welfare, which helps them get selected in office. In the long-run, however, the outcome of integration will lead to the diminution of power that future domestic political elite can wield when their time comes. Given all the economic benefits and political rationale of regional integration, there are successful cases as well as negative ones involving regional integration. The European Union (EU) has emerged as a great accomplishment that has brought European nations together as a unified political and economic identity through the four steps of integration. By contrast, the Forum for Asia-Pacific Economic Cooperation (APEC) has a long way to go even to achieve the modest goal of a free-trade area.

What leads to the stark variation of degrees of regional integration across the world? The theories in the literature on regional integration invariably offer two kinds of interpretations:

either the international context as the source of regional integration or domestic forces as a cause of regional integration. Our central argument in this paper is that domestic institutions and the regional integration process must reinforce each other in order for successful integration to emerge. Domestic institutions encompass a wide spectrum, from national ethos to religion and from the form of governance to the propensity toward savings and consumption. In this paper, we focus on one kind of domestic institution, namely, the economic variety. Our central thesis prescribes the following condition for successful regional integration: member states in a regional organization will reduce their variances in economic institutions as the result of the process of regional integration and a convergence of economic institutions will contribute to further integration. The second section presents an overview of theories of regional integration. The third section discusses our central thesis. The fourth section introduces the methodology used to test our hypothesis as well as the operationalization of degrees of regional integration and convergence of domestic institutions. The fifth section reports statistical results and explores various cases tested. The last section concludes the paper with implications for some fledging regional organizations.

II THEORIES OF REGIONAL INTEGRATION

A common definition of regional integration states that it is a shifting of certain national domains (loyalties, expectations, and activities) toward a new center (Haas 1958). Lindberg refines the definition by proposing that it is an “evolution over time of a collective decision making system among nations. If the collective arena becomes the focus of certain kinds of decision making activity, national actors will in that measure be constrained from independent action.” (1971: 46). More simply it is “a series of voluntary decisions by previously sovereign

states to remove barriers to the mutual exchange of goods, services, capital, or persons” (Smith 1993: 4). Integration efforts mainly differ on the degree of state sovereignty loss. While a degree of lost sovereignty occurs in any integration effort, one can see that those efforts that have a higher emphasis on political integration will have a higher degree of state sovereignty loss than those that focus primarily on the economic component. The loss of sovereignty occurs in any integration effort because once a country liberalizes a part of the economy (for example trade), the state no longer has the policy making power over that particular item. However, many integration treaties establish tribunals and regulatory commissions in attempt to ensure fair practice, safeguard workers, and/or safeguard the environment. There are also cases, like the EU, where leaders consciously take sovereignty in certain areas away from the nation-state and place it in the hands of supranational institutions. Integration therefore is a form of collective action among nations in order to obtain a certain goal. This goal can be as grand as political unification (in the case of the EU) or something less demanding on national sovereignty such as the free movement of goods and services, as is found in the North American Free Trade Association (NAFTA).

What conditions allow for these nations to achieve their goals? The earliest theory of regional integration, functionalism, stated that certain functions will move away from the nation-states’ control and toward supranational institutions (Mitrany 1975). These new units would hold the decision making power once enjoyed by the nation-state (O’Brien 1995). Further evolution of this theory stated that the causal mechanism for this transfer was in the increasing complexity of governmental systems requiring a demand for highly trained specialists at the national level. These specialists would tend to solve problems at the international level (Haas 1958). Successes at the international level would then produce spill over into other functions

thereby increasing the level of integration among the member states. However this theory lacks empirical support (Caporaso and Keeler 1995; Dougherty and Pfaltzgraff 1990; Milward and Sørensen 1994). It may have been overly ambitious to find hard evidence because as Pentland states, “The relation between functional need and structural adaptation, central to the theory, is ‘necessary’ only in the sense of being an ideal or norm, not in the sense of predetermining the direction of change” (1973: 98). Functionalism’s one important contribution is the importance of looking at the structural conditions of nations in the attempt to understand the sources for the loss of sovereignty. One popular condition found in the literature is the state of the global economy. This literature mainly views integration as stemming from how the individual state fits within the global hierarchy of international transactions to how a state has been affected by the global conditions. The other view is to look at the conditions at the level of the domestic level in order to find the answer for regionalism.

The State of the Global Economy

Exogenous shocks refer to the degree that the domestic economy is vulnerable to global economic crisis. Many small states have long recognized that they are heavily dependent on trade because they cannot produce all necessary goods and as a result are highly vulnerable to any global economic shocks. These states produce highly adaptive decision-making systems as a result (Katzenstein 1985). Such countries therefore may have different incentives toward regional integration. The logic of the following arguments is that political elites will only take the regional integration option if there is a benefit for the home country.

Milner (1997a) refers to the nature and extent of the externalities due to openness. When the nature of the externality is negative or becomes increasingly negative for every unit of openness

then the demand for integration increases from the political elite's coalition because the costs of interdependence outweigh the costs of integration. The cost of interdependence is the low degree of home country benefits vis-a-vis if it were to adopt integration policy. The cost of integration is the degree of sovereignty loss. Demand will therefore be highest when the negative externalities are high but the current material benefits are low. Interestingly enough this process could produce increases in the demand for openness: Should the national decision to increase openness produce increases in integration and greater material benefits, then the demand from domestic groups will increase and thereby produce more openness and greater integration with the global economy.

Bouzas and Ros (1994) also see a relationship between the openness and integration. They suggest an inverted U-shape relationship in which countries with very low and very high levels of existing openness to the global market will be less likely to opt for integration while those at middle levels will be more likely to opt for integration. Countries with low levels of openness (highly protected economies) will suffer greater amounts of adjustment costs, while those with high levels will have already enjoyed any benefits from liberalization and may not be willing to take on the costs of adjusting to the demands of potential trade partners. Those in the middle will not have the disincentives of the low and high-level countries and may therefore have an abundant quantity of potential benefits.

Other works that focus on the external impacts of globalization on domestic politics show that crisis management is the central ingredient for the demand for integration. Pauly (1997), in reference to capital mobility, suggests that the political elite will opt for integration to head off negative externalities so as to increase domestic legitimacy.

The Domestic Economy

The incentives and disincentives for the political elite are found in the readiness of a country's economy to accept the adjustments of regional integration. Neo-classical economic theory states that individual countries will achieve higher long-term growth by adopting free trade policies (Krugman and Obstfeld 1997). This is accomplished in two related ways. The removal of transaction barriers reduces the costs of goods and services because producers will transfer the savings to the consumer. Also, increases in producer competition generate efficiencies by better allocation of production factors. This allows each area of the world to fully realize their respective comparative advantages. However in the short-term adjustment period some sectors of the economy may initially suffer, especially those that enjoyed benefits from protectionist policies. Therefore the domestic economy must be "ripe" before national political elites will opt for regional integration.

Milner (1997b) describes the demand for integration as stemming from the degree of home benefits. It is assumed that some degree of material benefit must be present in order for a demand to occur. Others (Bouzas and Ros 1994; Haggard 1997) point out that countries that have undergone severe domestic economic crises will tend to be more likely to participate in regional integration than those who have had minor crises. This would explain the higher development of regional integration in Latin America than in East Asia. Along similar lines, Cohen (1997) argues that the potential of the political elite to use inflationary policy will tend to make private investment voice demands for greater integration. The loss of sovereignty over fiscal and monetary policy is a plus for private investment because the political elite no longer has the inflationary policy instrument that will devalue savings. Garrett (1998) and Ortiz (1996) state that workers, trade unions, and left parties are actually benefiting more under regional

integration than once theorized. Integration may help mold the domestic power structure depending on the effects it has on the society.

Although the literature on the domestic conditions is slight, the logic of the arguments is sound. The greater the domestic advantages the more likely that the political elite will opt for regional integration. This logic also presents a paradox: By adopting regional integration, national leaders are actually reducing their power in the home country. However solving the paradox is straightforward once we think back on the time horizon of most leaders. Many of the works on the political economy of domestic policy (Alesina et al. 1997; Levi 1988; Magee et al. 1989) indicate that politicians think ahead only to the next election cycle or business cycle. In the case of integration, the loss of sovereignty occurs over a long period of time. By the time sovereignty is eroded in a significant way, the politicians in question will either be dead or retired. They can therefore reap the political benefits (assuming a integration produces economic gains) without much of the political costs.

III AN INSTITUTIONAL THESIS OF REGIONALISM

Despite a wide array of arguments on regional integration as discussed in the preceding section, what is lacking in the literature is a strong emphasis on the relationship between domestic institutional compatibility and regional integration. Furthermore, no studies have directly tested the causal structure of such a relationship

Various authors have noticed that domestic institutions may converge because of international factors, thus providing valuable hints for our research. Haggard (1997) points to integration resulting from a domestic economic crisis due to global economic declines. Again, it is pointed out that the process of integration is more like a reaction to past and future global

economic problems than for achieving higher gains as a result of cooperation. Castro-Rea's view (1996) is that domestic preferences among nations converge as a result of global economic problems. Also domestic actors can push for integration in one issue area at the expense of another in order to solve negative externalities (Ros 1992). One common external problem is the large fluctuations of currency rates (Bouzas and Ros 1994). Economic integration can possibly solve this issue by removing inflationary policy from the hands of politicians thereby stabilizing exchange rates (as suggested in Cohen 1997 above).

A successful regional group requires that domestic institutions be compatible across member states. One assumption for this argument is that compatible institutions reduce transaction costs. Heterogeneous institutions imply distributive conflict that prevents further integration. Haggard (1997) describes two forms of distributive conflict – the conflict between insiders and outsiders and conflicts among potential members. These factors have deep domestic roots in the process of regionalization.

Furthermore, compatible institutions decrease uncertainty, which relates to transaction cost. When domestic institutions converge toward a set of relative homogenous standards, the degree of uncertainty will be mitigated. A government can effectively empathize with and relate to its counterpart when formulating a policy that affects regional integration. Under these circumstances, member states are likely to reach a consensus both within themselves and across the regional group.

Meanwhile, it should be emphasized that an effective integration process changes domestic institutions and makes them conform to the regional group. One classic example is that a precondition for Spain and Portugal to become members of the European Community was that they install a democratic political system. Similarly, when Brazil and Argentina entered into a

partnership called “Argentina-Brazilian Economic Integration Program” (ABEIP), they had a political agenda. The political purpose of the ABEIP was to strengthen the newly emerging democratic governments in these two countries (Manzetti 1992). The political requirements of a regional organization aim at reducing political uncertainty and transaction costs of regional integration. Consequently, the member states of an established regional group converge toward similar political systems. Given that political institutions tend to be homogenous among effective regional groups, our interest lies in the evolution of economic institutions characterized by monetary and fiscal policies such as inflation and money supply, government spending, taxation and openness of the economy. Successful integration will change domestic economic institutions to make them compatible with regionalization.

Since the primary concern for the political elite is the distribution of benefits to the supporting coalition, the closer the domestic conditions are to an “ideal” situation, the more likely they can reap the maximum rewards. Political elites cannot simply have exogenous incentives to join or form regional integration organizations without having a supportive coalition. At the nexus of the two levels there exists some compatibility among the various actors.

Each of the above exogenous arguments have an element of domestic constraints. Milner’s (1997a) argument of negative externalities rotates around the wishes of the domestic coalition. The force behind the coalition’s demand is the structure of the domestic economy. If the domestic economic structure could absorb shocks from the international environment, then demands by the domestic coalition would not vary much from the status quo. A similar argument can also be made regarding Bouzas and Ros’s (1994) suggested relationship between the current domestic economic policies and the country’s vulnerability to the international

environment. The other claims (Haggard 1997; Pauly 1997; Ros 1992) again depend on how the domestic economy can deal with the fluctuations of interest rates, exchange rates, and capital markets.

The same can be said regarding the domestic arguments. The political elite cannot enter into regional integration without some constraint by the regional system. Bouzas and Ros's (1994) and Haggard's (1997) economic crises argument can only be valid if the different national actors can adopt a collective action to solve any issues with the severe periodic downturns in the domestic economies.

Our major thesis is that institutional compatibility and regional integration should reinforce each other in order for regionalism to be effective. The lack of institutional homogeneity leads to deficiency of group synergism that supports further integration. Similarly, commitment to regional integration results in the modification of domestic institutions to make them compatible across membership states. If national institutions remain heterogeneous in the process of regional integration, it is a signal that integration is not effective and profound.

So far the most successful case of regional integration has been the EU, which evolved from a free trade area into an economic union, with deep implications for a political union. By contrast, integration in Latin America has not been smooth. For instance, both the Central American Common Market (CACM) and the Andean Pact (ANCOM) "fell into obscurity by the early 1980s, when the initial goals of liberalizing trade and coordinating macroeconomic policies became first delayed, then implemented only half-heartedly, and eventually postponed indefinitely" (Mansetti 1992: 103). The problem with further integration within these two groups of countries may reside in the lack of effect of institutional change on integration. If the

coordination of macroeconomic policies has little effect on regional integration, the momentum of the process cannot be sustained.

Similarly, “in spite of several efforts the countries of East Asia have not achieved significant formal institutionalization of economic relations” (Grieco, 1997: 167). Particularly, the ASEAN countries have lacked achievement in the area of economic co-operation. “Neither its preferential trading arrangements nor its attempt at industrial co-operation have done much to increase intraregional trade and investment” (Imada and Naya 1992: xi). A proper understanding of the mechanism of regional integration requires a perspective of domestic sources and consequences of regional integration. In particular, we argue that the interaction between an enhancement of domestic institutional compatibility and the strengthening of regional integration is a necessary condition for the evolution of informal regional cooperation into formal and effective regional integration.

This argument of interaction between regional integration and domestic institutions can be displayed in the following figure.

[Insert figure III-1 about here]

If this institutional thesis of integration is correct, then we should find that the data will support the scenario that the European Union is located in the upper left cell, with the ANCOM and ASEAN countries in other cells. Additionally, it will not be surprising that the degree of integration for the Forum for Asia-Pacific Economic Cooperation (APEC) remains very limited. “The most substantial difference between the APEC and its Western Hemisphere counterparts has to do with fundamental political processes and commitments. Not only are the means for

achieving cooperation unclear, but the very nature of the commitments to be made are both equivocal and contested” (Haggard 1997: 45). The lack of institutional compatibility among the APEC members prevents major breakthroughs for this group of countries to emerge as a powerful regional group, a process that will continue to be countered by the large variance of political and economic systems and practices among the member states.

IV METHODOLOGY AND OPERATIONALIZATION

This paper attempts to quantify the relationship between domestic institutions and regional integration. More importantly, it seeks to understand the causal effect between the two variables. Granger (1969) has provided a useful definition of statistical causality by testing with standard time-series methods. Though it is assumed that the change in the dependent variable is caused by the change in the independent variables, the existence of a relationship between the dependent and independent variables may not prove the existence of causality or its direction. Therefore, it is impossible to test for causality in the context of the lexical meaning of causality (Kennedy 1996: 68).

The intuition of the Granger test is that the past can cause the future, whereas the future cannot cause the past. Letting W_t be the universe of information up to and including time period t , the Granger definition is as follows: X causes Y , given W_t , if Y_{t+1} can be better predicted using past X ($X_s, s \leq t$), than by not using it. This entails a comparison of the forecasting ability of W_t with and without X . If past X significantly contributes to forecasting of Y_{t+1} , then X is said to *Granger cause* Y .

This concept and test of causality conveniently help to infer the causality between political freedom and economic freedom. This procedure is also important, for Granger non-causality is a

necessary condition for strong econometric exogeneity (Sargent 1976; Sims 1972). Thus, if the evidence shows that integration causes institutional homogeneity, then there is support for the idea that the process of integration possesses a higher degree of permanence than economic institutions. If the reverse is true, then domestic institutions will prove a powerful means toward improving regional integration. The result in the next section will check for Granger causality between integration and domestic institutions, given the information on past degrees of integration and institutional compatibility.

We use Sargent's test for Granger causality because of its easy implementation and evidence of its superior small sample properties (Sargent, et al. 1982). The equation we estimate is:

$$Integration_t = \mathbf{a} + \mathbf{b}(L)integration_{t-1} + \mathbf{g}(L)Institution_{t-1} + \mathbf{e}_t$$

where $\mathbf{b}(L)$, $\mathbf{g}(L)$, $\mathbf{q}(L)$, $\mathbf{l}(L)$, and $\mathbf{w}(L)$ are the lag operators. For example,

$$\mathbf{b}(L)Integration_{t-1} = \sum_{j=1}^m \mathbf{b}_j Integration_{t-j}.$$

Then, a standard F test will be conducted on the null hypothesis of Granger non-causality, i.e., $\mathbf{b}_0 = \mathbf{b}_1 = \mathbf{b}_2 = \dots = \mathbf{b}_m = 0$. Granger causality from institutional compatibility to regional integration is readily tested by replacing $Integration_t$ with $Institution_t$ as the dependent variable and testing $\mathbf{g}_0 = \mathbf{g}_1 = \mathbf{g}_2 = \dots = \mathbf{g}_n = 0$.

Measuring Regional Integration: The Integration Achievement Score

The level of regional integration is referred to as the integration achievement score (IAS), first developed by Hufbauer and Schott (1994). The calculation of the IAS in their work involves a smaller number of regional integration organizations for one year (1994). We adopted

their method and expanded the period to include each year of the organizations from their implementation dates through 1995.

IAS's are the average scores of five categories that measure the level of regional integration. Each category has a value of 0 through 5, with higher values translating to higher levels of integration. Since the EU is the more highly developed regional organization, the IAS's of the other organizations are in comparison to it. Trade in goods and services is the first category. Higher levels of liberalization of barriers to the trade of goods and services among the member states receive higher values in this category. In the case of the EU, at its inception as the European Coal and Steel Community (ECSC), it receives a value of 2. After the signing of the Treaty of Rome it receives a value of 3 because trade liberalization had expanded into a customs union with its full realization in 1968 (Wood and Yesilada 1996) moving the value to 4. The value remains at 4 up to 1996. The 1970's and early 1980's marks the period of "Euro-pessimism" in which movement towards higher levels of integration stagnated. Therefore since 1968 there has not been much variation in this category for the EU.

The second category is free movement of capital. Liberalization in this category refers to direct investment in partner countries with the associated ability to withdraw investment. This category closely parallels free trade and services for the EU. In 1952 through the signing of the Treaty of Rome, the EU receives a value of 2 because the capital mobility was restricted to a limited amount of enterprises. After 1958, the score increases to 3 after the establishment of the customs union. This allowed for greater liberalization in capital mobility but national government procurement was not open to firms of partner countries (Cecchini 1988). After 1992 the value of this category increases to 4 for the EU because the Single European Act (SEA) allows for complete freedom of capital movement (Holland 1994). It does not achieve a 5,

however, because member countries still favor takeovers of existing firms from home nationals (Hufbauer and Schott 1994).

Following liberalization of capital is labor mobility. The ability of labor to seek higher wages or other employment opportunities in the partner countries signifies that a single labor market is present. This single labor market is a strong indicator of an integrated economy because another factor of production can be efficiently distributed. As the ECSC, the EU did not have much in the way of allowing workers access to labor markets. After 1957, the value increases to 2 because real barriers to labor mobility were not removed until the SEA allowed for free movement of individuals without passport restrictions within the European Community (McKay 1996). After 1992 the value increases to no more than 3 because the transfer of professional qualifications are limited as are the transferability of pension rights (Hufbauer and Schott 1994).

The next category is that of supranational institutions. Supranational institutions take over decision making in various areas from the nation-state. In order to score the maximum value in this category, the supranational institutions need not command all authority within the integrating region. For example in the case of the United States, a fully integrated region, federalism does not dictate that all power rests in Washington, DC. The individual states hold power and sovereignty in many areas. For the EU, the value of 2 describes it from the time of the ECSC through the Treaty of Rome. Under the ECSC, the creation of the High Authority transferred the authority of decision making for the production of coal and steel to the nine-member panel, however their decisions were subject to approval by the Council of Ministers (McKay 1996). From 1957, new institutions were created that are present today: the Commission, Parliament, and Court of Justice, increasing the value to 3. The value increases to

4 after 1974 due to demise of the Gaullists in France and a resulting increase of real authority of the Commission (Wood and Yesilada 1994). The value increases to 5 after the adoption of the SEA (Hufbauer and Schott 1994).

The last two categories involve the monetary and fiscal categories of regional integration. The category of monetary coordination refers to the progress in the establishment of common policies that adjusts exchange rates among the member countries. The value of this category is zero up through the adoption of the Treaty of Rome when the value increases to 1. Under the Treaty of Rome monetary coordination was set on the agenda but did not receive full attention until 1972 with the establishment of the “Snake,” increasing the value of monetary coordination to 2. The Snake did not fair well due to the economic conditions of the times requiring various member countries to pull out in order to shore up the home economies (Molle 1990). In 1979 the first real steps toward monetary union came about with the European Monetary System (EMS). The value increases to 3 under the EMS because it established the European Currency Unit (ECU) and the Exchange Rate Mechanism, which required a pledge to maintain national currencies within a band of $\pm 2.25\%$ of the ECU (Molle 1990). Since the data set ends in 1996, the more recent developments of the Euro are not included. The final category is fiscal coordination. This refers to the establishment of spending criteria for the member countries. The EU scores a zero for most of its development under this category. It was not until the Treaty of European Union that public deficits were required to be maintained under 3% of GNP and that public debt-to-GNP ratios were set at under 60% (Hufbauer and Schott 1994). At this juncture the EU receives a value of 1.

The following table lists the 1995 scores for each of the regional organizations in this paper.

[Insert table IV-1 about here]

The Convergence Index

We use the standard deviation of the economic freedom variable (Gwartney and Lawson, 1997) to measure institutional compatibility. A large standard deviation implies substantial difference among member states in their economic institutions and therefore a lack of compatibility in the area of economic policies. The index has seventeen components that are allocated to four major areas: (1) money and inflation, (2) government operations and regulations, (3) takings and discriminatory taxation, and (4) international exchange. These four aspects represent the major dimensions of a country's economic institutions and operations. The Appendix indicates the sub-components of the aggregate level of economic freedom. The first area includes money supply, price variability, a citizen's freedom to own foreign currency bank domestically and maintain a bank account abroad. The second area comprises government consumption, presence of state-owned enterprises, price controls and other government regulation, and existence of competitive markets. Third category consists of transfer and subsidies, taxation, and military conscription. The last component is made up of trade protection, exchange black markets, openness of the economy, and a citizen's freedom to engage in capital transactions with foreigners. All these sources present a quite complete picture of the economic institutions in a certain country.

In order to create aggregate scores comparable across nations, first, a zero to ten rating scale is used for each component in the index, with ten representing the highest possible rating and zero the lowest; second, weights are assigned to these preliminary values. Three kinds of weighting systems are utilized. The equal impact system involves using a weight which is the

inverse of its standard deviation, thus less weight is given to a component when it has a great deal of variability across countries. This method results in each component exerting an equal impact on the index. The weights are also adjusted for differences in the variation in the component ratings across countries. An alternative weight is to ask experts to provide their estimates for the importance of each component, and to use this survey data as a basis for attaching the weights. The third approach is to ask area specialists to rate countries, and run regression using the economic data. If the predicted value for the subjective rating is correct, then the parameter estimates are used as component weights.

Gwartney et al. (1996) recommend the second indicator, because it reflects the collectively weighted assessment of various experts. The three indices have five observations for each country in the data set, representing five year intervals from 1975 to 1995, inclusive. In this study, we adopt a procedure that fits cubic spline curves to the nonmissing values of variables to form continuous time approximation of the input series. Output series are then generated from the spline approximations.

As the Granger causality method requires the duration of time series, we select regional groups that have the longest history of existence: EU, CACM, ANCOM, ASEAN, and Central African Customs and Economic Union (UDEAC). The starting and ending years in the time series are defined by the length of the series for the economic freedom data (1975-1995). Caribbean Community (CARICOM) has existed since 1968. It is not included in the study because quite a few member states are missing in the economic freedom database (e.g. Antigua & Barbuda, Dominica, Grenada, Guyana, Montserrat, St. Kitts & Nevis, St. Lucia, and St. Vincent & the Grenadines).

V Statistical Analysis and Discussion

Before we run the Granger causality test, we examine the convergence of domestic economic institutions of most of the existing regional economic organization. Table V-1 reports the mean and standard deviation of each of the four main categories of economic freedom. They reflect the core of the economic systems in eight regional groups in the Americas, Pacific Asia, Central Africa, and Europe.

[Insert table V-1 about here]

The first category displays the largest variance for all regional groups, ranging from 1.29 for the EU to 3.31 for CACM. Inflation creates uncertainty in the economy and causes the home currency to depreciate. It has a negative consequence on regional integration. Monetary policy can have important implications for regional cooperation. It is difficult for regionalization to deepen if some member states suffer from serious inflation. The difference in the level of inflation across member states increases transaction costs for regional integration, as no country would like to import inflation into its own economy.

Similarly, fiscal policy also affects regionalism. Government takings and discriminatory taxation consist of transfer and subsidies as a percentage of GDP, top marginal tax rate, and the use of conscription to obtain military personnel. A government may utilize taxation and welfare transfer to realize its domestic political goals, which are associated with its desire to remain in office. Regionally, however, such fiscal policy may have implications for other nations. No government would like to subsidize the citizens of another country. The largest variation in this category occurs to the UDEAC group, ranging from 0 (The Central African Republic) to 7.5

(Chad). The EU has some variation in this category, ranging from 0.5 (Belgium, Denmark, Italy, and Sweden) to 4.5 (Britain). The least varied is the ASEAN country, with a standard deviation of 0.573.

Government operation and regulation are captured by general government consumption as a percentage of total consumption (private + government), the role and presence of the government operated enterprises, price controls, and the freedom from government regulation and policies that cause negative interest rates. The difference in governance may have serious consequence on regional integration. Without concerted fiscal policies, it would be very difficult for member states to maintain unity of the regional organization. Except the EU, the regional groups in Table V-1 have a relatively large within-group variance in government operations and regulations.

By contrast, the variance for international exchange, which consists of tariffs, the difference between official exchange rates and black market exchange rates, actual trade sector, transactions with foreigners, tends to be low for EU, UAEDC, and NAFTA. Both EU and NAFTA have formalized their trade agreements among their respective member states and the intraregional trade has been on the rise.

Table V-2 ranks these groups on the mean and standard deviation, with one indicating the highest number for the former and the lowest number for the latter. In terms of the aggregate level of economic freedom in 1995, the ASEAN ranks the first (7.14), followed by the APEC (7.01), NAFTA (6.97) CACM (6.22) and EU (6.08). UAEDC has the lowest level of economic freedom (4.08), lower than ANCOM (5.3), MERCOSUR (5.8) and CACM (6.22).

[Insert table V-2 about here]

The aggregate score for EU is dragged down by its taxation and government regulation. Some EU countries have been well known for their liberal social security and welfare policies. Some Asian economies have very high economic freedom. The levels of economic freedom in Hong Kong and Singapore have been the highest and the second highest, respectively, in the world. One problem for further integration that involves these economies lie in the variance of the economic systems across regional groups, particularly, the APEC. Within the ASEAN group, the problem is the homogeneity of political systems. Indonesia, the Philippines, Singapore, Brunei, Thailand, Malaysia all has different ratings regarding political rights and civil liberties in the 1995 survey by the Freedom House.

As indicated earlier, the regional organization that has the lowest level of variation in domestic institutions is favored by potentials for the deepening of integration. The EU countries evince a low level of variance of the aggregate score of economic freedom (not to mention its almost homogenous political systems), led by UDEAC only. However, the EU has better chance at success of economic integration than the UDEAC, as the former group's total score of economic freedom is much higher than the latter's.

Table V-3 presents the F-statistics and their significance level for the null hypothesis that the granger causality does not exist. The results of Granger causality tests depend on the choice of lag length. If the chosen lag length is less than the true lag length, the omission of the relevant lags may cause bias. If the chosen lag length is greater than the true lag length, the inclusion of irrelevant lags causes the estimates to be inefficient. Based on the information of preliminary partial autocorrelation estimates, a first order lag seems appropriate. However, two lags are used to ensure a test of some more lasting effect. It would be interesting to test the relationship between integration and convergence of various sub-components of the economic

freedom score, as that would reveal the more precise mechanisms of integration. We settle on the aggregate score for the sake of the limiting space of the paper while encouraging future works to perform a similar test on some of the sub-components.

[Insert table V-3 about here]

For UDEAC nations, we cannot identify a causal structure between the homogeneity of domestic institutions and regional integration. However, the lack of evidence may be due to the lack of variation in the data for integration. Africa does not often come up on the regionalism radar screen because of its extremely weak efforts. The goals of this African effort, which began in 1964, are to establish a common external tariff, establish a uniform tariff for intraregional trade, and harmonize domestic policies for production (Lawrence 1996). The arrangement has not yet implemented any form of liberalization for trade, but they have established a common code for investment policy (Lawrence 1996). No such cooperation exists for services or labor mobility. The promise for regional integration in Central Africa is not bright. The nations desperately hold on to protectionist policies although there seems to be an open discourse toward liberalization. The protectionist policies are often held in place by populist regimes that provide patronage in order to maintain the seat of government.

For ANCOM countries, the coordination of domestic institutions appear to have little effect on the degree of integration, though the integration process within ANCOM has an effect on domestic institutional compatibility, which tends to bring member states in line with their macroeconomic policies. This result is true of using both the first and second lags. The Cartagena Declaration established of the Andean Pact in 1969. The institutions of ANCOM

include the Andean Commission, the decision making body, and the Andean *Junta*, which monitors progress and makes recommendations to the Commission (Hufbauer and Schott 1994). The objectives of ANCOM were to create a common market with a harmonization of social and economic policies (Ocampo and Esguerra 1994). The economic policies did not stray from the import substitution industrial policy (ISI) popular in Latin America at the time. Instead they sought to adopt common planning in heavy industry, control of foreign investment, and regional trade liberalization within the confines of ISI. Under the original framework, the result can be described as a development of multilateral ISI regionalism. They envisioned a pooling of common resources and mutual aid as a response to the domestic economic crises brought on by international economic shocks during their individual experiences in export-led growth. To this end, the Commission adopted the Decision 24 policy that fixed the amount of profit remittances for multinational corporations and set a time frame for the relinquishment of majority ownership of domestic firms by foreign companies (Bulmer-Thomas 1994).

The early development of ANCOM did not produce a high level of integration. Overall, the institutions of the Pact did not work well. They were not able to implement the goals of a customs union and common market mainly as a result of the domestic political changes, both in regime instability and policy preferences. Chile left the Pact in 1976 mainly due to the desire of the newly installed Pinochet regime to adopt liberalization policies that greatly outpaced the goals of the Cartagena Declaration, especially in regard to foreign capital (Lawrence 1996). This was a particularly strong blow to integration given the strong complementary nature of the Chilean economy with Colombia and Venezuela (Ocampo and Esguerra 1994). The lack of monetary coordination was also devastating for the Pact. The debt and commodity crises in the 1980's saw an era of strong devaluations of their currencies and the imposition of trade

restrictions in order to correct their individual balance of payments deficits (Bulmer-Thomas 1994). This move produced increases in transactions outside the region at the same time reducing them within the region. Bolivia left the Pact in 1985 (but later rejoins in 1992) because of a dramatic economic crisis that reached its peak in that year (in late 1985, Bolivia saw their annualized inflation rate reach 24,000%).

In 1991, the remaining Pact members signed the Caracas Declaration, which reaffirmed the decisions of the *Acta de la Paz* (1990). These decisions reinvented the idea of ANCOM with intent to adopt liberalization of intraregional trade and the formal abandonment of ISI (Hufbauer and Schott 1994). However domestic political instability in Peru and Ecuador required them to temporarily opt out of these new agreements in 1992.

The strongest outcome of the development of ANCOM was its influence on the domestic economic policies of the member states. This is evident in the adoption of ISI within the region during its early period and the more recent changes toward liberalization in the present era. The low points occurred during periods when the domestic institutions defected from earlier agreement due to dramatic political changes. The future of the ANCOM seems promising given its strong effect on domestic institutional convergence. Since the present convergence seems to be presently producing economic policy that may increase the levels of political stability, we may see positive incentives for the continuing development of ANCOM.

Similarly to ANCOM countries, CACM countries evince a strong effect of integration on domestic institutional convergence, though the evidence regarding the effect of institutional convergence on further integration is statistically inconclusive. Furthermore, the effect of integration on institutions among the CACM countries is of a more immediate nature than that among the ANCOM countries.

In 1960, the goal of CACM was to form a common market with internal free trade and a common external tariff by 1966 (Bouzas and Ros 1994). The CACM regional institutions include the Central American Bank for Economic Integration, which was to coordinate the economic growth policies of the member states and the Central American Compensation Chamber, whose creation was to produce a multilateral payments system (Bulmer-Thomas 1994). The objects of CACM in its first life never came to fruition due to the 1969 “Soccer War” between El Salvador and Honduras and the political instability during much of the 1970’s among and within the member states except Costa Rica. The incompatibility among the former member states grew out of ideological differences that were exacerbated by Cold War politics.

The effort was reignited in the 1980’s but the spark did not catch until the 1990’s. The regional integration effort was an attempt to increase stability among the members of the 1960 agreement and Panama through the coordination of trade and industrial policy along liberal economic principles (Rodríguez 1994). The re-start of CACM had a large impact on domestic institutional compatibility by providing positive incentives. Through these incentives, the members sought to increase economic growth and political stability. By renewing the effort, the members could now petition the EU for access to the European market, thereby increasing their export base. Also access to the US and Mexican markets were more feasible under the new CACM. Regional integration also provided the space of the re-start of the Organization of Central American States. This organization, started in 1951, was also a casualty of the institutional compatibility in Central America.

For EU countries, there appears a mutual effect between regional integration and institutional compatibility. While the process of integration tends to homogenize domestic institutions, the reduction in the variance of institutions further strengthens the integration

process. It should be noted that institutional effects on integration are of more immediacy than the effect of integration on institutional convergence. By contrast, the integration process in EU takes a relatively longer period to reduce domestic institutional differences. In other words, it is sooner to see the effect of institutional convergence on integration than the other way around among the EU countries, though both processes exist and mutually reinforce each other.

Volumes have been written on the history, development, and future of the EU. In this section we do not hope to attempt to summarize all of the details but instead wish to concentrate on the two most salient issues regarding European integration: deepening and enlargement. Deepening refers to the newer efforts in moving the integration process from a purely economic set of events to a political union of nation-states. Expansion into the Eastern Europe offers the EU a challenge of writing a new chapter in the post-Cold War era. The discussion of the two issues revolves around the impacts the EU has on the member states and vice-versa for the promises and problems of future integration.

The deepening of European integration is a process of fits and starts. The first bold move into bringing Europe closer was the Treaty of Rome (1957), which moved the process from the Coal and Steel Community to the European Economic Community with the aim of establishing a political union of European states (Barber and Reed 1973). However the next significant rounds of deepening did not occur until the implementation of the Single European Act (SEA) and the Treaty on European Union (TEU or Maastricht), although the issue was continuously discussed in the interim (McKay 1996).

The deepening of integration demonstrates the strong influence the EU has on changing the policies of its members. The SEA amendments (1986) to the Treaty of Rome requiring of the members significant policy changes in order to move the region into a true common market

(Urwin 1991). The main provisions to this end were an end to the non-tariff barriers that impeded intraregional trade by changing an array of domestic laws and procedures (Cecchini 1988). Also included was the beginning of a common social policy to improve uniformity in standards of social protection (Wood and Yesilada 1996). The TEU marks the latest attempt in the deepening process. It formally adopted the Social Charter, which required the members to change their social policies for the protection of workers when such decisions come from the Commission (Holland 1994). Maastricht also established the groundwork for the European Monetary Union (EMU), requiring a change in member behavior in significant ways. It established convergence criteria on budget deficit spending and public debt as a percentage of GDP and the adoption of common monetary policy (Garrett 1998).

Enlargement into Eastern Europe will influence the direction of the EU's integration process because of the inclusion of a set of newly democratized and lesser developed nations. The potential eastern expansion may include the membership of the Czech Republic, Bulgaria, Hungary, Poland, Romania, and Slovakia. The possible membership of these countries may offer some problems for the EU, especially in the area of agriculture. It will have to reexamine its Common Agricultural Policy (CAP) because the inclusion of the eastern countries may increase the budgetary problems of the CAP (Wood and Yesilada 1996). The inclusion of the eastern countries also offers promises for the EU. Overall EU long-term benefits may increase as a result of a larger market with higher investment potential for western firms. While infrastructure development will be a high concern for new investment, the potential enlargement also offers opportunities from the abundance of high skilled labor (Bofinger 1998)

For ASEAN, the process of integration tends to reduce the heterogeneity of domestic economic systems, though the reverse effect cannot be ascertained. Regional cooperation tends

to make ASEAN member states coordinate their economic policies and norms. However, the reduction in institutional differences has yet to strengthen the integration of ASEAN. At best, ASEAN is an example of a quasi successful integration effort.

The signing of the Bangkok Declaration (1967) initiated ASEAN into the family of regional integration groups (Palmer and Reckford 1987). It now comprises all the countries of Southeast Asia. It was not until 1975 that the members decided to create a uniquely ASEAN institution: The ASEAN Secretariat. The Secretariat's main function is to be an information and bureaucratic center for the various ministerial meetings and committees. The main decision making body is found in meetings of the member foreign minister referred to as the ASEAN Standing Committee (Department of State 1992). This decentralization of decision-making is within the spirit of Bangkok Declaration, which states that ASEAN would be organized around consensus among the members and not within a central authority (Edwards and Wong 1996).

The Bangkok Declaration also stated the primary aims of the group, some of which are just beginning to become a reality. The members wished to use ASEAN as a vehicle to accelerate growth, promote regional stability, and collaborate on training and research in such areas as agriculture and industry (Palmer and Reckford 1987). The major advance for the aim of economic development was through the signing of the ASEAN Free Trade Agreement (AFTA) in 1992, which now includes all the members of ASEAN.

The AFTA is the primary example of the limits put on regional integration among a set of domestic institutions. The trade agreement is very limited in scope, especially compared to the others discussed in this paper. Liberalization of capital, labor, and services are not covered and no dispute settlement exists (Edwards and Wong 1996). Trade may become cheaper in 2003 as a limit of zero to five percent is placed on a limited set of items (Edwards and Wong 1996). In

addition, members have the right to temporarily exclude “sensitive” items from the list (Edwards and Wong 1996). This limited trade package results from national preferences lined toward protectionism for “sensitive” industries and the continuing high level of competition among the members often viewed in ideological terms (Edwards 1996).

ASEAN also provides an example of how regionalism can influence the institutions of domestic institutions. ASEAN was very influential in the democratization process in Cambodia. It served as the primary supporter of Prince Sihanouk’s proposals of Vietnamese withdrawal and eventual formation of a coalition government (Palmer and Reckford 1987). The role played by ASEAN in the Vietnamese withdrawal was in part facilitated by the desire of Vietnam to join the regional group (Palmer and Reckford 1987). The establishment of an interim government and eventual democratization was no easy task on the part of ASEAN given the long conflictual history among the coalition partners. However the promise of joining the newly established free trade area and possible economic assistance allowed ASEAN to influence the outcomes. This was also crucial during the more recent Cambodian regime crisis. Cambodia’s scheduled 1997 membership was postponed as a result of the coup by Hun Sen that ousted Norodom Ranariddh. The prospect of not being able to join ASEAN prompted a resolution to the crisis allowing Cambodia to become a full member in 1999.

The combination of statistical analysis and historical exploration of the above five regional groups confirms our theory that successful regional integration requires that domestic institutions and the integration process enhance each other. In the concluding section, we discuss some cases of integration that have not been in existence for long, which precludes effective statistical analysis. However, they show consistent evidence supporting our theory.

VI IMPLICATIONS AND CONCLUDING REMARKS

The experiences in contemporary regionalism vary greatly throughout the world. Although regionalism in some parts of the world has a relatively long history, they vary in the depth of integration. In Europe we see deep integration, but the Latin American experience attracts low levels of integration with the African efforts attracting even smaller levels. This section reviews experiences of some new comers. Particular, we examine MERCOSUR, NAFTA, and APEC.

MERCOSUR

The Treaty of Asunción (1991), established MERCOSUR's objectives: the liberalization of intraregional trade, a common external tariff, harmonization of laws and regulations concerning rules of origin, and the mutual consultation on macroeconomic policies (Hufbauer and Schott 1994). It also established two supranational institutions. The first, the Common Market Council, includes the four national presidents with their ministers of economics and foreign relations. The Council supervises the implementation and operation of the agreement (Fritsch and Tombini 1994). The Common Market Group administrates the eleven working groups established by the treaty (Fritsch and Tombini 1994). In addition, a dispute settlement procedure was established at the first ministerial meeting (December 1991) (Hufbauer and Schott 1994).

The regional integration effort, while young, produces possibilities to influence domestic institutions in a few ways. The statement of Las Leñas decrees that among the major goals of MERCOSUR is the democratization and consolidation of democracy in the region (Peña 1993). The initial negotiations of MERCOSUR began with Brazil and Argentina, which was in the midst of their consolidation efforts (Fritsch and Tombini 1994). The promise of democratization

in Paraguay and continuation of democratic consolidation in Uruguay led the way for their membership (Hufbauer and Schott 1994).

NAFTA

After the signing of the Canadian-United States Free Trade Agreement (CUSFTA) in the late 1980's, Mexico joined the other two in negotiating a free trade area that began in 1994. The hallmark institution of NAFTA is the Free Trade Commission, which supervises the implementation of the agreement and resolves trade disputes (Hufbauer and Schott 1993). The Commission's trade dispute mechanism, the same mechanism found in the CUSFTA, was the model adopted by MERCOSUR (see above). The broad objectives of NAFTA are to reduce tariffs and other non-tariff barriers for goods and services, liberalize capital mobility, and partially liberalize labor mobility.

Like MERCOSUR, NAFTA is a relatively young effort in regionalism but it has already begun to influence domestic institutions. During the negotiations, it was clear that for Mexico capital mobility, in the form of direct investment, needed to be an imperative part of the final treaty (Ros 1992). The debt-led growth and loan defaults in the two prior decades, Mexico had lowered incentives for capital flows into the country (Bulmer-Thomas 1994). The great need for capital on Mexico's part and the security needed by Canadian and US investors prompted a stronger continuation of the economic liberalization efforts begun under the de la Madrid administration (Lustig 1993).

Other important homogenization effects are in the two NAFTA supplemental agreements. The labor side agreement established the North American Commission on Labor Cooperation, which is a consultation group on domestic labor standards (Hufbauer and Schott 1993). This is

an effort to produce compatible labor practices and to bring Mexico more in-line with Canadian and US labor laws. The environmental side agreement established the North American Commission for Environmental Cooperation, which requires the three members to improve and enforce domestic environmental laws (Hufbauer and Schott 1993). The NACEC will help monitor the environmental conditions of the existing and newly created industrial areas in order to safeguard land, water, and air resources from any harmful effects of economic growth projected under NAFTA. Like the labor agreement, the environmental agreement is an effort to bring Mexican regulations and enforcement closer in-line with those of Canada and the US.

APEC

APEC began with a ministerial meeting in Canberra, Australia, 1989, and obtained more substance with the Bogor Declaration of Common Resolve in 1994 (Lawrence 1996). The 18 members comprise the members of ASEAN, NAFTA, the Asian Tigers, Australia, Chile, China, Papua New Guinea and New Zealand with many other countries seeking full membership. The primary institution is the Secretariat, which oversees meeting, publication, and research on behalf of the organization (Edwards and Wong 1996).

At present APEC hopes to develop “open regionalism” for free trade and investment by 2010 for the industrialized nations and 2020 for the developing countries (Lawrence 1996). Open regionalism refers to the establishment of trade and investment liberalization among APEC members as well as between APEC and non-APEC members (Edwards and Wong 1996). The mechanism envisioned for nonmembers will follow the most favored nation (MFN) principle found in the World Trade Organization (WTO) (first established under GATT). The Osaka Action Plan (1995) provides that the implementation of liberalization will be left up to the

individual members (Edwards and Wong 1996). These individual plans not only include the dismantling of impediments to international transactions, but would also include domestic policies, regulatory systems, and product standards (Lawrence 1996). The plan also asks each member to put in place early reforms in order to demonstrate sincerity for the commitments outlined at Osaka.

While the plans, commitments, and promises presents a promising future for regionalism under APEC, certain problems persist for integration. First, no commitment was made for the “sensitive industries.” The many various domestic institutions are still politically tied to protected sectors and the resolve to settle this issue has yet to materialize (Edwards and Wong 1996). Second, political issues are very salient between China and the US surrounding intellectual property rights and human rights issues. The latter issue is frequently debated during renewals of China’s MFN status and for inclusion of China in the WTO. Also recent “independence” talks by Taiwan may further strain trade ties with these members. Trade tensions between Japan and the US are sporadic but important to consider. Recent accusations by the US at the WTO involve the alleged dumping of Japanese steel. Continuing disputes revolve around the auto industry and telecommunications. Finally, difficulty may arise in coordinating any APEC agreement with already established regional agreements such as AFTA and NAFTA. While the APEC members have already established a significant degree of economic interdependence, economic integration may be a very long-term reality.

The historical and institutional experiences of these organizations show that while these regional groups vary in their origins, they can become successfully integrated if they can reduce their domestic institutional differences to such degree that they will promote integration. On the surface, the roots seem to vary depending on the individual regional circumstances. While they

may have different triggers and needs, these regional experiences actually have commonalities at the domestic and international levels. The meeting point of the two levels is the compatibility of the national institutions involved in each effort toward regional integration that further reduces the heterogeneity of domestic institutions.

Tables and Figures

Figure III-1 Integration and Institutional Compatibility

		Integration leads to institutional change	
		Yes	No
Institutions Leads to Integration	Yes	Successful integration	Stalling integration
	No	Stalling integration	Failing integration

Table IV-1 Integration Achievement Scores, 1995

Group	IAS
ANCOM	1.67
ASEAN	0.33
CACM	0.83
EU	3.33
UDEAC	0.33

Table V-1 Indices of Economic Institutions by Group, 1995

Group	Statistic	Money	Government	Takings	Int'l exch.	Sum
ANCOM	\bar{x}	3.775	4.875	6.625	5.350	5.300
	s	2.392	1.417	0.869	0.985	1.007
APEC	\bar{x}	8.320	6.486	6.153	7.973	7.007
	s	2.024	1.859	1.921	1.098	1.123
ASEAN	\bar{x}	8.720	5.400	7.760	8.040	7.140
	s	1.143	1.082	0.513	1.172	0.684
CACM	\bar{x}	5.200	7.740	7.100	6.700	6.220
	s	3.314	0.950	0.583	1.122	1.023
EU	\bar{x}	9.169	6.362	1.877	8.577	6.077
	s	1.290	0.704	1.210	0.650	0.546
MERCOSUR	\bar{x}	3.300	6.275	6.350	6.225	5.800
	s	2.364	1.461	1.292	1.632	1.417
NAFTA	\bar{x}	8.100	6.800	5.300	8.467	6.967
	s	3.035	1.249	1.136	0.808	0.902
UDEAC	\bar{x}	3.580	3.680	4.540	4.060	4.080
	s	1.678	1.182	2.788	0.796	0.492

Table V-2 Group Rankings

GROUP	Money		Government		Taxes		Int'l Exchange		Sum	
	\bar{x}	S	\bar{x}	S	\bar{x}	S	\bar{x}	S	\bar{x}	S
ANCOM	6	7	7	7	4	3	7	4	7	5
APEC	3	4	3	8	5	7	4	5	2	7
ASEAN	2	1	5	3	1	1	3	7	1	3
CACAM	5	5	1	2	2	2	5	6	4	6
EU	1	2	4	1	7	5	1	1	5	2
MERCOSUR	8	6	5	6	3	6	6	8	6	8
NAFTA	4	8	2	5	8	4	2	3	3	4
UDEAC	7	3	8	4	6	8	8	2	8	1

Table V-3 Granger Causality Test Statistics

	Lag (1)	Lag (2)
<i>UDEAC</i>		
Integration to Institution	--	3.537
Institutions to Integration	--	3.303
<i>ANCOM</i>		
Integration to Institution	7.768*	12.689*
Institution to Integration	3.524	0.152
<i>CACM</i>		
Integration to Institution	148.175*	3.536
Institution to Integration	3.142	3.303
<i>ASEAN</i>		
Integration to Institution	0.118	19.561*
Institution to Integration	1.884	1.850
<i>EUROPEAN UNION</i>		
Integration to Institution	0.351	4.311*
Institution to Integration	4.381*	2.456

Notes:

1. Numbers in the table are F statistics.
2. The asterisk * indicates statistical significance at the 0.05 error level.
3. The first lag was not run on UDEAC countries for lack of variation in the integration data.

APPENDIX ECONOMIC FREEDOM

1. Money and Inflation (Protection of money as a store of value and medium of exchange)

- A. Average annual growth rate of the money supply during the last five years minus the potential growth rate of real GDP.
- B. Standard deviation of the annual inflation rate during the last five years.
- C. Freedom of citizens to own a foreign currency bank account domestically.
- D. Freedom of citizens to maintain a bank account abroad.

2. Government Operations and Regulations (Freedom to decide what is produced and consumed)

- A. Government general consumption expenditures as a percent of GDP.
- B. The role and presence of government-operated enterprises.
- C. Price controls—the extent that businesses are free to set their own prices.
- D. Freedom of private businesses and cooperatives to compete in markets.
- E. Equality of citizens under the law and access of citizens to a nondiscriminatory judiciary.
- F. Freedom from government regulations and policies that cause negative real interest rates.

3. Takings and Discriminatory Taxations (Freedom to keep what you earn)

- A. Transfers and subsidies as a percent of GDP.
- B. Top marginal tax rate.
- C. The use of conscripts to obtain military personnel.

4. Restraints on International Exchange (Freedom of exchange with foreigners)

- A. Taxes on international trade as a percent of exports plus imports.
- B. Difference between the official exchange rate and the black market rate.
- C. Actual size of trade sector compared to the expected size.
- D. Restrictions on the freedom of citizens to engage in capital transactions with foreigners.

Source: Gwartney and Lawson (1997).

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Biographic Statements

Yi Feng (Ph.D. in Political Science, University of Rochester, 1992) is Associate Professor at the School of Politics and Economics, Claremont Graduate University. He has published more than forty journal articles, book chapters and reviews on the topic of political economy of growth, development and political transformation. His works have appeared in both political science and economics journals such as *British Journal of Political Science*, *European Journal of Political Economy*, *Journal of Peace Research*, *Journal of Conflict Resolution*, *Defence and Peace Economics*, *International Interactions*, etc. He has edited *Financial Market Reform in China: Problems, Progress, and Prospects* (with Baizhu Chen and Kim Dietrich), published by Westview 1999 and *The Applied Expected Utility Model* (with Jacek Kugler) published by *International Interactions* 1997. He has recently completed a book manuscript titled *Democracy, Governance and Economic Performance: Theory, Statistical Analysis and Case Studies*. His current research interests include regional integration and globalization and the labor market and endogenous trade policy in China. He is also a participant in project on political development, demographic change and sustainable growth, which is sponsored by the National Science Foundation.

Gaspare M. Genna is a Doctoral Candidate at the School of Politics and Economics, Claremont Graduate University and Adjunct Professor at the University of Redlands where he teaches Comparative Politics, Politics of Globalization, International Political Economy and Statistical Methodology. His dissertation is entitled *Shifts in Power, Sovereignty, and Loyalty: Affective Support for the European Union*. In this work, he looks at formation of citizen loyalty for EU institutions and argues that public political values are not reflected in various supranational institutions resulting in low levels of affective support. He is also working on a study entitled *The Political Economy of Regional Integration and the Loss of State Sovereignty*. Here he looks at the domestic and international conditions that produce regional integration. Attention is also given to the conditions that draw the political elite to opt for higher losses of sovereignty (political integration).