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Financial instability: is regionalism the answer?

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FINANCIAL INSTABILITY: IS REGIONALISM THE ANSWER?

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ABBREVIATIONS

AFC	Asian Financial Crisis
AFTA	ASEAN Free Trade Area
AMF	Asian Monetary Fund
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CEPT	Agreement on the Common Effective Preferential Tariff
CSFP	Common Foreign and Security Policy
EC	Economic Community
ECB	European Central Bank
ECOWAS	Economic Community of West African States
EEC	European Economic Community
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
FDI	Foreign Direct Investment
FED	Federal Reserve Bank
ITO	International Trade Organization
MERCOSUR	Mercado Comun del Sur
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
SEATO	Southeast Asian Treaty Organization
S&P	Standard and Poor’s

UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

INTRODUCTION

The prime objective of scholars of International Relations is to find consistent answers to the question of order in the realm of relations among multiple actors in the world's political and economic system. In other words, academics of this field attempt to develop theories, models, and hypotheses that can best describe and explain past, present, and future patterns of international relations. In this sense, this thesis will not be different from any other analytical research with respect to its traditional main purpose.

However, it will probably differ with regard to its general interdisciplinary approach that is best exemplified by the theoretical framework and methodology chosen to achieve its goal and support its key argument. In fact, underlying the thesis is the conscious decision to combine the discipline of International Relations with International Political Economy, as it is maintained that there is a reciprocal interdependence relationship between the political and economic dimensions of matters. It is asserted that in some cases political views, while in some other instances economic reasoning influence choices of actors at the international level. However, given the rise of economic and financial Globalization it is assumed that the economic aspect within issues has gained increasing importance for an accurate analysis of world politics. As associate professor at the American University in Cairo, Dr. Ibrahim El Nur affirms that such an approach can be extremely insightful, as it allows drawing a clear connection line between international relations and the economic dimension that lies underneath them and often represents the prime cause of actions by actors in the international system. Furthermore, El Nur claims that this combination of disciplines and theories is worth exploring, as issues from diverse realms are becoming progressively more interconnected in the globalized era (El Nur, 2007 interview).

Since the end of the Second World War there has been a nearly universal trend toward regionalism, best represented by the European and Southeast Asian cases, and the rise of more than one hundred other regional agreements. This tendency, however, has experienced a particularly steep increase since the 1980s due to significant political and economic developments. The rise of economic and more importantly financial globalization fostered by impressive technological progress is regarded as one of the key factors correlated to this new wave of regionalism. Such advancements have utterly changed the whole realm of international relations and raised a number of questions regarding governance, negative effects of increased financial instability and possible responses by states to such deep and fast changes (Gilpin, 2000 pp. 40-41).

Financial instability and governance as the area of study in International Relations represent the general topic of the thesis. The first concept is a possible consequence of an uncontrolled, precipitate and rushed process of globalization. At the same time, the second refers to the challenge posed by the former with regard to the problem of how to deal with it effectively in order to reduce the risks of financial instability that threaten the economic and thus political and social stability of a country or region. In this context, the former president of the World Bank, James, D. Wolfensohn, made the following public statement in August 1999:

> This report (World Development Report 1999/2000) seeks neither to praise nor to condemn globalization and localization. Rather it recognizes them as forces that bring new opportunities, but also raise new or greater challenges in terms of economic and political stability" (Wolfensohn 1999 cited in Kim, 2000 p. 1).

By the same token, Joseph Stiglitz, 2001 Nobel Laureate in economics, asserts in an internet-based interview that the high number and frequency of financial crises occurred in the last twenty years are to be observed from a broader perspective. They indicate that such financial problems are not isolated; on the contrary, these can be thought of as part of an unstable systemic architecture (Stiglitz, 2007 interview).

More specifically, an analysis of how financial crises may be correlated to the distribution of power among the main actors and their attitude toward regional integration will be conducted. In this context, regionalism in terms of trade unions and, at a higher level, monetary unions will be examined as linked to the question of governance of financial instability by the means of the case study of the European Union, i.e. EU, and the Association of South East Asian Nations, i.e. ASEAN. Moreover, attention will be dedicated to the evaluation of future developments regarding the collocation and influence of these regional organizations in the international system and the general trend towards deeper regional economic integration. In this context, special consideration will be given to the analysis of the possible impact of an eventual financial crisis of the United States of America on the power relations among the various players in the international arena with particular regard to regional organizations.

The work will be divided into two main parts: the first part will entail two different sections represented by a detailed explanation of the research puzzle and its components, as well as a literature review concerning the key issues of financial instability, power, and rise of regionalism. The second part of the thesis will contain two sections: the separate case studies of the EU and ASEAN. The analysis will then be brought to an end with a conclusion that will synthesize and evaluate the critical findings of the thesis in relation to the research question. This last assessment is to be viewed as crucial, as it will allow gathering all the single pieces of the research puzzle together by connecting the key dots among the theoretical framework, the purpose of the analysis and the empirical results.

PART 1

STRUCTURE, CONCEPTS, AND CONTEXT

CHAPTER I

RESEARCH QUESTION, METHODOLOGY, AND CONCEPTUAL FRAMEWORK

In the following first chapter of the thesis, the research question will be presented in order to draw the focus of the reader to the key structural issues of the analysis. In a further step, the main argument will be illustrated. Subsequently, the methodology used to verify the main hypothesis will be discussed briefly. Finally the theoretical framework utilized to conceptualize the research question will be introduced and more closely examined in order to show its components in a clear and unmistakable manner.

Research Question and Objectives

The research question of the thesis deals with the general environment of financial instability and looks at regionalism as a phenomenon that serves to avert the risks deriving from it. The title reveals the key correlational relationship that constitutes the object of study within the thesis: financial instability as an important element related to the prevalence of regionalism.

The question that the thesis intends to discuss is as follows: is economic regionalism to be considered the answer to the risks of financial instability? Is financial instability closely linked to the fact that economically more vulnerable countries seek mechanisms to protect their economic power and build a shield in the form of regional economic and monetary integration in order to avert the risks of globalization that eventually favor strong economies and so attempt a systemic change?

Answering these questions is important for different reasons: firstly, it will allow for a better understanding of how economic and financial globalization has changed the realm and dynamics of international relations; secondly, it will be possible to explain the mechanisms of international political change from the point of view of economic interests; thirdly, it will be feasible to observe the changing economic structure of the international system from a strategic perspective and comprehend how economic power lies at the heart of the globalized international system; finally, the analysis will facilitate evaluating historical events and making assumptions regarding future developments that will significantly shape future international relations.

Main Hypothesis

The main argument refers to the fact that financial instability is related to the fact that economically vulnerable countries seek mechanisms to protect their economic power and build a shield in the form of regional economic and monetary integration in order to avert the risks of globalization that eventually favor strong economies and attempt a change in the international system. At the same time, it is argued that more powerful states will endeavor to undermine such efforts made by weaker states at fostering regional integration in order to prevent their relative political and economic power in that specific region from being diminished. It is clearly identifiable that the mode of interaction at the level of the world's political system and the way change takes place within this realm derive from a realist perspective.

This hypothesis has deep implications for the process of formation of economic and political international relations and is thus crucial for understanding international political change and future developments in the structure of the international system. On the other hand and away from such a broad perspective, it is also maintained that the phenomenon of regional integration analyzed in and for itself occurs as states from the same geographic region have a relation of high mutual dependence that makes it beneficial for them to participate in regional cooperation and coordination of policies.

Nevertheless, the main conclusion of the thesis remains drawn from the observation of international political change at the higher level of interaction among actors in the global political and economic system, thus not considering regional events merely on the basis of their regional context. On the contrary, regional developments need to be integrated into the broader international system in order to conceptualize their potential impact on international relations, and specifically on those reciprocal relations among powerful states and more vulnerable states that have formed regional organizations.

Methodology

How to proceed in order to effectively deal with the research question and the purpose of the study represents a crucial part of the analysis and needs to be accurately defined and specified. Considering the high degree of complexity of the issues that constitute the research puzzle, it is important to support and strengthen the main argument of the thesis by the means of a wide range of sources. By doing so, the reliability of the findings will be increased and credibility will be granted to the conclusion of the thesis.

First of all, the analysis will start with a historical review of the growing relevance and reach of regionalism since the end of the Second World War, while dedicating particular attention to the strong momentum that regionalism gained shortly before and in the aftermath of the fall of the Soviet Union. In this realm, the difference between the first and the second wave or regionalism will be more closely explained. It will also be essential to stress the continuously growing importance of economic power over the last sixty years in defining interactions among actors and thus shaping the functional mechanisms of the international system. In fact, it will be shown that critical political, socio-economic and technological events have led to a redefinition of the concept of power different and more complex than it has usually been explicated in realist terms.

Subsequently and not necessarily adopting a comparative approach, official documents of regional agreements and treaties signed by members of regional organizations such as the EU and ASEAN will be studied with respect to their declared objectives. After that, the focus will be shifted toward an evaluation of the increasing breadth and depth of policy coordination and the required institutional arrangements. This will certainly be helpful in realizing the scope and depth of regionalism as a geo-political phenomenon.

Furthermore, attention will be paid to the observation of macro-economic indicators such as trade flows, foreign direct investment flows and others demonstrating the increasing economic interdependence within regions. Different time frames will be used for studying such incremental characteristic of regional interdependence. Graphs and data will be made available in order to facilitate the understanding of the meaning of such economic indicators.

In addition to these materials, interviews have been arranged with representatives from the political and economic departments of regional organizations such as the EU Commission and various diplomatic missions of EU and ASEAN member countries including Slovenia and Indonesia in order to receive first-hand information about past events and future prospects of development and deepening of regional organizations for a better understanding of their objectives. The valuable insight gained in such meetings will be critical for a clearer comprehension of the mode of interactions among actors in the global system. In this sense, it will be possible to receive direct information about the process of regional integration and the modus operandi of regional organizations within the world's political and economic system. Special attention will be given to the relations between such regional bodies and bigger regional players; e.g. in the case of Southeast Asian ASEAN's interactions with regional powers such as China, Japan, and the US will be further examined with regard to the main argument of the thesis.

For instance, a visit to the Embassy of Slovenia was organized, in which a particularly insightful talk was held with the Counselor and Deputy Head of Mission, Sonja Cujovic, who has made a valuable contribution to the analysis thanks to her important experience within Europe and in Southeast Asia as well. Moreover, a meeting with the Heads of the Political and Trade Departments of the Delegation of the EU Commission to Egypt took place, in which essential issues were discussed. Also, a series of two different talk sessions with the Third Secretary of the Embassy of Indonesia, Danang Waskito, have allowed for a deeper and closer discussion about critical regional issues, such as ASEAN's role, its internal and external relationships, as well as national and regional responses to the Asian financial crisis of 1997. Direct consultations with diplomatic staff are considered as significant, as they enable the scientific investigation to reach beyond the mere evaluation of documents and data and make it possible for scholars to observe regionalism from a different, more practical perspective.

Finally and in addition to the sources mentioned above, it has been regarded as equally relevant to include the opinion of experts from the academia, who definitely possess the ability to complement the insight delivered by diplomatic staff given their broad knowledge as well as independent and autonomous thinking. For this purpose, Dr Jill Edwards from the History Department and Dr Ibrahim El Nur from the Political Science Department at The American University in Cairo have been interviewed.

For practical and transparency reasons, here follows a detailed list comprised of all the scholars and diplomatic staff who have been involved in the analytical research and evaluation of facts and data:

- Mr. Michael Ryan, Counselor, Political Affairs, Delegation of the European Commission to Egypt;
- Mrs. Barbara Stacher, First Secretary, Trade Affairs, Delegation of the European Commission to Egypt;
- Mr. Thomas Viot, Expert, Trade and Economic Section, Delegation of the European Commission to Egypt;
- Mrs. Sonja Cujovic, Counselor and Deputy Head of Mission of the Embassy of Slovenia;
- Mr. Danang Waskito, Third Secretary of the Embassy of Indonesia, Information Section;
- Dr. Jill Edwards, Professor in the History Department and Director of the European Studies Program at The American University in Cairo;
- Dr. Ibrahim El Nur, Professor in the Political Science Department at The American University in Cairo;

Conceptual Framework

The conceptual framework of the thesis will include two dimensions integrated with each other: Gilpin's theory of international political change at a macro or global level and Keohane's and Nye's theory of interdependence at sub-macro or regional level. In other words, the theoretical basis for the thesis will be characterized by two layers that are connected with each other reflecting an integration of liberalist into realist thought in order to form one single framework. In the following paragraphs sufficient explanations will be provided

Starting from the macro level, the underlying conceptual framework will be drawn from a political and economic perspective on change in world politics. Gilpin's theory of international political change offers a useful tool for comprehending the nature and dynamics of change (Gilpin, in Viotti and Kauppi 1999 pp. 145-152). However, within this research thesis the focus will be shifted more toward aspects that are secondary in his original model. The importance of the tendency of smaller and less powerful states toward regionalism for counterbalancing the more powerful states or hegemons will be highlighted, while the validity of the core assumptions of Gilpin's theory are still maintained. Indeed, international relations continue to be characterized by a continuing struggle for wealth and power among independent actors in a state of anarchy. On the other hand, the shape of such struggle has been changing over time due to political, economic, technological and other developments that have brought about change in the international system. This change implies a redistribution of power that causes actions and reactions from both powerful and less powerful states to modify the equilibrium of the system in their favor and so advance their own interests. In the face of the consciousness of less powerful states of the fact that no significant change can be achieved by each one individually, their drive towards regionalism is seen as a mechanism for changing the system for their own benefit and as a counterbalance measure against more powerful states.

In sum, not a complete reversal of Gilpin's model, but only an adaptation of it will be adopted, which serves the purpose of the thesis of explaining regionalism as a phenomenon correlated to financial instability that can be conceived as a linked trend by weaker states toward changing power relations in the international system in their favor. Thus, a relationship between regionalism and international political change is established. At the same time, however, as will be illustrated, more powerful states will still seek to shape the international systems and the relations among actors according to realist principles and decision-making process.

As a complementary part of the theoretical framework used for this thesis and in order to understand the significance of regionalism in the dynamics of Gilpin's theory of international political change at the macro level, Keohane's and Nye's theory of complex interdependence at the sub-macro or regional level will be integrated into the basic theoretical framework of the thesis. At the sub-macro or regional level, interdependence, as defined by both authors as referring to situations characterized by reciprocal effects among countries resulting from international transactions of various kinds (the focus will be directed toward states, although other actors are acknowledged), is considered as the main feature of international relations among member states of regional organizations. Countries within a specific region are assumed to have a relation of high mutual dependence that makes it beneficial for them to participate in regional coordination of policies. Such interdependence makes the rise and promotion of common interests possible, although not necessary (Keohane and Nye, in Viotti and Kauppi 1999 pp. 307-317).

For this thesis, the first characteristic of the concept of complex interdependence that deals with multiple channels connecting societies is regarded as less important, since the focus is shifted toward the state as the main actor. On the contrary, particular attention will be given to the second and third characteristics of interdependence: the former refers to the idea that the agenda of interstate relationships consists of multiple issues not organized along hierarchical lines that need policy coordination in the face of high opportunity costs. The latter feature deals with the assumption that military force is not used by governments toward other governments within the same region in a situation of stable and durable complex interdependence (Keohane and Nye, in Viotti and Kauppi 1999 pp. 311-312). In this context, the authors argue that the potential role of international institutions in political bargaining is highly increased (Keohane and Nye, in Viotti and Kauppi 1999 p. 316).

Keohane's and Nye's opinion that both Realism and their theory of interdependence represent ideal types and that most reality-based situations will fall somewhere between these two extremes is representative for this research work. Such stance on these theories of international relations allows integrating them into one single model that combines key aspects of both.

In sum, Keohane's interdependence theory will be used in order to prove that cooperation among states is possible at a sub-macro or regional level in the presence of mutual dependence and interests within a certain confined region. Then, this Liberalist approach will be integrated into a broader realist perspective at the macro level that will allow explaining how cooperation within a region or regionalism can be regarded as a realist mechanism for advancing the members' own interests against other regional or global hegemons. Indeed, it is maintained that weaker states seek regional integration in order to increase their leverage against major powers. By doing this, they provide protection of their economies in the face of financial instability and the deriving high probability of financial crises that would affect them more severely than powerful countries, which would benefit in relative terms from a realist perspective.

Limitations of Theories

In this section of the thesis the focus will be directed toward the discussion over the limitations of both theories that form the conceptual framework underlying the analysis. This will make it possible to reach a more complete understanding of the reasons for the chosen integration of two distinct theories and so for the double-layered structure of the theoretical framework. This concise examination will be organized into three different subsections: the first two will encompass a critique of each separate theory with respect to the research question, while the last subsection will present the reasons for an integration of both theories and reinforce the view that these may represent complementary parts of a single theory.

Gilpin's Model of International Political Change

Although Gilpin's model entails some differences from the early realist writings of Thucydides and Thomas Hobbes, it certainly maintains a vast part of its essential characteristics. Firstly, the author's starting point is represented by the typical realist postulation of a state of anarchy in the international system. In this sense, international relations are understood as a recurring struggle for wealth and power among independent actors, in which there are no binding rules or generally accepted laws with the necessary sanctions mechanisms that could force actors to abide by them. This assumption clearly derives from Hobbes' state of nature of the human being and is extrapolated to the level of international relations among states. In this context, realists do not refer to anarchy as an image of violence, destruction, or chaos. On the contrary, they tend to focus merely on the absence of any authority above states, which are seen as sovereign and independent actors. For such reasons, it is possible to assert that anarchy is the defining characteristic of the environment, within which states interact with other each other, thus shaping international relations (Viotti and Kauppi, 1999 p. 68).

The other typical realist feature of the international system is represented by the uneven distribution of power among states (Viotti and Kauppi, 1999 p. 71). Most modern realists describe power as the sum of military, economic, technological, diplomatic, and other capabilities at the disposal of the state in relation to the capabilities of other states (Viotti and Kauppi, 1999 p. 64). Therefore, it seems obvious that despite the absence of authority there is a hierarchy of power in international politics (Viotti and Kauppi, 1999 p. 68).

Hence, according to the characteristics of the international system proposed by realist theory, alliances and coalitions may have a merely temporary character and are not long-term oriented. They are transitory phenomena that help sustain the stability of the international system by creating a bipolar or multipolar balance of power among opposite sides. This surely constitutes a serious practical limitation, when it comes to analyzing the empirical data, since it cannot be accounted for stable, solid, and long-term oriented multilateral and regional agreements such as the EU or ASEAN. In other words, the premises of a state of anarchy combined with an uneven distribution of power among states make the realist theory too deterministic. It is assumed that there are objective conditions that cannot be altered or influenced by policymakers (Viotti and Kauppi, 1999 pp. 73, 83-84).

Secondly, it appears clear that the state is regarded as the only relevant actor in the international system, which follows the realist state-centered view of international relations (Gilpin, in Viotti and Kauppi, 1999 p. 148). However, this is not entirely representative of the empirical reality, as it can be stated that non-state actors, such as influential multinational or other non-governmental organizations that operate in a cross-national environment do play a key role in the process of policy making. Consequently, this fact has a critical impact on the decision-making process of the executive body of a country (Viotti and Kauppi, 1999 pp. 84-85). From the point of view of the thesis, states are still regarded as the main players in the international system. Nevertheless, the importance of other non-state actors is also acknowledged, although this is definitely not the focus point of the analysis.

Thirdly, Gilpin's model shares with Realism the fact that it is mainly concerned with military security and it considers war as the primary mechanism for settling disputes at the international level. In this respect, peace is only seen as a period of truce between wars (Gilpin, in Viotti and Kauppi, 1999 p. 148). It is also for this reason that cooperation in terms of alliances among different states is treated as an instrumental part of the stability theory of balance of power and does not make any real difference to the state of anarchy of the international environment. Of course, this cannot explain a number of real situations, in which war has not been the prime means for resolving a crisis. On the contrary, the role of peaceful negotiation and conflict resolution needs to be acknowledged. Furthermore, even economic interdependence is conceived in terms of security and distribution of power. According to realist thought, this should thus be minimized, as it could compromise the capabilities of an individual state in relation to another by allowing the latter to have some leverage over the former (Viotti and Kauppi, 1999 p. 77). This specific feature shows the limited usefulness and shortsightedness of realist theory, since it does not recognize the consequent reciprocity of interdependence, which allows for a mutual deterrence from hurting the other's interests by giving leverage to both sides.

Hence, the model does not fully acknowledge other important issues, such as economy or society. Indeed, realists have usually tended to view the economy as subordinate to political choice. Thus, the issues of national and international security are defined as the object of high politics and are regarded as more important than economy, trade, finance and other socioeconomic and humanitarian matters, which form the object of low politics (Viotti and Kauppi, 1999 p. 77). From the perspective of the thesis, nevertheless, the economic dimension of power is considered more critical to international relations given the high level of interdependence created by the process of economic and financial globalization as well as the need for sound economic performance in order to finance foreign policy. Therefore, it can be asserted that in many cases economy dominates or at least influences political choice to a great extent, and not only vice-versa as sustained by realist theory. In this regard, one could also speak of the increasing relevance of geo-economics compared to geo-politics.

Another crucial limitation that is worth examining refers to the question of rationality. Gilpin, according to the realist tradition, assumes that states are rational actors, and their decisions and actions are based on sound rational reasoning. It goes without saying that this point is also connected to the issues of defining national interests and the view of the state as a unitary actor. The author takes a very clear stance on this matter, as he claims that states will seek to bring about change in the international political and economic system by the means of territorial, political, and economic expansion, if the expected benefits of action exceed its expected costs. The effect would be a modified distribution of power among actors in the global system (Gilpin, in Viotti and Kauppi, 1999 pp. 149-152). However, there are a number of difficulties with such approach to states behavior. In fact, the main flaw in Gilpin's model lies in the oversimplifying rationality assumption. This is problematic, as it presumes the availability of perfect information as well as the ability to process and analyze huge amounts of data and facts. These conditions are almost never given in reality. In addition, this premise leads to an underestimation of subjective and situational variables, such as human behavior, that is not necessarily rational. As a consequence, the objectives of states, the definition of their national interests and actions retain a certain level of subjectivity and might also be affected by the complex interplay of various forces within the state.

Furthermore, Gilpin does not directly address the reasons for states to undertake actions aimed at changing the international system in their favor. Regarding the presumed state of anarchy of the global environment as the major cause for such states behavior can be seen as an oversimplification of reality and disregard of other objective and subjective factors that play a role in a specific situation. In this sense, Gilpin's approach based on a cost-and-benefit analysis that underlies the decision-making process is controversial, because there is no perfect information at the disposal of the decision-makers, so that decisions are most probably not only based on objective data, but also on subjective considerations as well as situational factors. Rationality is necessarily bounded or limited, and can never be absolute.

Despite all these limitations of Gilpin's model, the author has made his most valuable contribution to the development of Realism as a theory and in general to the study of International Relations by the means of shifting the attention toward the dynamics, patterns, and circumstances, under which international political change occurs. In this context, it is important to note Gilpin's recognition of the possibility that political, economic, and technological developments may play a significant role in spurring change or producing the conditions, under which change takes place. The key limitations with regard to his contribution are twofold: firstly Gilpin's model focuses excessively on security and war as the primary vehicle of change, while there have been a number of peaceful transitions, negotiations and conflict resolutions that remain unexplained by this model. Secondly, the author considers international political change as being attempted and eventually achieved merely by stronger states by deploying their higher capabilities compared to more vulnerable countries. This perspective has no explanatory validity, when individual powerful states have to deal with weaker states grouped in broad and cohesive regional organizations that prefer to lead negotiations as one single actor in order to maximize their leverage and minimize the influence of their counterpart. This represents a crucial point for the theoretical framework of the thesis, as the focus of the analysis will be directed toward the behavior of such less influential states and their actions represented by regional institutions. At the same time, it is acknowledged that bigger regional or global powers will still try to achieve change for their own benefit. In order to do this, they might resolve to undermine the drive toward regionalism, as they view it as a threat to their regional power.

In sum, it can be asserted that there are a number of relevant limitations and weaknesses in Gilpin's model of international political change. However, his main contribution has been extremely important for the further development of the model itself into a more comprehensive one that is able to gain a considerable higher explanatory capability achieved by expanding its reach and dealing with its shortcomings.

Keohane's and Nye's Model of Complex Interdependence

Liberalism in general and Keohane's and Nye's model specifically can be considered as the complementary counterpart of Realism. In fact, most of the weaknesses of Gilpin's model and the realist tradition can be identified with the strengths of the liberalist approach. From this point of view, the strengths of Realism and Gilpin's framework in particular can be regarded on the whole as the shortcomings of liberalist theories.

Indeed, Liberalism shows little regard for the traditionally realist state-centered view of international relations. In fact, it needs to be underlined that in the end the states are the primary actors in the international system, as they make and implement decisions, although they might be influenced to a certain degree by several internal and external forces during the policy and decision-making processes. Certainly, it is neither feasible to estimate how big such influence is in reality nor to reach an exact understanding of how intricate such interplay of factors is. For this reason, Liberalism offers a useful theory in realizing the complexity of real situations; however, it does not provide an effective practical method for simplifying the extremely high amount of information at hand, which is obviously necessary in order to attain a precise and accurate analysis of the policy and decision-making process.

As the analysis of Keohane's and Nye's model is taken further and deeper, a few more critical flaws need to be more closely examined: firstly, a crucial limitation of Keohane's and Nye's theory is represented by its inability to explain the still high degree of frequency of war as a mechanism to solve international disputes. Especially, as far as regional conflicts are concerned, the model does not deliver any satisfactory answer to the question of order, as the concept of complex interdependence is not capable of illuminating the reasons and circumstances, under which conflicts are still resolved by violent means.

Secondly, there is an inherent disregard of the state of anarchy in the international system. The fact that international regimes, institutions and organizations might arise due to a situation of mutual dependence does not necessarily mean that the absence of any hierarchy of authority is overcome.

Thirdly, another important limitation derives from the consideration that Keohane's and Nye's model does not possess a truly global character, but is rather confined within a certain geographical region. This is an essential point for a full understanding of the theoretical model developed for the thesis, as it exemplifies the need for an integration of both theories into one single conceptual framework.

Despite such weaknesses, the fundamental contribution that Keohane and Nye have made to the study of International Relations is definitely represented by the illustration of a world, in which actors might find themselves in a situation of complex interdependence. With respect to the research question and main argument of the thesis, both political scientists have facilitated the construction of the theoretical framework as a synthesis of Realism and Liberalism by pointing out the possibility that international organizations will act as arenas for political action by weak states (Keohane and Nye, in Viotti and Kauppi 1999 p. 317). This specific advancement provides the grounds for sustaining the key hypothesis that more vulnerable states will use regional agreements and institutions in order to increase their individual leverage in a context of financial instability against strong regional and global powers by bringing their capabilities together and acting as one single player.

Need for an Integration of Both Theories

How does order come about or is achieved in the international system? This is the ever recurring question for scholars, academia and diplomats who deal with international relations. Realism and Liberalism, as exemplified in the specific models of Gilpin, on one side, and Keohane and Nye on the other, offer two plausible explanations of the mechanism that regulates and fosters order in the global system. The very fact that both theories of international political change and that of complex interdependence seek to find an answer to the same question of order in international relations makes it worth exploring ways, in which an integration of models can bring the analysis forward.

Of course, Liberalism provides a different perspective on international relations than Realism. Both theories draw the attention to multiple variables and important features. By doing this, they are never antithetical or irreconcilable; on the contrary, as has been previously discussed, they should be regarded as complementary parts of the same group of theories. For instance, the differences between Realism and Marxism are much deeper and more substantial, while Liberalism and Realism do have many common characteristics and points of encounter.

Their integration takes place at the level of the international system analyzed from a broad viewpoint, as the key aspects of each model are evaluated in terms of their compatibility. At this point, it is worth reminding that a number of modifications and adaptations of the original models have been decided and implemented in order to respond to their inherent weaknesses and deliver the grounds for a successful incorporation into one single framework. It is argued that the crucial difference between macro and sub-macro level perspectives represents an essential element that enables the construction of a clearly identifiable double-layered conceptual model. From a sub-macro point of view, Keohane and Nyes's concept of complex interdependence facilitates understanding the rise and relevance of regional cooperation. At the same time, from a macro standpoint these regional players comprised of weaker states need to be included into the wider context of an anarchy-based international system, within which the destabilizing forces of financial and economic globalization are more likely to damage vulnerable countries than others. According to the realist approach, because they feel threatened by more powerful countries and the risks of financial instability, they decide to increase the level of integration and use regional organizations as an effective means to raise their individual leverage in international relations. Hence, the capability of weaker states to seek and achieve international political change is fully acknowledged.

CHAPTER II

FINANCIAL INSTABILITY, POWER, AND REGIONALISM

The second chapter of the thesis will include a review of the main literature concerning the three most important areas that form the context, within which the analysis of international relations is pursued. As the heading suggests, these consist of the issues of financial instability, power, and regionalism. An introduction to the following relevant questions is offered, while these will be further explained and illustrated in the second part of the thesis by the means of the case studies of the EU and ASEAN:

- What is economic and financial globalization? What are the reasons for global financial instability?
- How is power to be defined in the context of globalization?
- How can the rise of international regimes and in particular regional organizations be explained? What impact has globalization had on regionalism?

Globalization and Financial Instability

In this section of the second chapter, some of the key aspects of the process of globalization will be presented and discussed. Among these there is certainly the question of finding a proper definition for this extremely complex concept. Furthermore, the role of global capitalism and technological progress will be illustrated also in terms of their destabilizing effect on the world's economic and financial architecture. In order to provide empirical evidence of the instability deriving from globalization, studies and charts of a representative sample of relevant financial crises will be provided.

The Problem of Definition

Undoubtedly, globalization is one of the most discussed, controversial, and confusing concepts of contemporary politics. Three are the main questions that arise: the first is concerned with the definition of the notion; the second aims at establishing whether globalization constitutes a new or an old phenomenon; the third and last investigates the nature of its impact.

There is no single clear-cut, widely accepted definition of the term, as its meaning depends on the perspective, scale, and depth of the analysis. Indeed, there are a number of possible explanations that direct the attention to specific aspects worth considering. For instance, the former UN Secretary General Kofi Annan made the following public statement in September 3, 1998:

> Globalization has an immense potential to improve people's lives, but it can disrupt – and destroy – them as well. Those who do not accept its pervasive, all-encompassing ways are often left behind. It is our task to prevent this; to ensure that globalization leads to progress, prosperity and security for all. I intend that the United Nations shall lead this effort (Annan 1998 cited in Kim, 2000 p. 1).

From a similar point of view, the British sociologist Anthony Giddens made the succeeding comment during a session of the Reith Lecture organized by the BBC network in 1999:

> Globalization not only pulls upwards, it pushes downwards, creating new pressures for local autonomy. The American sociologist Daniel Bell expresses this very well when he says that the nation becomes too small to solve the big problems, but also too large to solve the small ones…..globalization is becoming increasingly de-centered not under the control of any group of nations, and still less of the large corporations. Its

> effects are felt just as much as in the Western countries as elsewhere (Giddens 1999 cited in Kim, 2000 p. 1).

These definitions all point out different central traits of the concept that are worth analyzing further: firstly, the global character and reach of globalization, which leads to the consequence that there are issues that concern the global sphere and cannot be tackled from a narrow locally-oriented angle. In fact, it can be asserted that there is an evident, although fuzzy contrast, and discrepancy between the global and local context, so that responding or finding answers to new or altered problems has become more complex. Secondly, it appears clear that globalization is more than a one-dimensional phenomenon. As a matter of fact, it involves many different realms and takes place in all key aspects of contemporary international life, not only in the economic, but also in the social, cultural, diplomatic, political, security, and environmental domains, albeit at a different pace and intensity (Kim, 2000 pp. 10-11). Finally and more significantly, the broadly accepted truth is mentioned in the preceding quotes that globalization offers great opportunities, but at the same time poses serious threats to the ability of states, non-state actors, people and communities to act, react and adapt in a deeply changed environment. In other words, this phenomenon poses a challenge of governance, i.e. there is a need to define clear rules in order to govern newly introduced or altered processes.

Probably the simplest, however most effective definition of globalization was delivered by Jones, who argues that the quantitative characteristics of this phenomenon have developed to a point, at which they have generated a qualitative change in world affairs:

> The most general qualitative proposition about globalization is that it is characterized by time-space compression, in which distant events and developments impact upon local conditions with greater immediacy and speed than in the past (Jones, 1999 p. 365).

This definition summarizes in a clear-cut manner the new elements added by globalization that pose new challenges to the question of governance by states. This represents a principal area of interest for the research question of the thesis, that is how to cope with financial instability deriving from the phenomenon of globalization from the point of view of the major actors in the international system, i.e. states.

Global Capitalism and Instability

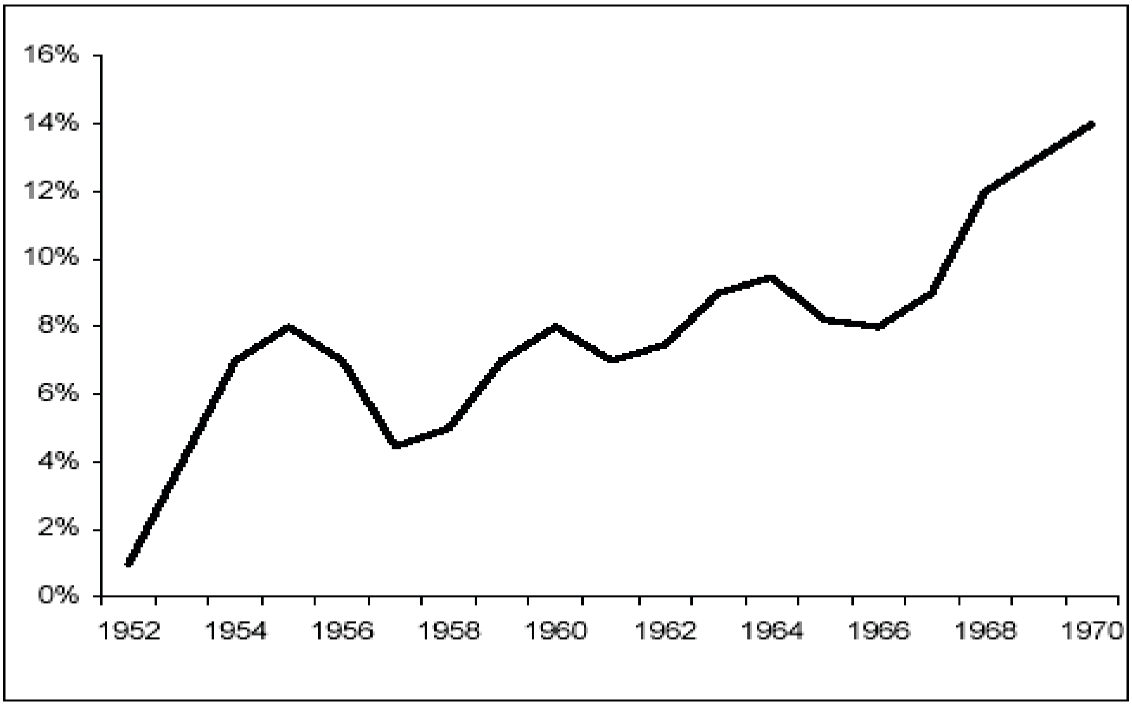
The most frequently debated dimension of such broad and complex process is definitely represented by the so-called economic globalization, which may be interpreted as the cause of financial instability. This has its roots in the spread of global capitalism over the last two hundred years and more intensively in the aftermath of the Second World War, as will be more closely examined in this subsection. Special attention will be given to the latest economic and technological developments that have fostered a new level of economic integration, while facilitating instantaneous capital flow and thus increasing the probability of financial unbalances and quick speculative trends. This will be demonstrated by the means of a few selected cases of financial crisis that occurred in the last twenty years, i.e. the US stock market crash of 1987 and the Mexican currency crisis of 1994.

In the last few decades, the growth of international trade has been higher than that of world output. However, increased international trade is not only the cause of economic globalization as the nurturing of interdependence between economies at a global level. Indeed, there are few key developments in technology, finance and foreign direct investment (FDI) by multinational corporations (MNCs) that need to be thoroughly scrutinized. In this respect, globalization is the result of many different changes and advancements. Hence it can be regarded as an aspect of modern capitalism, founded on technological progress (Gilpin 2000, p. 18-29).

In the second half of the last century, trade barriers have declined significantly due to successive rounds of trade negotiations, as it is exemplified by the drop from forty to only 6 percent of the average tariff levels of industrialized countries on imported goods. The general trend is illustrated in appendix I. In addition, since the late 1970s a wave of deregulations and privatizations has further opened national economies to trade and FDI. At the same time, the invention of new technologies in transportation, such as trucks and more importantly air carriers, has drastically reduced transportation costs, encouraged trade expansion and investment in other economies. In fact, this has facilitated the growth of FDI, which has been even higher than that of international trade. Since the 1980s FDI has risen with an astonishing average annual growth rate of 15 percent. Such significant development, i.e. the expansion of MNCs and the rapid increase in FDI, has had a deep impact on the structure of the world economy by integrating different national economies more utterly. Hence, economic interdependence on a global scale has been strengthened. As a consequence, on the other hand, grave economic or financial unbalances created in one region can have impressive spill-over effects to other regions, and sometimes even on the global economy as a whole (Gilpin, 2000 pp. 18-21).

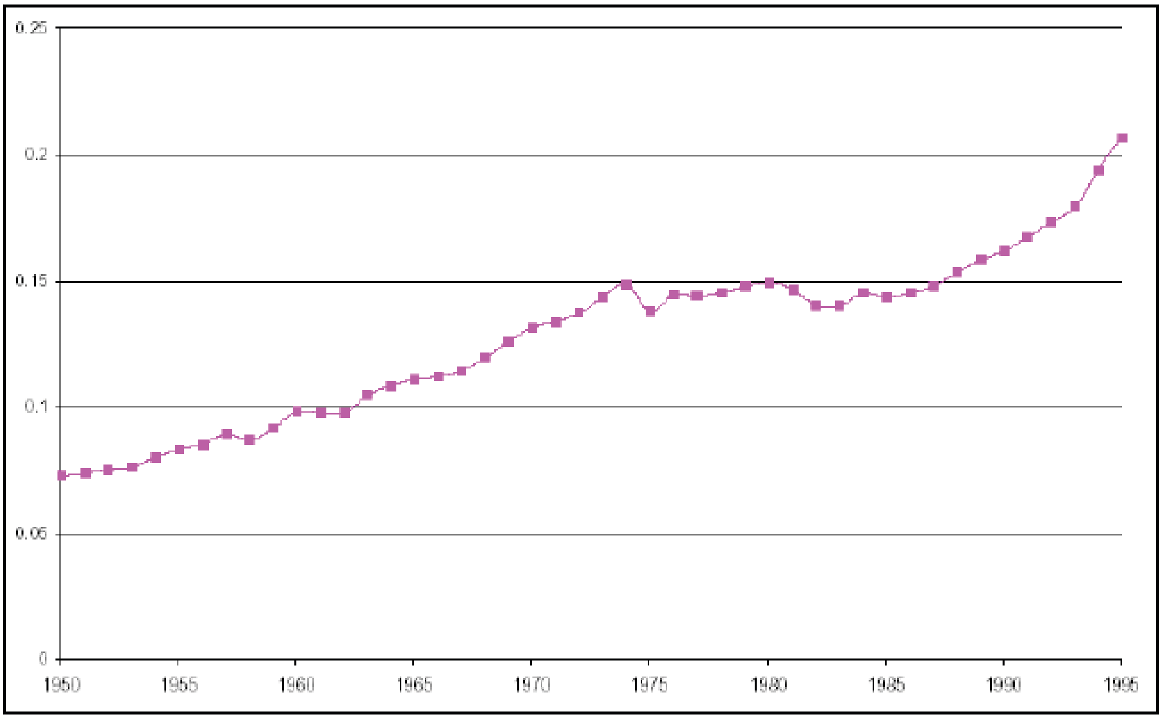
The following figures and tables highlight the outstanding growth of trade flows and FDI in absolute terms and in relation to GDP growth. Figure 1 shows the stunning expansion of exports during the three decades that followed the end of the Second World War. The curve illustrates the fact that the aftermath of that war marked the beginning of a new and unprecedented era of international trade, when one takes into account that the previous one was highly biased by colonialism and trade flows between colonies and colonial powers. At the same time, figure 2 indicates the consequent growing importance of trade as a portion of world output between 1950 and 1995. On the other hand, tables 1 and 2 emphasize the uneven distribution of inward and outward FDI stocks by group of economies, which makes it easy to comprehend the enormous disparity between developed and developing countries. It is worth noting that such serious global unbalance has only minimally changed overtime. Indeed, if the first group's share of FDI stock as of 1980 is compared with its more recent value of 2002, it can be concluded that no relevant shift has taken place, as this figure dropped by only 1 percent from 88 to 87 percent of the world FDI stock. Furthermore, figure 3 presents data concerning the annual growth of outward FDI stock by region for the same period of time between 1980 and 2002. It appears clear from this figure that FDI has grown substantially over the past three decades and the level of interconnectedness among economies has increased dramatically. Finally, figure 4 is extremely insightful, as it puts the growth of world GDP, exports and FDI into relation for the period from 1970 to 2003. It is clearly discernible that during the 1970s the growth of these figures was equal and that exports quickly became more relevant during the 1980s. However, the data show that over time, precisely during the 1990s, FDI gained more relevance and weight. In fact, its growth has been remarkably higher than that of output or trade.

Figure 1. Total Merchandise Export Growth 1952-1970, % Change



Source: World Trade Organization

Figure 2. World Trade/Output Growth 1950-1995, % Change



Source: Terborg, 2003 p. 57.

Table 1. Inward FDI Stock, by Group of Economies in Billions of US$

Group of economies	1980	1990	1995	2000	2001	2002
World	**699**	**1 954**	**3 002**	**6 147**	**6 607**	**7 123**
Developed countries	392	1 400	2 041	3 988	4 277	4 595
Developing countries	307	551	921	2 030	2 174	2 340
Africa	32	51	78	145	158	171
Latin America and Caribbean	50	117	202	609	706	762
Developing Asia	216	340	583	1186	1215	1305
Central and Eastern Europe	..	3	40	129	156	188
Memorandum:						
Least developed countries	3	8	16	36	41	46

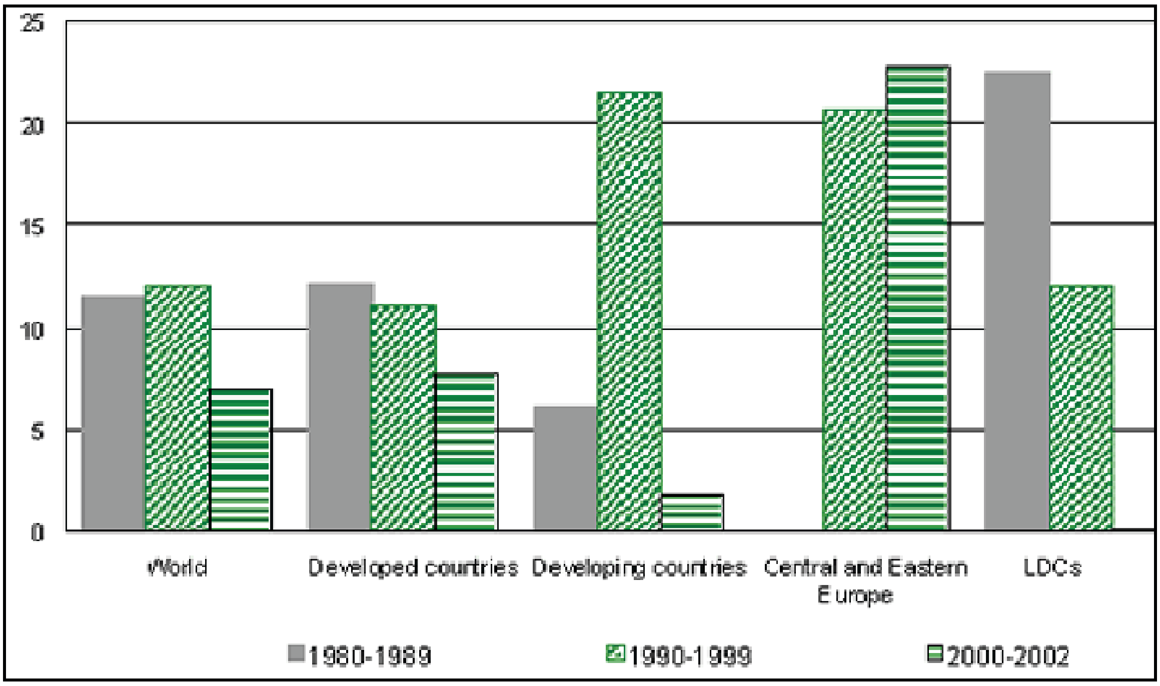
Source: UNCTAD

Table 2. Outward FDI Stock, by Group of Economies in Billions of US$

Group of economies	1980	1990	1995	2000	2001	2002
World	564	1763	2901	5992	6319	6866
Developed countries	499	1629	2584	5155	5488	5988
Developing countries	65	133	311	817	807	849
Africa	7	21	33	49	43	44
Latin America and Caribbean	52	63	91	160	168	173
South East Asia	5	41	179	594	577	611
Central and Eastern Europe	..	1	6	19	25	29
Memorandum:						
Least developed countries	..	1	2	3	3	3

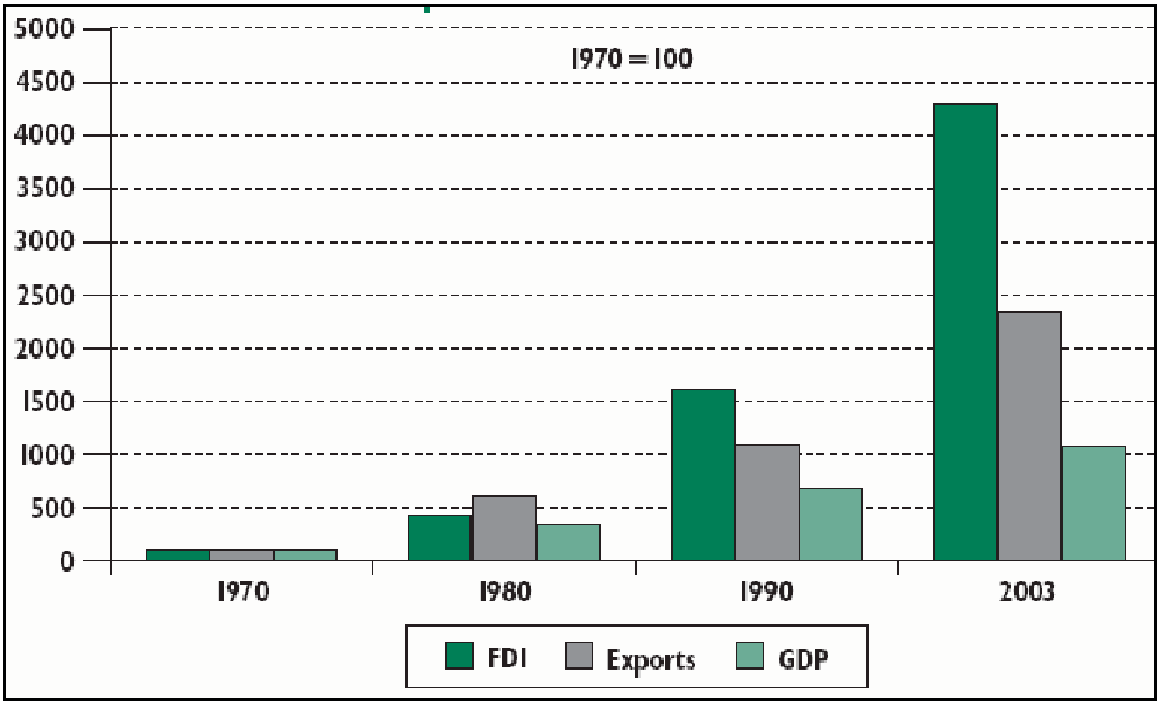
Source: UNCTAD

Figure 3. Annual Growth Rates of Outward FDI Stock, % Change



Source: UNCTAD
Note: Data for Central and Eastern European are for 1992-1999 and 2000-2002 only.

Figure 4. World Total FDI, Exports, and GDP



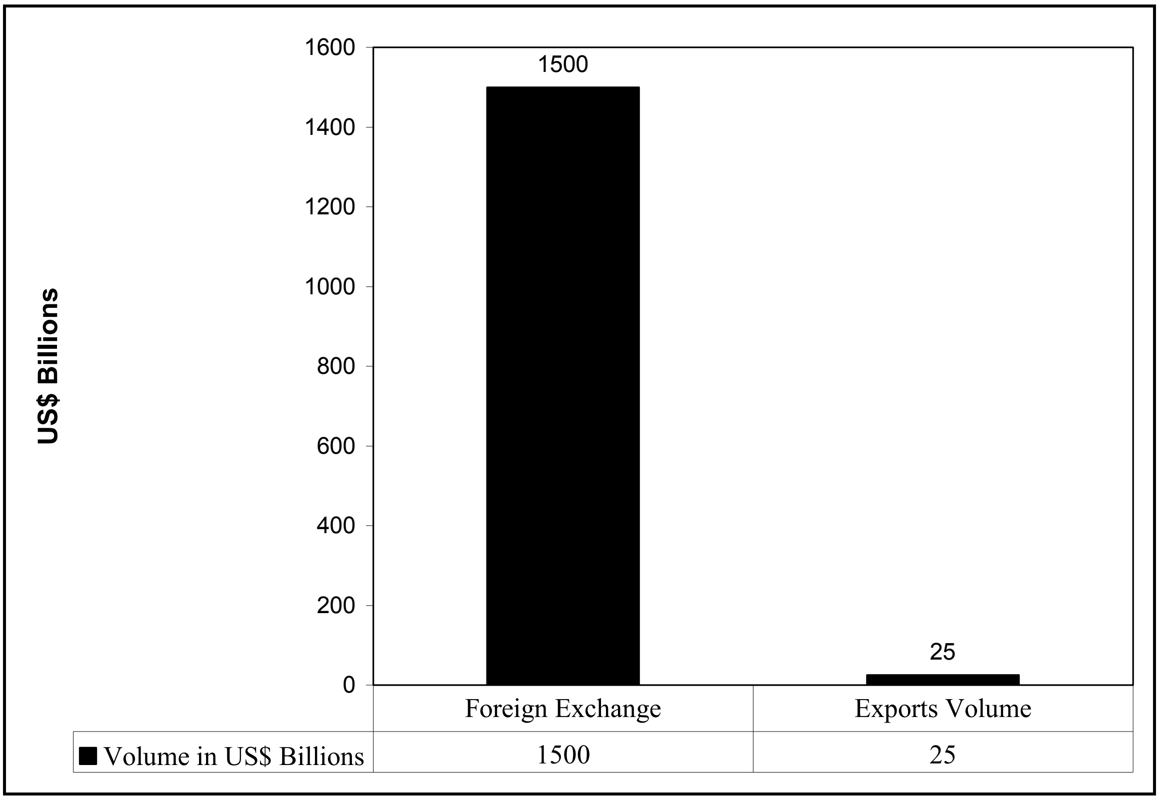
Source: UNCTAD

As a result of this number of developments, FDI has grown faster and more substantially than both international trade and world output. As a matter of fact, through a comparison between figure 1 and 2 on one side, and table 1 and 2 on the other, it appears evident that FDI has become the figure, by which global economic interconnectedness is measured. In this context, it is important to take into consideration the data contained in appendix II and III regarding the inwards and outward FDI stock ranking by country. It seems justified to state that the global economic interdependence or globalization is dominated by developed countries that are the biggest investors and receivers of investment at the same time. This provides them with a unique power to influence the economic course of the rest of the world. In this sense, weak states and regions cannot exert a decisive amount of influence on global economic affairs. For this reasons, it is possible and reasonable to assert that developing countries and regions, i.e. the South, are vulnerable to the power of the developed world, i.e. the North.

Furthermore, successive and continuous advancements in communication and information technology have caused transaction costs to fall dramatically within a short period of time. The broad introduction of the computer and internet has had an extraordinary impact on every aspect of social, economic and political life. It appears obvious that the use of such devices will have an important impact on the productivity of the global economy. The rise of the New Economy does not only refer to software companies. On the contrary, from a broader perspective it deals with the implementation of these technological advances in all aspects of economic activities. Although it is not entirely foreseeable, the information and communication revolution is likely to have a much greater impact in the medium-long-term by producing a new wave of modern industrial revolution based on computing systems and internet, and create a new Kontradieff wave (Gilpin 2000. pp. 29-34). This Russian economist drew the attention in the 1920s to the possibility of long economic cycles – roughly fifty years long – in the economies of major capitalist countries that arise from clusters of innovations at particular times and in particular economic sectors. These clusters create a new leading sector of the economy which grows rapidly and drives a general economic upswing, such as the Kontradieff waves fostered by the steam and electric power (Goldstein, 1985 pp. 411-412).

One of the main effects of such progress has been the formation of a far more highly integrated international financial system. Capital has become mobile through the use of computer and internet in a way that it can be moved from one part of the world to the other within seconds. In addition, since the mid 1970s, the removal of capital controls and the creation of new financial instruments have greatly contributed to fostering a highly integrated financial system. This can be easily exemplified by the volume of foreign exchange trading that reached the astonishing level of around US$ 1.5 trillion per day in the 1990s. At the same time, the global volume of exports was US$ 25 billion per day (Gilpin, 2000 pp. 21-22). Such figures can directly explain the higher financial integration and linkage between different economies compared to their trade relations. As the mobility of capital is often driven by short-term decisions of speculative nature, global finance has become a cause of economic instability. For these reasons, the possibility of the very same phenomenon of spill-over effects among interconnected regions fostered by huge unbalances, which has been identified in the realm of international trade and FDI, can be expected to be even more realistic and substantial for the domain of financial globalization. It seems obvious to arrive to such conclusion if a comparison between the weight of economic and financial globalization as separate processes is drawn, i.e. US$ 1.5 trillion per day in financial transactions exceed by far the volume of US$ 25 billion per day in trade. This huge difference is illustrated in the following figure 5 (Gilpin, 2000 pp. 21-22).

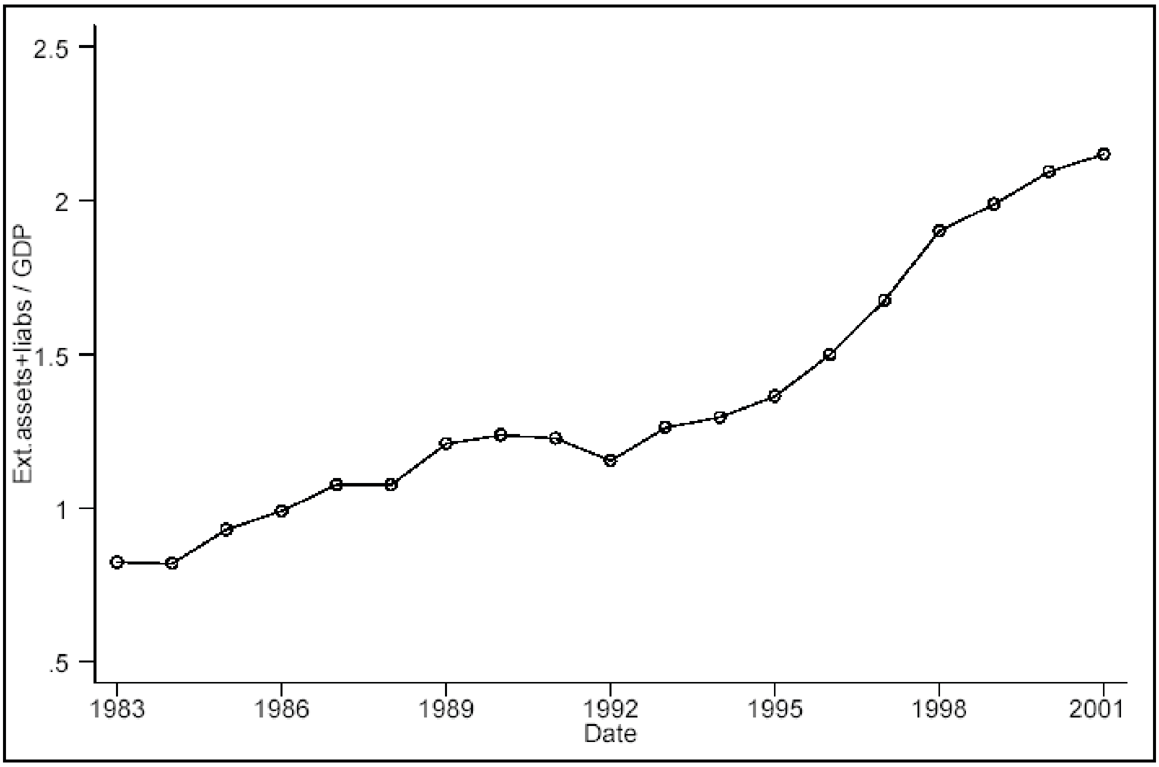
Figure 5. Foreign Exchange to Exports in US$ Billion per Day



Source: Gilpin, 2000 p. 22

The prevalence of a highly integrated international financial system is also confirmed by the significance of a few other developments. For instance, the amount of investment capital seeking higher returns has grown enormously. In fact, by the mid-1990s, mutual funds, pension funds, and the like totaled US$ 20 trillion. This represents ten times the 1980 figure. In addition, the weight of these substantial investments is greatly magnified, as a growing part of them is financed with borrowed funds. Finally, derivatives and other financial instruments play an important role in international finance. Given their total value of approximately US$ 360 trillion, which is even larger than the value of the entire global economy, they have massively contributed to the rise of financial instability. From the perspective of these facts and statistics, it goes without saying that this unstable financial interconnectedness has a profound impact on and a big potential for destabilization the global economy (Gilpin, 2000 p. 22).

Figure 6. Evolution of International Financial Integration, 1983-2001



Source: Lane, 2003 p. 45

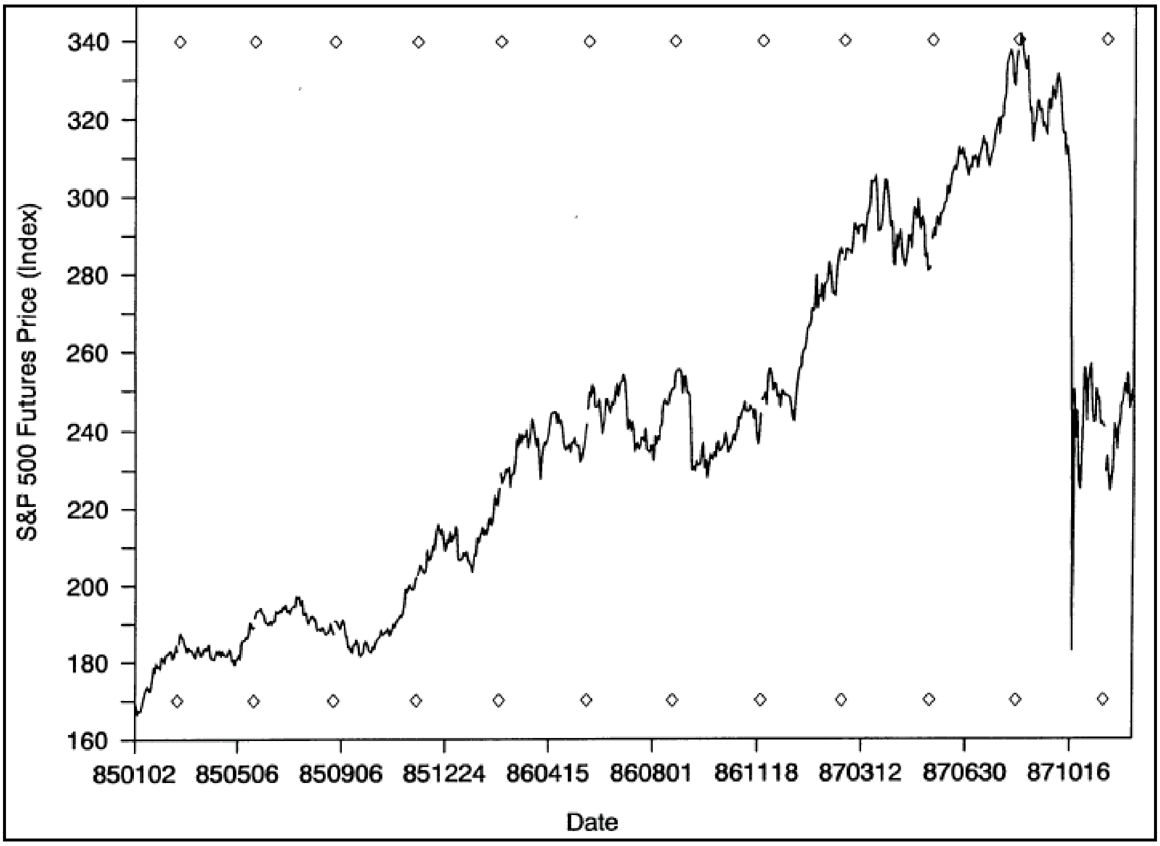
As can be seen in figure 6, this financial revolution has had the effect of linking national economies more closely to one another, increasing the capital available to developing countries, and in some cases accelerating economic development. However, it is a matter of fact that large portions of these financial flows and capital investments are short-term, highly volatile, and speculative. For this reason, international finance has become the weakest and most unstable aspect of the global capitalist system. In fact, the immense scale, velocity, and speculative nature of financial transactions have made governments more vulnerable to sudden changes in these movements. As will be presented in the following subsection, there are a number of events, e.g. the crash of 1987, the European currency crisis of 1992, the Mexican peso collapse of 1994, and the devastating East Asian financial crisis of the late 1990s, which confirm this hypothesis and support the argument that individual countries have become more exposed to forces that they are not capable of controlling. It will be shown that this problematic condition drives governments to seek mechanisms to shield the value of their economy, of which regional integration provides the best example (Gilpin, 2000 p. 22).

Examples of Financial Instability

At this point, a few cases will be presented and briefly examined, which will enable a better understanding of the scale and scope of such highly unstable international financial system. The specific financial crises that hit the European Monetary System and East Asia during the 1990s will be more closely analyzed in the second part of the thesis within the respective chapters concerning European and Southeast Asian regionalism.

The prevailing global financial instability became increasingly apparent since the Black Monday of October 19, 1987, which is to be remembered as the worst day in the history of the American stock markets. In fact, within only one single day of transactions, the Dow Jones Index dropped an astonishing 22.6% of its total value. This event triggered a serious downward movement on the major stock markets of the world, e.g. the London Stock Exchange Index lost 20 percent of its value within one week, the German Dax suffered a drop of around 30 percent within one month, and the rest of the markets followed the same trend (Benetazzo, 2005 pp. 52-55). As can be seen from the following graph, the collapse of the Standard and Poor's 500 Index was even heavier, falling by approximately 45 percent within only one week of transactions.

Figure 7. S&P 500 Index, 1985-1987



Source: Bates, 1991 p. 1010.

The crash of 1987 came unexpectedly. In fact, if the information concerning the put and call options is analyzed, it needs to be underlined that the price for put options, which serve as a crash insurance, was unusually high during the year preceding the crash until the market peaked in August 1987. After that, however, the price for put options went back to normal levels during the two months before the actual collapse (Bates, 1990 pp. 1009-1012). This figure clearly indicates that market participants expected substantial negative jumps in the market, although there were no strong fears of a crash in the two months immediately preceding Black Monday. For this reason, it is argued that if the crash was a rational bubble – a sort of self-fulfilling prophecy – this burst in August, not on October 19 (Bates, 1990 pp. 1036-1037).

Prior to this event, an unprecedented worldwide stock market boom had taken place lasting for almost four years, from 1983 to 1987. Similarly to the situation in 1929, such prolonged wave of positive increases in stock prices caused a general sense of euphoria among investors. Of course, a few analysts were conscious of the fact that such boom was unsound and unsustainable in the long-term, and that at some point an adjustment would occur. Thus, in many respects, the crisis of 1987 resembled the crash of 1929. A number of events unleashed a chain reaction that finally brought the situation out of control. The government bond market in the United States was mainly dependent on Japanese buying. Therefore, when Japan started selling these bonds in order to face a strong speculative wave in the internal bond and stock market, the downward pressure on the US Dollar was enhanced. At the same time, the US administration was apparently planning to limit tax deductibility in leveraged buyouts of companies, which caused discontent among investors. The last major factor was a dramatic article in the Sunday, October 18, issue of the New York Times, in which the Treasury Secretary, James Baker, openly advocated for a devaluation of the American currency (Soros, 1988 pp. 65-69). This undermined the credibility of the US market dramatically and spread panic among market participants, who sought an exit from such unstable circumstances. As a consequence, an enormous amount of sell orders was accumulated during the weekend, so that the Dow Jones Index was already losing around 10 percent at market opening on October 19 (Benetazzo, 2005 pp. 54-55).

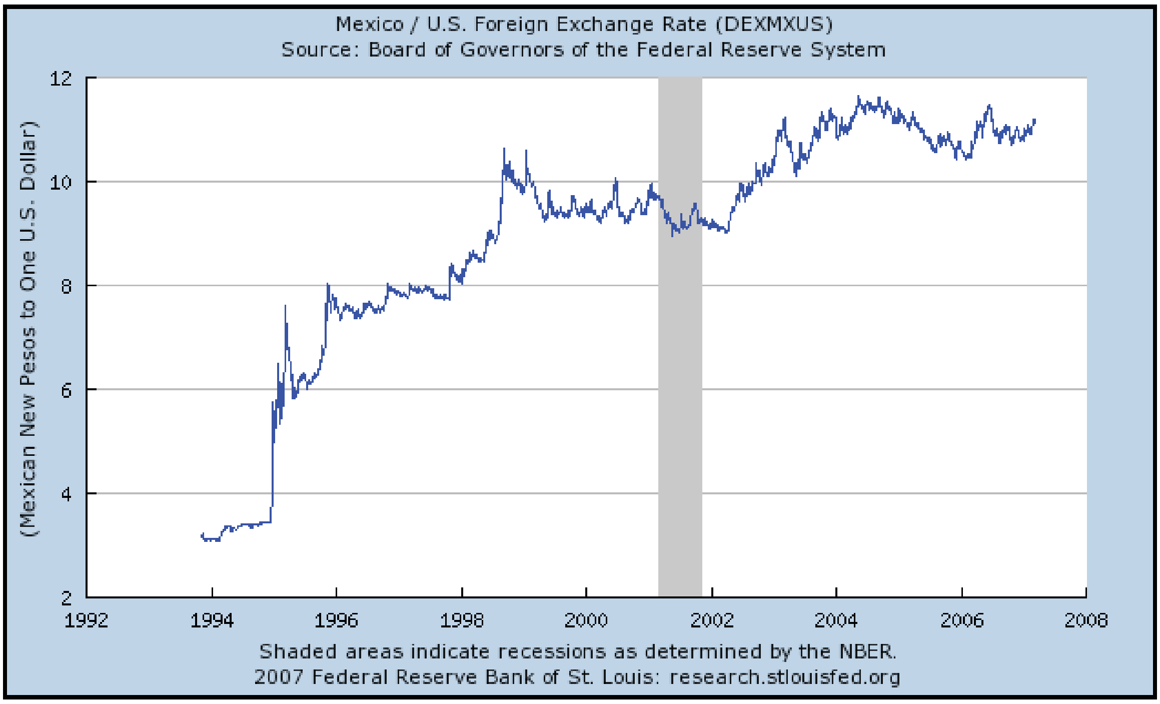
In this context, it needs to be remembered that this crash occurred in 1987, when financial markets were not as developed as they are today. For example, during the 1990s hedge funds and the like greatly increased their share of investment. Indeed, these speculative firms have come to control more than 10 percent of the American stock market, so that they can exert a decisive influence on the overall direction of the market as well as on the movement of individual stocks. If for instance the development of the price of crude oil is examined, it could be concluded that its increase would reflect the actual rise of demand toward a stable supply. In reality, this is only partially true. As is known, private investors have recently entered the market of futures, thus increasing the speculative pressures on such financial instruments. Nowadays, one only needs an online bank account in order to buy and sell commodities such as crude oil, gas and others. This fact illustrates the extremely enhanced potential for market distortions by short-term oriented, speculative investments.

A second example of instability is provided by the financial crisis that struck the Mexican Peso in 1994. Of course, the specifics of the situation as well as the causes of the individual crisis are different from case to case. However, it can be asserted that there is a systemic problem underlying this chain of events that have occurred in recent times in different regions of the world. In the instance of Mexico, the question that arises is whether there were any indicators signaling the build-up to the crisis that occurred at the end of 1994. It is argued that this financial crisis was not the result of poor fiscal performance by the Mexican government, which is quite different from the nature of the previous Mexican crisis of 1982. In fact, during the period of 1990-1994 Mexico's operational budget balance had been in surplus and Mexico's debt/gross domestic product ratio was low, down from 78.4 percent in 1986 to 34.7 percent in 1993. From the point of view of some scholars, the Mexican financial crisis was determined by unexpected external and internal shocks that were not dealt with by sound and adequate actions (Sachs, Tornell, Velasco, Giavazzi and Szeleky, 1996 pp. 16-19).

Two important figures were indicating that Mexico was heading toward a financial stalemate, although not necessarily a crisis: a currency overvaluation and a large and increasing current account deficit. At the beginning of the 1990s, the Mexican Peso increased by 20-25 percent relative to the long-term. The latter figure, defined as the balance between savings and investments, started deteriorating during the same period of time due to a declining national savings rate. Nevertheless, it is argued that these factors alone are not capable of explaining a deep financial crisis such as the one that occurred in 1994 (Sachs, Tornell, Velasco, Giavazzi and Szeleky, 1996 pp. 19-21). Indeed, many countries around the world show similar, if not even worse economic conditions, but these have not led their economy to any comparable collapse. This came unexpectedly given the absence of strong or unmistakable warnings.

Therefore, it can be asserted that other factors such as the political shocks of early 1994 had a considerable impact on convincing many foreign investors to begin the withdrawal of their funds from the Mexican economy, which ultimately brought about a strong downward pressure on the Peso and so caused the crisis. The assassination of political leaders and the rise of an armed rebellion in the state of Chiapas led by the Zapatista National Liberation Army posed serious challenges to the internal political stability of the country (Gilbreth and Otero, 2001 p. 7). In addition, the financial vulnerability to external forces that was generated through the economic liberalization reforms sponsored by the IMF during the 1980s and 1990s contributed to the deepening of the impasse. After the political assassinations of early 1994, the Mexican currency devaluated by approximately 10 percent. It can be imagined that a further depreciation of the national currency would have alienated the Mexican population even more. Of course, the presidential elections coming up in August 1994 did not allow for any further loss of political support to the ruling Institutional Revolutionary Party. This helps understand the decision of the Mexican government not to devaluate. However, in the months following the elections, the national reserves continued to drop sharply to a point where it became counterproductive or too onerous to sustain the Peso against the withdrawal of funds from Mexico. This situation exposed the Mexican currency to speculative attacks. In December 1994, the public announcement of the state of the economy and the related devaluation caused major panic among investors, which in the end massively and decisively contributed to the emergence of the crisis. Due to the fact that the Mexican economy was not insolvent, but only illiquid at the time, it can be maintained that a softer landing would have been possible by implementing adjustment policies at the right time. It appears that the political objectives of the ruling party in the following elections constituted a higher priority for the Mexican political leaders (Sachs, Tornell, Velasco, Giavazzi and Szeleky, 1996 pp. 40-43). Figure 8 shows the sudden and drastic movement of the Peso-US Dollar exchange rate. The Mexican currency lost approximately 60 percent of its value within one year, dropping from three to almost eight Pesos per one US Dollar.

Figure 8. Number of Mexican Pesos for 1 US Dollar, 1993-2007



Source: Federal Reserve Bank of St. Louis

The crisis itself assumed enormous proportions. During 1995, Mexico's gross domestic product shrank by 6.9 percent. The implications for the middle and lower classes were severe. Approximately one third of total Mexico's businesses went bankrupt, which caused the Mexican industry to work only at 40 percent of its potential output capacity. Unemployment rose dramatically, as around two million workers lost their jobs. Consequently, there was a considerable 29 percent drop in basic nutrition in the first eighteen months after the devaluation. Even the sound growth of the gross domestic product in 1996 driven by the export sector that profited from the Peso devaluation was not capable of offsetting the socio-economic damages caused by the crisis. This brief set of figures illustrates the graveness of the impact of the crisis on the Mexican economy and people (Morris and Passe-Smith, 2001 pp. 134-135).

By the means of both examples analyzed in this subsection, it has been undoubtedly demonstrated that individual countries are vulnerable to the intrinsic instability of the highly integrated international financial system established in the past decades. In fact, the general pattern that can be identified follows the common line of external, unexpected shocks causing the sudden movement of extremely volatile funds, which ultimately fostered a crisis situation.

However, there is a key difference that needs to be underscored and emphasized: a weaker economy such as Mexico's was not able to recover quickly from the damages and disruption caused by the withdrawal of international capital and the deriving steep currency collapse. On the contrary, in the medium-term the American economy managed to respond adequately to the 1987 crash and rapidly regained the path of economic expansion. At the same time, nevertheless, a number of long-term oriented matters arose, such as the debatable sustainability of American monetary policy and the declining role of the US Dollar as a stable and credible international currency, which posed even more complicated and deeper reaching questions (Alvarez, 2002 p.263). In this regard, it seems reasonable to think that more vulnerable countries will seek mechanisms to protect their economic power more actively than strong ones.

Of course, there are many more cases that illustrate the prevalence of international financial instability. As a matter of fact, eighty to one hundred countries have faced a crisis since the mid-1970s (Stiglitz, 1999 pp. 1509-1512). For instance, the Russian Ruble crisis of 1998 is also aligned to the same pattern. During the 1990s in Russia, the economic and human consequences of the crisis were devastating. The industrial production fell by 60 percent, while the GDP dropped by 54 percent (Basu, 2003 pp. 893-894). Such financial disaster occurred because of an unregulated and drastic change from communism to capitalism coupled with a suddenly increased exposure to external threats as Russia liberalized and opened up its economy to international markets. In fact, empirical studies show that the probability of a financial crisis is particularly high in the five years following capital market liberalization (Stiglitz, 1999 p. 1509). Other cases, such as the collapse of the Turkish Lira, the recent Argentinean and Brazilian currency crisis provide additional evidence of the argument that such instability is the result of the current form of the globally integrated financial system. In this context, the East Asian financial crisis of 1997-1998, which will be more closely examined in the second part of the thesis, can be regarded as a perfect example of the greatly destabilizing influence of financial globalization (Gilpin, 2001 pp. 3-13). The liberalizing governments of East Asian nations such as Korea, Thailand and Indonesia lifted capital controls and so allowed that highly speculative money poured in from investors seeking new opportunities for high returns. When became clear that market participants had distorted stock prices beyond their real value, the trend quickly turned to a negative bias. As a consequence, investment flows fled faster than they had entered, leaving those nations with deflated currencies, high rates of corporate insolvency, and worrying socio-economic implications. In the face of these disrupting events, George Soros, probably the most influential investment banker and speculator in the world, revealed his fears of the possibility that more vulnerable countries might opt out of the capital markets or introduce mechanisms to control capital movements (Alvarez, 2002 pp. 263-264).

Such exceptionally high incidence of financial crises can definitely be considered as sufficient empirical evidence of the existence of a systemic failure. Regardless of the various different forms and shapes that a single crisis may assume, the Nobel-prize laureate Stiglitz uses the following metaphor:

> If there is a single accident on a road, one is likely to look for a cause in the driver, his car, or the whether. But if there are hundreds of accidents at the same bend of the road, then questions need to be raised concerning the construction of the road itself. Roads need to be redesigned not for perfect drivers, not for drivers trained to drive on race tracks, but for ordinary mortals. If average drivers repeatedly find the curves too difficult to navigate, it is time either to reengineer the design of the road or to impose regulations on the cars that drive on it (Stiglitz, 1999 p. 1509).

Following the same mindset and adopting a similar parallel, Soros came to the conclusion that as at an Indianapolis 500 car race, too much speed could have fatal consequences. In order to cope with this situation, Soros recommended the creation of an international bank that would bring stability by linking all monetary policies together (Alvarez, 2002 pp. 261-262). On the other hand, Stiglitz strongly supported the introduction of measures aimed at stabilizing capital flows. By analogizing with another metaphor, the author makes the succeeding point:

> Without a dam, the melting of the snows at the top of a mountain may give rise to disastrous floods resulting in death and destruction. A well designed dam will temper the flow of water, but it will not stop the movement of water from the mountaintop to the seaside. However, by stabilizing the flow, the dam serves to reduce and perhaps eliminate the deathly and destructive aspects of the torrent (Stiglitz, 1999 p. 1512).

Besides such self-evident crisis of governance, as has been previously outlined, the main problem does not merely reside in the prevalence of financial instability taken in and for itself, but more importantly in the fact that weaker countries are far more gravely and frequently affected than stronger ones. Stiglitz affirms that in the era of globalization money usually flows from less developed to industrialized countries, i.e. from the South to the North (Stiglitz, 2007 interview). From a rational point of view, this makes perfect sense, as the opportunities offered in these markets for investment in funds, stocks, treasury bonds, and other financial instruments are surely more advanced, secure and profitable. For this simple reason, in fact, resources flow from poorer to richer regions of the world. Consequently, in addition to the inflow of highly volatile, speculative capital, this further undermines the financial stability of weaker economies that loose locally originated capital at their disposal, which are diverted to other markets, thus increasing their exposure to external forces.

This underlying crucial reality that economically weaker states are far more severely affected by such uncertainties is essential for a better understanding of the current and future developments that will shape the governance debate and the international financial architecture in the coming years and decades.

Power in a Changed Environment

The question of definition of power in the era of globalization is to be dealt with in the following section. This phenomenon highlights a number of interconnected developments and events that have eventually generated a set of new conditions (Jones, 1999 p. 357). The environment, in which international relations take place, has changed substantially over the last few decades. Undeniably, there has been a proliferation in the number of actors participating in the governance and policy-making process. As a consequence, this increase of power centers at different levels – domestic, transnational, and international – has forced the primary player in world politics, i.e. the state, to constantly adapt to the various challenges it is confronted with. Indeed, when managing public issues, decision-makers in governments must increasingly take into account the interests and agendas of other influential actors, such as NGOs and MNCs. However, it would be wrong to view multiple centers of power as a threat to the authority of the state or to assume that the state is in retreat. On the contrary, it has been able to adjust and retain a decisive role in governance and policy-making by the means of aggregating interests, making policies, and enforcing rules (Wolfish and Smith, 2002 pp. S51-S52).

Concerning the definition of multiple centers of power, there are two main approaches: the first stems from a typical realist tradition and is exclusively concerned with states. In contrast with the Cold War era, it suggests the existence of three or more powerful countries interacting in the international system. In this context, power is described as state capabilities and resources employed to pursue its interests. As Nye points out in simple terms, power is traditionally defined as the ability to effect desired outcomes, and if necessary, to change the behavior of others to make this happen (Nye, 2004 pp. 4-10). From this conventional perspective, international politics is characterized by the distribution of capabilities among states as the primary political actors. Kenneth Waltz goes even further by suggesting that only great powers really matter in the international system (Wolfish and Smith, 2002 p. S54). Of course, Waltz's extreme and old-fashioned view is not accepted here for two reasons: firstly, the thesis acknowledges the significance of weaker states in the international system; secondly, the existence of other actors, such as regional organizations, is considered relevant for better comprehending the dynamics of the interactions taking place between strong and vulnerable states.

In this context, Nye's distinction between hard and soft power is viewed as helpful in understanding the different dimensions of power with regard to international and transnational politics. According to Nye, the first form of power refers to the coercive capabilities of a state to achieve desired outcomes through military and economic means. On the contrary, the latter relies on the appeal of one's ideas, thus it refers to the ability to achieve desired outcomes through attraction rather than coercion (Wolfish and Smith, 2002 p. S54).

In connection with Nye's conceptualization, the second approach to multiple centers of power adopted here differs from the first, as it explicitly recognizes the importance of other, non-state actors, e.g. speculators from the formal and informal private sector contributing to financial instability, while states are still seen as the most powerful players in the international system. According to the type of actors and their peculiar objectives, the sources of power may vary greatly, encompassing tangible as well as intangible capabilities. For instance, it is obvious that in the case of speculators a large capital accumulation represents the major foundation of their power (Wolfish and Smith, 2002 pp. S52-S53). Another example for the emergence of a multicentric world can also be found in the continuing rise and growing role of Asia as a third pillar of the world economy (Wolfish and Smith, 2002 p. S54). It seems obvious that this approach raises the complexity of the analysis considerably. For this reason, it is important to reiterate that the focus of the thesis is mainly directed toward states as the primary actors, while the others constitute minor, although non-dismissible forces in the international environment.

In addition and in line with the research question and theoretical framework, a more classical definition of power will be adopted from a rather moderate realist perspective. As previously illustrated, realism offers a quite static view of power, as this is defined as the sum of military, economic, technological, diplomatic and other capabilities. However, the factor of change related to the distribution of power plays a critical role within the outlined research puzzle. For the purpose of the thesis, special consideration is given to the economic dimension of power seen in relative, not simply in absolute terms among states in the international system (Viotti and Kauppi, 1999 p. 64). As Nye argues, economic power has become more essential in a world of economic globalization because of the relative increase in the costliness of force and because economic objectives have become more significant (Nye, 2004 pp. 4-10).

Furthermore, economic power can be regarded as crucial and prior to all other sources of power, as it constitutes the basis for the availability of those resources needed to achieve predetermined objectives. For instance, foreign policy can only be practiced, if there are sufficient financial means to project hard or soft power in international affairs. In this context, one could view the collapse of the Soviet Union as an economic and financial failure. It can be inferred that economic power lied at the foundation of Soviet political and military power in international relations, as it allowed financing an aggressive foreign policy. The sudden collapse of this vital aspect of power severely affected the remaining constituents of power.

In sum, both strong and weak states as the principal actors as well as other non-state actors interact in a multicentric world, at the heart of which the economic dimension of power plays a critical role.

International Regimes and Regional Organizations

While introducing the topic of this section, it needs to be underlined that since the end of the Second World War the study of regimes has undoubtedly attracted the attention of many International Relations scholars. According to the prime objective of their research field, i.e. explaining order in world politics, they aimed at finding answers that would account for the emergence of rule-based cooperation in the international system in the form of international regimes in general and regional organizations in specific. In addition, attempts have been made to determine how these would affect state behavior as well as to identify the factors that determine their stability (Hasenclever, Mayer and Rittberger, 1996 pp. 177-178). For the purpose of the thesis, it is regarded as crucial to understand the dynamics of the appearance and strengthening of regimes, as this will largely contribute to a more complete understanding of the prevalence and relevance of regionalism.

There are three different theories that have tried to shed light on these matters: interest-based liberalism, power-based realism, and knowledge-based cognitivism (Hasenclever, Mayer and Rittberger, 1996 p. 178). Since the theoretical framework utilized here stems from a synthesis of the liberalist and realist tradition, the latter theory is not considered significant. Before dealing with the two relevant approaches, there is a need to clarify the meaning of regimes and institutions in the first place. The most widely accepted definition of international regimes is as follows:

> Regimes are implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations. Principles are beliefs of fact, causation, and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice (Krasner 1983, p. 2).

On the other hand, this definition has been often criticized, because it offers a list of various elements that are hard to differentiate conceptually and often overlap in real world situations (Young, 1986 p. 106). Krasner's characterization seems fairly complicated and not precise enough to preclude disputes about the proper description of a given regime (Hasenclever, Mayer and Rittberger, 1997 p. 12). From this perspective and focusing more on the explicit quality of agreements among states, the consensus definition can be replaced by a more straightforward formulation with lower controversy content. This formal approach can be based on the concept of institutions, defined as persistent and connected sets of rules that prescribe behavior, constrain activities and shape expectations (Keohane 1993, pp. 26-29). Hence, regimes can be classified as institutions with explicit rules, agreed upon by governments, which pertain to particular set of issues in international relations (Keohane, 1989 p. 4). In contrast to a broader behavioral approach, this narrow definition also enables a clear and sharp distinction between the concept of regimes and cooperation. In fact, regimes are examples of cooperative behavior, and facilitate cooperation, but this can also take place in the absence of established regimes (Haggard and Simmons, 1987, p. 495).

Regimes can be considered as arising, when states acknowledge such formal agreements as having continuing validity. In this sense, there are two noteworthy characteristics of regimes with regard to their degree of institutionalism, i.e. the extent to which they matter in world politics: effectiveness and resilience. The former aspect is concerned with whether regimes are abided by and achieve their proposed objectives. The latter feature considers the regimes' robustness against exogenous challenges (Hasenclever, Mayer and Rittberger, 1996 p. 178).

Based on these two important traits of regimes, the liberalist and realist theories, although they differ in some respects, share their fundamental assumption of rationalism that portrays states as self-interested, goal-seeking actors, whose behavior is aimed at maximizing their individual utility in an environment of international anarchy affecting their interactions (Hasenclever, Mayer and Rittberger, 1997 pp. 23-24).

From the start, interest-based models have been very influential in the academic discourse and have come to represent the mainstream approach to international regimes. Their main characteristic lies in the emphasis on the role played by regimes in helping states realize common interests without completely dismissing the impact of power and its distribution. The existence of common interests in one or more issue-areas that can be attained only through cooperation is a necessary, but not sufficient condition for cooperative behavior. In fact, it is argued that regimes help states overcome the Pareto-inefficiencies caused by the so-called Prisoner's dilemma resulting from a situation of non-cooperation or non-compliance with explicitly established rules or norms. Thus, they serve to individual states as an effective means to achieve higher joint gains in absolute terms.

The central difference of power-based realist theories can be identified with their hypothesis that states are more directly concerned with the relative distribution of power in the international system. In this sense, as the realist state cares about the benefits accruing to its competitors, rule-based cooperation is less easily obtained (Hasenclever, Mayer and Rittberger, 1996 pp. 183-185, 196).

Within the thesis, a synthesis of both the interest-based and power-based schools of thought is adopted. In agreement with the double-layered theoretical framework of this study, it is argued that each theory constitutes a part of the same puzzle reflecting the reality of international relations. At the macro-level, it is assumed that powerful states would be more inclined either not to establish or comply with formal regimes at all or to follow a power-based approach, within which the resulting power distribution would increase their relative power. The North American Free Trade Agreement, i.e. NAFTA, is an example of this trend, as the US was willing to enter a regional trade agreement with Mexico and Canada in order to change the relative distribution of power in their own favor. On the other hand, weaker countries would most probably tend to adopt an interest-based stance with regard to their specific regional integration, or at the micro-level. At the same time, they are affected by the macro-level circumstances, thus they are willing to use the creation of a regional organization as a tool to raise their individual leverage in the international system. This tendency is exemplified by the cases of the EU and ASEAN, which will be discussed later.

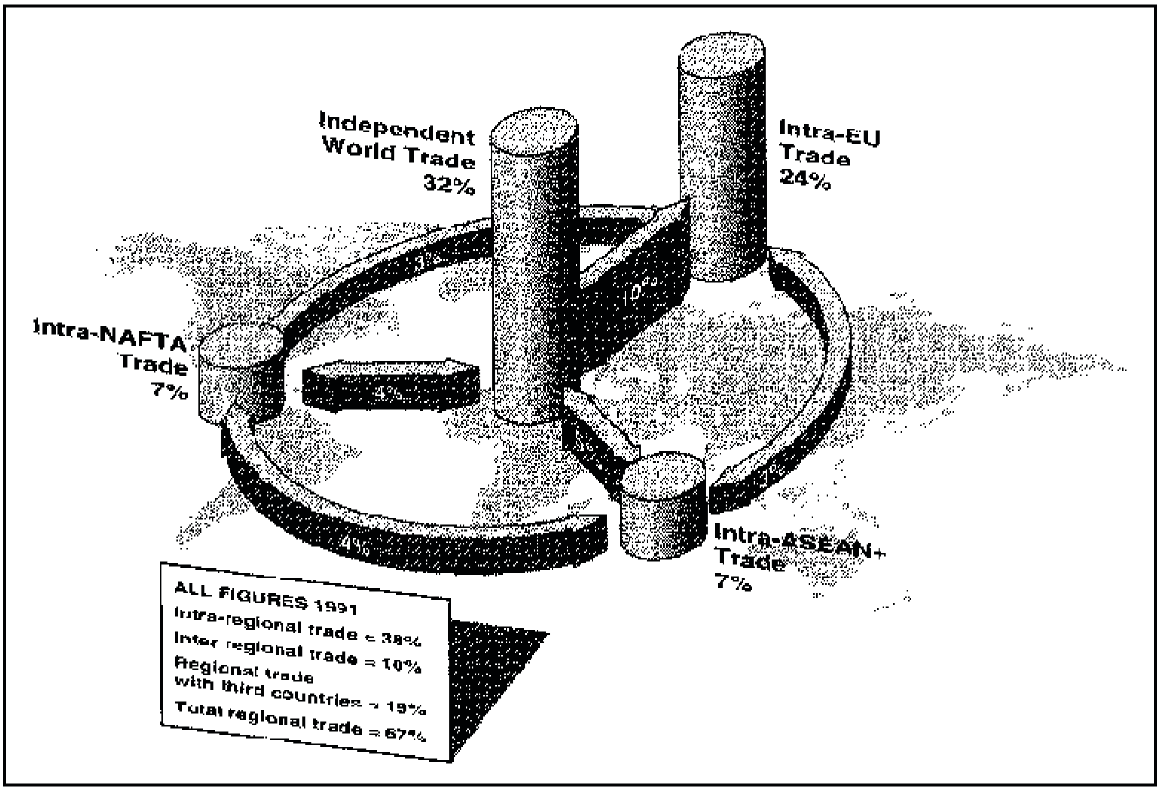
It is important to underscore that regimes are distinct from organizations as they lack the capacity to act; however, they constitute the foundation for the rise of organizations (Hasenclever, Mayer and Rittberger, 1996 p. 179). There are three main practical arguments that account for the emergence and sharp increase in the number of regional agreements: firstly, within regions consisting of highly interdependent states, regimes perform the functions of reducing uncertainty and thus transaction costs for their members. Secondly, their success in performing these functions raises their value to members and creates a demand for their maintenance. Finally, regional organizations containing a group of rather weak, vulnerable and approximately equally powerful countries increase the leverage of individual member states in their interactions with third parties, and most importantly with regional and global hegemons. In sum, high degrees of interdependence and the success of existing international regimes eventually lead to their expansion, deepening, and so the formation of regional entities that have the capacity to act on the international stage (Keohane 1993, pp. 34-38).

The new wave of regionalism that has taken place since the mid-1980s has had a great significance for the global economy. As Gilpin argues, the reason for the steep increase in regional agreements can be regarded as a consequence of the failure of the Uruguay Round negotiations (1986-1993) in bringing about a more generalized global free-market agreements system, which was primarily caused by Europe's reluctance and inward turn. As a consequence, many nations joined regional trade agreements that proliferated in the 1980s and reached the number of almost one hundred by the late 1990s. Examples of this trend are the Single European Act, NAFTA, the South American regional bloc of Mercosur, ASEAN, and the Economic Community of West African States (ECOWAS). At the same time, as Gilpin points out, many developing countries have started perceiving the advantages of regionalism that would promote their economic interests while balancing the regionalization in Europe and North America. This tendency can be considered as a response to an economic version of the "security dilemma", in which each regional bloc attempts to strengthen its own position in the global economy and protect the interests of its members (Gilpin 2000, pp. 40-45).

The following figure shows the growing relevance of regionalism from an economic perspective. Figure 9 illustrates world merchandise trade and the role of three regional groupings: the EU, NAFTA, and ASEAN, which dominated trade in the world economy of 1991. In that year, intra-regional trade accounted for 38 percent, while intra-EU trade alone accounted for 24 percent of all such trade. In contrast, trade between these three main regional organizations is responsible for merely 10 percent of the total. This empirical evidence makes a strong case for regionalism against multilateralism as one of the most influential trends in the recent era of globalization (Michalak and Gibb, 1997 pp. 265-266). Both phenomena are recognized as divergent and competing forms of international governance in a changed environment. Some analysts reach even further by making the following straightforward statement:

> National governments have responded to globalization by weakening their commitment to multilateral trade and allied themselves instead into more powerful regional blocs. Thus regionalism, not globalization has emerged as the alternative path to achieving the goal of managed free trade (Michalak and Gibb, 1997 p. 265).

Figure 9. World Merchandise Trade



Source: IMF, Direction of Trade Statistics, Michalak and Gibb, 1997 p. 267.

At the same time, if the issue is observed from a different perspective, regionalism and multilateralism may be considered complementary and non-exclusive parts of the same system, in which regional organizations act as trade blocs in order to promote multi-regional and thus multilateral trade. An example of such possibility can be provided by the fact that the Mercosur agreement was mainly driven by the interests of the EU to deal with another regional player in order to simplify negotiations and extend the benefits to all member states (Stacher, 2007 interview).

In this context, it is definitely significant to note the clear distinction between the phenomena of regionalization and regionalism that was proposed by Fishlow and Haggard in 1992. According to their view, regionalization refers merely to the regional concentration of economic flows. On the contrary, regionalism is defined as a political process characterized by economic policy cooperation and coordination among member states of regional organizations (Mansfield and Milner, 1999 p. 591). For this reason and from the angle of regionalism, intra-regional economic flows are considered critical as they ultimately strengthen the internal regional economic power of the member countries by reducing their exposure to external threats such as the instability deriving from globalization. As showed by table 3, there has been a steady process of increasing the level of regional economic interdependence since the 1960s as opposed to the wider trend to multilateral trade. This data provides ample empirical grounds to hold the assumption that mutual dependence of states within a specific region is higher than otherwise.

Table 3. Intraregional Export divided by Total Export of Each Region

Region	*1960*	*1970*	*1975*	*1980*	*1985*	*1990*
European Community	0.345	0.510	0.500	0.540	0.545	0.604
European Free Trade Area	0.211	0.280	0.352	0.326	0.312	0.282
Association of Southeast Asian Nations	0.044	0.207	0.159	0.169	0.184	0.186
Andean Pact	0.007	0.020	0.037	0.038	0.034	0.046
Canada–United States Free Trade Area	0.265	0.328	0.306	0.265	0.380	0.340
Central American Common Market	0.070	0.257	0.233	0.241	0.147	0.148
Latin American Free Trade Association/ Latin American Integration Association	0.079	0.099	0.136	0.137	0.083	0.106
Economic Community of West African States	N/A	0.030	0.042	0.035	0.053	0.060

Source: Mansfield and Milner, 1999 p. 599.

Because of the prevalence of a high degree of interdependence within a specific region and the fact that non-cooperation could be more detrimental to their individual power, weak states adopt an interest-based approach to international regimes at a regional level. They realize the importance of regional stability and are willing to focus on absolute gains, as non-cooperative behavior would undermine their collection of benefits. At the same time, because they are concerned with the dangerous instability deriving from the current international financial architecture and the anarchical structure of the international system, they are preoccupied with the relative distribution of power among actors in the broader context including regional and global hegemons. For this reason, vulnerable states concentrate their economic relations exemplified by trade statistics within their region also as a protection mechanism against eventual exogenous shocks. In addition, they use the structure of a regional organization in order to act on the world stage, increase their individual leverage and so face the challenges posed by external threats more effectively.

However, the likelihood that a regional organization can bring benefits for all its members increases particularly, when there is no hegemon within the organization itself. In this sense, as Joseph Stiglitz argues in a panel discussion on NAFTA in front of a crowd of academics and students at Science Po in Paris, Mexico has definitely not gained from regional integration with the US, as money has been flowing from Mexico to the US in form of increased capital investment and higher imports of American products. In fact, even though Mexican exports rose after implementing the trade agreement, its imports of US products had an even stronger growth, thus causing a worsening of Mexico's balance of trade with the US economy. As a result, the gap between the US and Mexico has widened and the little growth achieved in the first decade of NAFTA has been lower than during the 1960s and 1970s (Stiglitz, 2006 interview). Hence, this form of regionalism is not necessarily favorable for weaker states, as Mexico has unmistakably experienced a greater degree of vulnerability. In this sense, it is interesting to note that the Peso crisis occurred only shortly after the NAFTA agreement came into effect.

In sum, it can be inferred that in this case regional integration has been beneficial for the regional hegemon and detrimental for the weaker actor. In other words, the US gained power both in absolute, but more importantly in relative terms against Mexico. For this reason, it is maintained as a central pillar of the hypothesis of the thesis that regional integration makes sense for its members only in the absence of a regional hegemonic power. This finding will be supported by the evidence from the case studies of the EU and ASEAN, as will be shown at a later stage.

Finally, within this comprehensive overview, the key elements and concepts have been examined, which describe the context, within which the research question of the thesis has been posed. Anarchy, the rise of globalization and the deriving instability constitute the essential feature of the international environment. In relation to these developments, power has been defined in clear terms, and special attention has been granted to the economic dimension of power. Based on the study of international regimes and organizations, regionalism has been analyzed from a theoretical and empirical point of view.

In terms of the dynamics of the behavior of states, the following needs to be remembered: regional common interests and interdependence drive regional cooperation, which is formalized in regional agreements. At a later stage, these are embedded in the creation of regional organizations, which possess the ability to act in the international system and take part in interactions with other actors. Given the prevalent instability and anarchy in the international environment, it is reasonable for weaker states to engage in regional agreements and form regional organization that can allow for a substantial increase in their individual leverage against regional and global hegemons.

In the following chapters, the connection between all the elements presented so far will be built around the two case studies of the EU and ASEAN. This will be useful in combining the theoretical framework and concepts presented in the first part of the thesis with an empirical case study analysis. The applicability of the theoretical framework as well as the significance of the main hypothesis of this study will be more clearly demonstrated.

PART 2

THE CASE STUDIES

CHAPTER III

THE CASE OF THE EU

This chapter will entail a study of European regionalism, which will facilitate a better understanding of the main argument of the thesis. The case of the EU will be presented and evaluated by the means of a series of different sources and data. Starting from a historical perspective, the analysis will then be directed toward the objectives of the EU exemplified by explicit regional agreements and the construction of regional institutions with the ability to act. At a further step, economic indicators will shed light on the relevance of European economic regionalism as opposed to a multilateral approach. Finally, considerations regarding European regionalism in a time of global instability will be made. Within this part, the crisis of the EMS of the early 1990s will be overviewed as an example of the external threats deriving from the process of globalization. Throughout the whole chapter, critical insights into the history, reasons, dynamics and future of European regionalism will be provided by a number of interviews with high rank European diplomats and knowledgeable scholars from related fields of study.

History and Causes of European Regionalism

As has been argued in the first part of the thesis, regional integration depends on the presence of a certain degree of shared economic, political and other interests, before plans for its launch can be drawn. In the period of time directly succeeding the end of the Second World War, regionalism as an institutional form of international cooperation had become widely and usually identified with a number of newly developed security organizations, such as NATO, SEATO, and the Warsaw Pact (Yalem, 1962 pp. 460-466). With respect to such widespread opinion of that time, it is maintained that this represented a backwards-looking perspective that underestimated the potential for future developments of simple agreements into more comprehensive institutions, regimes, and eventually organizations. In an influential forward-looking article written in 1962, Yalem describes such possibility as follows:

> The process of integration is likely to begin with cooperation in relatively narrow spheres and, where such efforts are successful, to spill over into other areas and ultimately embrace some form of political union (Yalem, 1962 p. 470).

In the case of European regionalism, it can be easily asserted that this description is capable of reflecting the dynamics of the rise of regional integration. In fact, it is widely accepted that the experience deriving from cooperation in the military realm soon formed a trend toward wider and deeper integration, which first spread into a fairly specialized sector of economic production with the formation of the European Coal and Steel Community in 1951. This development helped such tendency to reach even further to include other areas of economic integration, e.g. creation of a single market with a common European currency (Yalem, 1962 p. 470).

The emergence of regionalism in Europe includes a variety of aspects and dimensions that need to be considered. First of all, European leaders realized the need for a close cooperation with the aim of ending the frequent and bloody wars between neighbors that had such devastating consequences for the economy and people of Europe (europa.eu). The solution of the ever-lasting rivalry between Germany and France was a key point in solving the uncertainty related to European security (Edwards, 2007 interview). Based on the Schuman plan, Germany, France, Italy, the Netherlands, Belgium and Luxembourg signed a treaty to run the heavy industries of coal and steel under a common management in 1951 (europa.eu). The choice of using the tool of economic integration in sectors that are critical for the construction of an effective military machinery is closely related to the recognition by European statesmen of the existence of a high interdependence among European countries both in security and economic terms. As has been accurately explained by the theory of international regimes and by Yalem, the successful cooperation in the narrow sphere of the coal and steel industry soon led to its expansion to other areas of economic cooperation. This was formalized in the foundation of the European Economic Community through the Treaty of Rome signed in 1957 (europa.eu). Such development clearly demonstrated the increasing value of regional agreements in Europe and the combination of various issue-areas forming a relationship of high mutual dependence among states within a certain region.

Secondly, the economic circumstances of European states after the disastrous human and socio-economic consequences of the Second World War considerably restricted the number of options for shaping the future of the continent. As can be deduced from a close look at the following table, Western Europe experienced a sharp decrease in the GDP per capita between 1937 and 1950. It can be argued that such economic catastrophe played an important role in the decision of European leaders to begin a process of regional integration. As Yalem points out:

> Many Europeans also believe that greater unity will provide compensation for the weaknesses of individual European states, and so make it possible for the continent to exert more influence on world politics than would otherwise be possible (Yalem, 1962 p. 465).

This argument is extremely important for the main hypothesis of the thesis, as regionalism can be explained at a macro level as a process of integration among vulnerable countries that realize the potential for greater leverage on world affairs by uniting their sources of power into one single body. Given the economic situation in the aftermath of 1945, European states could be seen as weak compared to the firmly established American and Soviet economic and military power.

Table 4. GDP per Caput as Percentage of US GDP per Caput

Year	*Western Europe*[a]	*Eastern Europe*[b]	*Japan*	*Asia*[c]	*Latin America*[d]
1870	85.9	41.9	30.2	23.6	32.6
1900	75.5	30.8	27.7	16.6	27.7
1913	69.8	29.3	25.1	14.0	26.5
1929	63.5	22.8	28.2	12.4	27.9
1937	73.3	31.7	34.6	13.5	30.7
1950	53.3	27.2	19.6	6.5	27.3
1973	73.9	34.5	66.3	10.1	28.6
1992	76.7	30.1[e]	86.1	14.3	23.4

Notes: *a* Western Europe: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, UK
b Eastern Europe: Bulgaria, Czechoslovakia, Hungary, Poland, Romania, USSR, Yugoslavia
c Asia: Bangladesh, Burma, China, India, Indonesia, Pakistan, Philippines, South Korea, Taiwan, Thailand
d Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
e 1989

Source: Toniolo, 1998 p. 256.

In addition to this crucial point, it needs to be underlined that some European politicians and intellectuals advocated the idea of a united Europe in the 1920s and 1930s, a tendency that can even be traced back to the early eighteenth century in the writings of Giuseppe Mazzini on “Giovine Italia”, i.e. “Young Europe” (Edwards, 2007 interview). However, this represents only part of the story. In fact, directly after the war, America exerted a great amount of political and economic pressure in pushing European states to form an effective buffer zone against Soviet penetration (Yalem, 1962 p. 465). By the means of the Schuman plan and the foundation of the Organization of European Economic Cooperation in 1947, which included Germany as a full member, the US encouraged Western Europe to look forward to an era of economic cooperation under American guidance (Sutcliffe, 1999 p. 187). At the same time, the growth of European regionalism was also hastened by European leaders’ acknowledgment that Europe needed to avoid permanent dependence on the US, and so to regain its full economic potential and independence. This could be achieved by a form of economic union that would provide the basis for a political union (Yalem, 1962 p. 465). As Edwards illustrates, there are official documents in the archives of the British government that testify the existence of the idea of a "Third Way" or "Third Bloc" as a measure to counterbalance American and Soviet influence in Europe (Edwards, 2007 interview).

Over the 1950s, 1960s and 1970s, a series of important developments in international politics definitely contributed to strengthening this position. Firstly, the Korean crisis of the early 1950s and the consequent UN peacekeeping mission can be considered mainly as an example of American involvement in world affairs, since US troops constituted the vast majority of the international task force. In this case, the major European states kept distance from any direct participation (Edwards, 2007 interview). Secondly, the Suez crisis of 1956 can be regarded as an important event that emphasized the need for unity in Europe. In fact, the unsuccessful British and French campaign in defense of their interests in the Middle East in general and their investment in the Suez Canal in specific demonstrated the weakness of individual European states in the international system characterized by a newly established distribution of power. The British confidence with American support proved wrong and the result was the realization of the failure to play a major role on the world stage. This crisis exemplifies the growing awareness among European states of the need to unite their tangible and intangible sources of power under one singe entity (Edwards, 2007 interview). Thirdly, the Vietnam War was sharply criticized by European leaders who strongly disagreed with the US administration. The fact that America's most reliable allies backed off and refused any involvement in that specific crisis should have been considered as a warning by the US government that it was making a grave mistake. Even the Britain, the staunchest US ally, did not support America in that occasion, which signaled the rise of a different view on foreign policy among European countries (Edwards, 2007 interview). Finally, later in the 1960s and beginning of the 1970s, this tendency was confirmed by the new German "Ostpolitik" advocated and promoted by the Chancellor Willy Brandt, which was aimed at improving relations with East Germany, Poland and the Soviet

Union. Although his policy of rapprochement or "Entspannung" was controversial even among Europeans, in the end it symbolized a clear rupture between the American and European way of dealing with the Cold War (Edwards, 2007 interview). These can be considered as the four main reasons that explain the European decision of adopting a "Third Way", through which Europe would regain a central role in world affairs and not be squeezed by the US and Soviet power.

At the same time, as has been previously highlighted, there were other motives for Europe to enhance coordination and build a tighter regional integration. Despite the already discussed European economic vulnerability after 1945, which fostered a tendency toward economic cooperation, the European economy developed at remarkably high rates during the 1950s and 1960s. In fact, Germany, France and Italy grew respectively at an average rate of 6.8, 5.1 and 5.7 percent for the period of time between 1950 and 1964 (Alford, 1988 p. 14). Meanwhile, the massive exploitation of oil fields in the Middle East that took place after the War brought about a shift from coal to oil as the primary energy source in Europe. As a matter of fact, this resulted in an increase in the consumption of foreign oil from 22 percent in 1955 to 60 percent in 1972 in relation to Europe's total energy needs. As a consequence, European countries became exposed to sudden changes in the price of this key commodity (Sutcliffe, 1999 p. 213). This reflection of the rising global interconnectedness and its inherent instability was perceived during the 1973-4 oil crisis, which had disruptive effects on the European economy (Morewood, 1999 pp. 223-224). Because of this critical event, the issue of financial instability was brought with greater force to the forefront of the debate over Europe's future and the alternative measures necessary to offset the related financial risks. In this sense, it cannot be seen as only a coincidence that the establishment of the EMS and Exchange Rate Mechanism (ERM) came into effect in 1979 and was enhanced in the aftermath of the second wave of oil shocks during the early 1980s.

While Europe continued to suffer from stagflation and Euro-sclerosis during the 1970s, the American and Japanese economy seemed to be revived and taking over the world scene. At the same time, growing competition was also coming from the "tigers" of Southeast Asia. Therefore, because of a set of multiple reasons European competitiveness in the global economy was clearly falling behind that of its competitors. In the end, this difficult situation provided another powerful incentive to the making of a wider and deeper regional integration (Gilpin, 2000 p. 197). These efforts represented by the complete removal of all barriers to the free movement of capital, goods, services, and people within the European Community were incorporated in the Single European Act in 1986, which constituted the basis for the creation of a single European market and Economic and Monetary Union (EMU) culminated in the Treaty of Maastricht on European Union (EU) in 1992 (Gilpin, 2000 p. 197). The bottom line is highlighted by the awareness among European leaders over the past few decades that economic power needed to be protected, since this provided the foundation for an effective foreign policy enabling Europe to play a decisive role on global matters.

In sum, this important section has touched upon various historical reasons of different nature that help explain the rise of European regionalism since 1945. At a micro or regional level, it has been possible to show the ever-growing awareness among statesmen of the existence of mutual interests and interdependence within Europe as well as the increasingly valuable function of successful regional agreements starting from a narrow scope and spilling over to other sectors. On the other hand, from a macro level perspective, it was demonstrated that external, exogenous events representing a newly altered distribution of power among the actors in the international system have largely affected the drive toward regionalism of European states that were not able to compete with the global hegemons of the US and Soviet Union on an individual basis.

In the following section, the Treaty of Maastricht and its objectives will be more closely examined in order to illustrate the evolution and shift of European regionalism to a more comprehensive political, economic, monetary and security organization.

Treaty and Objectives of the EU

According to the official website of the EU, the Treaty of Maastricht represents a new stage in European integration, since it opens the way to political integration. It creates a union consisting of three pillars: the European Communities, Common Foreign and Security Policy (CFSP), and police and judicial cooperation in criminal matters. The collapse of communism in Eastern Europe and the likelihood of a German reunification led to a commitment to reinforce the EC's international position (europa.eu).

A primary objective of a united Europe has been the creation of a European monetary and economic union to be reached through three gradual stages. The common goal behind this proposition was to constitute a protection mechanism against various threats to the financial stability of the European economy. The EMU would bring the following benefits for member states: elimination of foreign exchange transactions within the single European market reducing transaction costs; reducing the uncertainty of exchange rates; price stability against inflation; strengthening of the EU's bargaining power vis-à-vis the US; elimination of the risk of competitive devaluations; reducing the threat of currency speculative attacks; acceleration of economic and political integration; encouraging corporate restructuring and creation of large European firms able to compete against American and Japanese corporations (Gilpin, 2000 pp. 200-205).

As can be easily inferred by this brief list, many of the beneficial effects deriving from a single monetary policy with the institution of a European Central Bank (ECB) have a direct or indirect impact on the risks of financial instability caused by the process of globalization. For example, it will become much more difficult for speculators to attack the Euro reserves of the ECB, since an incredibly high amount of capital would be necessary to undertake such a venture. In addition, the rise of the single currency could pose a real threat to the role of the US Dollar in the international markets. These aspects will be more closely analyzed at a later stage.

The second goal is related to the aim of achieving unity in the politically sensitive realms of foreign and security policy. In fact, this has proven to be much more complicated to attain, as there might be a potential for serious conflicts of interests among European powers. However, critical events such as the escalation of violence in the former Yugoslavia and NATO's direct involvement in a conflict on European soil led the members of the EU to agree to create a military arm that would have the capability of autonomous action, free from the great influence of the US in military and security affairs (Gilpin, 2000 pp. 201-202).

Thus, with regard to the second objective of the Treaty of Maastricht, it can be affirmed that external developments, such as American military supremacy and rising Russian, Chinese, Japanese and Indian military spending might cause the EU to take further steps to strengthen its relative position within this domain of international relations. At the same time, nevertheless, it is maintained that economic power lies at the heart of the international system and constitutes the foundation for an active and effective foreign and security policy. So, it can be argued that the EU will probably focus on the economic dimension of power.

In this brief section, the essential goals of the Treaty on European Union have been presented and shortly discussed with respect to the main hypothesis of the thesis. However, a closer look at the specifics of economic integration, financial instability and future prospects of the EU will be taken in the following three sections.

Economic Indicators of European Integration

It is important to evaluate European integration from the point of view of economic indicators, since in the first part of the thesis it has been clarified that the economic dimension of power is especially significant in the context of globalization and its consequent instability. The interesting question that will be answered is whether globalization has generated a trend toward concentrating on regional rather than multilateral trade.

This section will begin with a review of the literature concerning European economic policy and the challenge posed by European economic regionalism to the spread of multilateralism. In the aftermath of the Second World War, the general attitude towards liberalization shifted away from strong protectionist policies and became more mixed. While the America took the lead in the negotiations for creating a highly institutionalized system of tariffs on trade, Europe was preoccupied with its reconstruction and the plan of European integration in order to promote inward stability and prosperity. The General Agreement on Tariffs and Trade established in 1947 that ushered in the institution of International Trade Organization (ITO) and subsequently in the World Trade Organization (WTO) ensured a multilateral approach to trade negotiations and enhanced the economic interdependence on a global scale by lowering trade barriers (White, 2001 p. 59). While European countries have been active members of such organizations, they continued to negotiate preferential regional and bilateral deals with former colonies, which brought about the Lomé Agreement in 1975 encompassing a large number of states in Africa, the Caribbean and the Pacific (ACP). This treaty enabled European countries to enjoy a smoother and freer access to trade and markets on a multi-regional basis regardless of the WTO rules of multilateral approach against preferential agreements. A similar development can be seen in the Barcelona declaration of 1995 that formalized preferential trading ties with a considerable number of

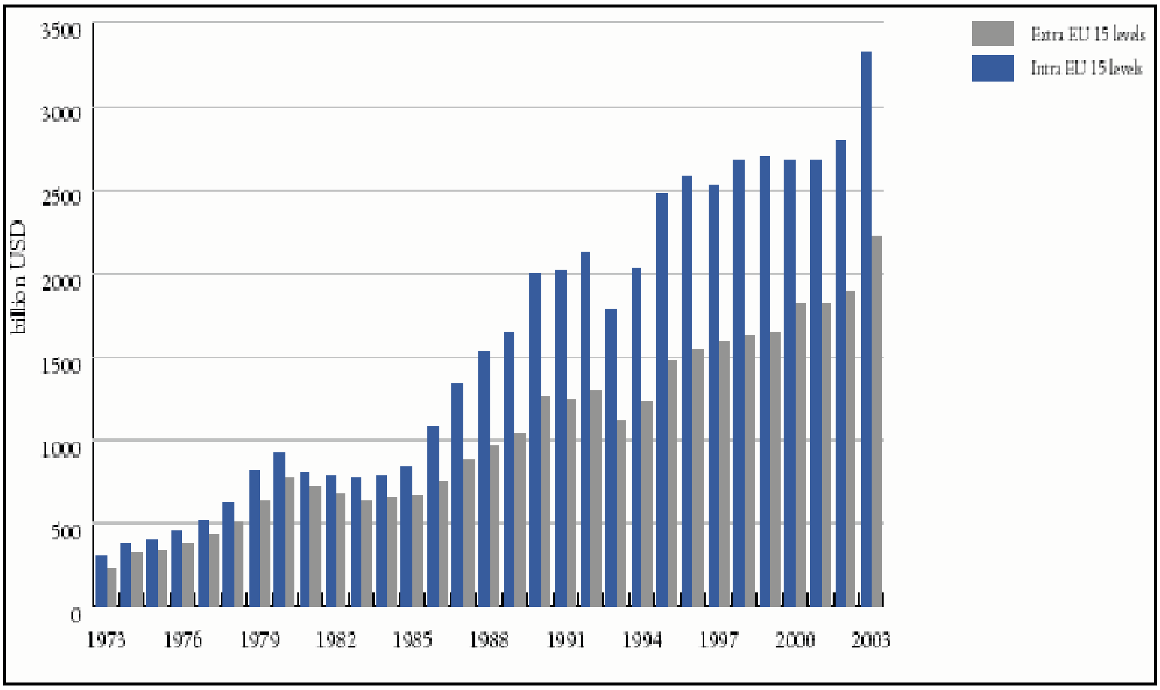
Mediterranean countries with the goal of the establishment of a free trade zone for 2010 (Aggarwal and Dupont, 2002 pp. 126-129).

From such examples, it appears obvious that Europe's performance in promoting multilateral liberalization of trade in the last sixty years can definitely be considered mixed. European countries have been key actors in the successful building of the WTO and in the enforcement of its attempts to reduce trade barriers and facilitate free trade on a global scale; at the same time, nevertheless, Europeans have arranged a number of preferential agreements on a regional basis and more importantly, European countries have aggressively protected some of their key sectors such as textile and agriculture (Aggarwal and Dupont, 2002 pp. 126-129). In this context, it is useful to remember that around 40 percent of the EU budget is spent to subsidize farmers all over Europe, but primarily in France. It seems clear that the policy of broad general trade liberalization pursued by European countries within the WTO has been counterbalanced by its preoccupation that the effects of a deeper reduction of trade barriers might negatively affect European industry and agriculture, thus European economic power (White, 2001 p. 60).

When the analysis is directed to the inward effects of European integration, it needs to be stated that the European performance seems to be definitely more positive. A closer examination of the statistics about the ratio of average merchandise exports and imports to GDP during 1970-2000 concerning the three member states Denmark, Ireland and the UK, that joined the EEC in 1973, shows a very interesting reality: the biggest part of the increases in trade and FDI figures registered in that period of time is intra-EU and needs to be considered as an economic effect of creating an integrated European free trade zone. In this sense, one could speak more of Europeanization rather than globalization in the sense of an intensified economic interdependence within Europe, since the source of such trade flows has been more related to EU member states rather than non-EU countries (Ruane and Sutherland, 2002 pp. 212-214).

The following figure is extremely useful in illustrating the differential growth of intra-EU compared to extra-EU trade for the period of time between 1973 and 2003. In must be noted that at the beginning of the 1970s, intra-regional trade was only slightly higher than external trade. Starting from the mid-1980s and in concomitance with the birth of the European single market, a clear shift can be recorded signaling the exponential growth of intra-EU trade versus the slower increase of external trade. As the time-span used for this analysis encompasses three decades of trade relations, the data can be considered a reasonably reliable measure for indicating the relevance of a given trend. This figure provides helpful empirical evidence of the process of regionalism, or Europeanization in the specific case of the EU. It can be asserted that member states have concentrated their economic relationships within Europe due to the increased strength and stability of the internal European market compared to the risks of financial instability that would arise in the global context.

Figure 10. Intra-EU versus Extra-EU Trade, 1973-2003



Source: OECD

European Regionalism in a Time of Instability

Despite the critical decision of European countries to raise the level and importance of intra-EU trade compared to external trade, this merely represents part of the interrelationship between regionalism and the problem of financial instability. The monetary issue needs to be considered in this instance, since the risk of a contagious crisis and negative spillover effects from one country to the other could be estimated high before the introduction of the single currency. In fact, it is argued that in order to create a more complete and effective protection mechanism against instability, trade Europeanization needed a monetary counterpart.

In this section, the crisis of the European Monetary System (EMS) that struck the British Pound and Italian Lira in the early 1990s and caused their subsequent exit of the EMS in September 1992 is examined. After five years of exchange rate stability that endured from 1987 to 1992, the EMS faced the most severe crisis of its fourteen-year history, in which other currencies besides the Pound and the Lira were also more or less gravely affected (Eichengreen, Wyplosz, Branson and Dornbusch, 1993 pp. 51-52). Figure 11 and 12 illustrate the drastic downward movement of the two most impacted currencies, which helps visualize the extent of the crisis.

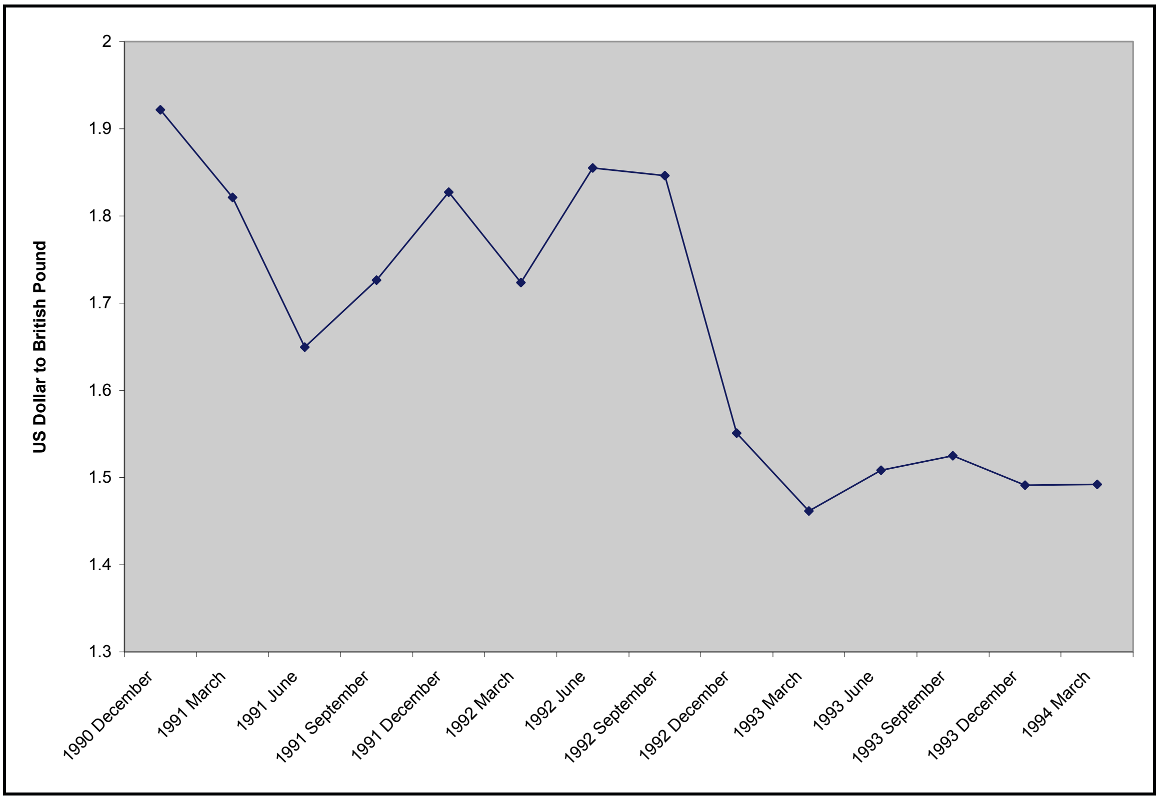
The simplest and most popular explanation of this event lies in the view that it prevalently took place in those countries that were experiencing a continuing decline in their competitiveness. The empirical data sustains this hypothesis for the Italian case, as public debt and inflation were high, labor costs were rising, and a declining US Dollar was undermining Italian merchandise exports. However, this can only account for part of the reasons (Eichengreen, Wyplosz, Branson and Dornbusch, 1993 p. 59). The main cause of the crisis can be identified in the complete removal of capital controls that was implemented in 1990 as part of the Single European Act for the completion of a single internal market by allowing free movement of capital, goods, services, and people within the EU. Undeniably, controls protected central banks' reserves from speculative attacks ranging from taxes on holdings of foreign currency assets to restrictions on the ability of banks to lend abroad. Indeed, all controls on intra-EC movements of portfolio capital and FDI as well as commodities were eliminated by July 1, 1990. Furthermore, it became hardly feasible to restrict the freedom of citizens of one country to open bank accounts in other countries, such as Germany that was considered the safest financial haven in Europe (Eichengreen, Wyplosz, Branson and Dornbusch, 1993 pp. 57-58).

As a matter of fact, the only two instruments available to national central banks to keep the exchange rate of the national currency within the margins given by the ERM were the following: interest rate policies and direct interventions on the foreign exchange market. For instance, in a situation, where the French Franc approaches the lower margin of its specified Deutsche Mark band, the Banque de France had two different options: it could sell foreign currency on the market by the means of its own reserves or by borrowing from other sources such as the international capital market and other central banks; or it might raise short-term interest rates to prevent the Franc from depreciating further (Zurlinden, 1993 p.43). It seems clear that the capability of monetary institutions to face speculative currency attacks was greatly reduced by the complete removal of all capital controls.

Given the emergence of disturbing symptoms in Britain's exchange rate fluctuations during the first three quarters of 1992, the Bank of England decided to engage in massive intervention in support of the Pound, reportedly expending as much as US$ 20 billion, or half of its total foreign exchange reserves of that time. Its discount rate was also increased; nevertheless, these measures were not sufficient. So, the government was not able to sustain the currency anymore and was forced to withdraw the sterling from the ERM on September 16, 1992. Italy followed Britain later on the same day, and Spain devalued the Peseta by 5 percent (Eichengreen, Wyplosz, Branson and Dornbusch, 1993 pp. 59-60).

Fears of a contagion through spillover effects to other countries and their currencies were justified, as it is argued that the French Franc and the Irish Punt came under attack as a result of the previous British and Italian crises (Eichengreen, Rose, and Wyplosz, 1996 p. 464). Although the transmission mechanism of a currency crisis from one country to the other can have multiple channels, one possibility is that a successful attack on one exchange rate leads to its real depreciation, which enhances the competitiveness of the country's merchandise products. As a result, this produces a trade deficit in the second country of the same region, a gradual decline in the international reserves of its central bank, and ultimately an attack on its currency (Eichengreen, Rose, and Wyplosz, 1996 p. 468).

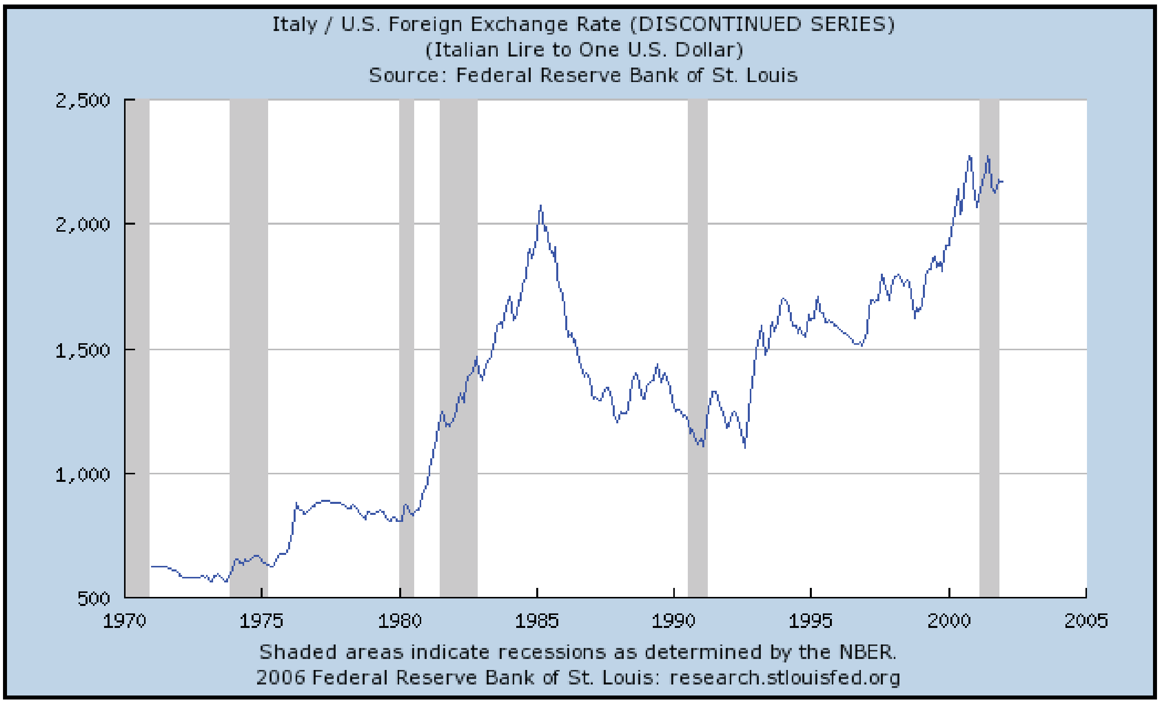
Figure 11. US Dollar to British Pound Exchange Rate, 03.1990-03.1994



Source: Bank of England

By the means of figure 11 and 12, the rapid substantial downward movement of the British Pound and the Italian Lira in 1992 becomes easily observable.

Figure 12. Number of Italian Liras for 1 US Dollar, 1970-2003



Source: Federal Reserve Bank of St. Louis

As a response to such fears of negative consequences on the EMS, the objective of the Treaty of Maastricht to create a single currency through the three-stage timetable required to achieve the EMU was not set aside. On the contrary, member countries realized the need for speeding up the process of monetary integration in order to avert the correlated risks of the emergence of a similar crisis on a bigger scale. It can be stated that European leaders developed the awareness of difficulties and possible bumps in the process of integration. At the same time, they were conscious of the many benefits accruing from it. Due to the dangerous example of financial instability of 1992, it does not surprise that the primary goal of the EU in terms of monetary policy is stability. The mandate of the ECB clearly states that this constitutes its primary objective (Ryan, 2007 interview).

In this context, the EU is to be considered as an exceptional and unprecedented kind of entity in the history of formal institutions. Member states have created one common supranational monetary policy represented by the independent mandate of the ECB, but at the same time they have kept national based fiscal policies within the limits imposed by the Maastricht treaty.

The monetary aspect is certainly one of the most important components of the process of European economic integration and it possesses the potential to make major contributions to it. Through the adoption of a single currency, many European countries have given the best answer possible to currency risks in regional investment decisions by completely removing them. The choice was strategic, as it further encouraged economic integration by elimination exchange rate risks within the Euro zone and lowering the risks of currency crisis. This can be regarded as one of the main reasons for the higher growth of intra-EU compared to extra-EU trade underscored in figure 10. As a result, they have achieved more stability and predictability important to the European business community.

Prospects of European Regionalism

In this section both internal and external potential problems and challenges will be discussed, which the EU might face in the future on its impervious way to become a global player. In this realm, the focus will be shifted to the recently renewed tendency of some EU member states towards a more protectionist posture with some nationalist nuance and on the affordability of the European welfare system in a time of global competition, in which the comparative advantage of production costs is definitely a key factor in attracting international investors. At the same time, attention will be given to important global economic developments such as the rise of the Euro as an international currency.

Adam Smith, the father of liberalism, represented the opinion that foreign trade is advantageous and desirable, when it becomes established naturally as a consequence of the economic development of a country. The most important advantages of trade, in his view, are the access to foreign markets, where surplus products can be sold, and the chance of acquiring certain goods for lower prices because of comparative production costs advantage of one country towards the other. The British philosopher did not promote free trade as the final goal without any reservations; on the contrary, he was aware of the risks of labor dislocation and massive unemployment that would result from a hazardous and over-hurried market opening policy. In this sense, Adam Smith acknowledged some validity to protectionist measures, when the industry is regarded as crucial to national security and defense and in the case that a tariff on a foreign product would simply signify a reaction to an equal tax on a domestic product (Rima, 2001 pp. 109-112).

Based on Adam Smith's moderately permissive attitude, some protectionist policies can be pursued, either in the case of a country's defense or as a retaliatory decision to counterbalance foreign tariffs on domestic products destined for foreign markets. This explains why anti-dumping protection against unfair trade practices is widely accepted within the framework of the GATT. Of course, there have been a number of studies trying to assess the impact of liberal and protectionist policies on the economy. For instance, a study realized in the late 1990s shows that the total cost of EU protection can reach a level of around 7 percent of its GDP, which is by itself an impressive and convincing argument for economic liberalization (Molle, 2001 pp. 434-438). An example of this tendency is provided by the EU discrimination against Japanese goods (Brewin, 1997 pp. 236-238). However, the issue is more complicated, since there are political reasons involved in the decision-making process that need to be taken into account. As Gilpin notes, Europe continues to be characterized by individual nation-states and rival nationalities that care mainly about their own economic and political interests (Gilpin, 2000 p. 226). Among the reasons are the fear of considerable job loss and the unwillingness of some governments to allow other European companies to be involved in a country's strategic economic realms. The latest disagreement between the French and the Italian governments over the intention of the Italian energy company Enel to take over the Belgian Suez controlled by Gaz de France delivers a useful example of such difficulty. In this context, there is a chance that a protectionist economic policy of a country, in this case France, might pose obstacles to the higher European project of creating one single market and consequently making a deeper political integration necessary to cope with issues of a common economic area. In other words, there is an explicit need to deal with and solve the problem of rising political and economic nationalism within the EU (Edwards, 2007 interview).

At this point, the attention will be directed toward the question of affordability of Europe's welfare system. It is generally assumed that the European model of social markets with lower market openness and a more comprehensive welfare system constitutes an intrinsic weakness that could reduce the European competitiveness on the global market and in the struggle against the other two models of American stock market based capitalism and Japanese oriented developmental capitalism.

In this regard, it is common opinion that there is a positive correlation between the economic performance and the extent of social costs that can be sustained. Today's rapid economic growth of emerging economies that are catching up with industrialized countries could threaten living standards in Europe, as more and more companies decide to shift their production sites to Asian countries such as China and India that offer much lower costs of unskilled labor and reasonable infrastructure. This could lead in turn to higher unemployment and increased welfare state costs in terms of greater unemployment subsidies. If the phenomenon of the ageing European population is then taken into consideration, it is possible to arrive at the conclusion that the welfare system might become unaffordable (Atkinson, 2002 pp. 255-256). European states will have to take measures in order to cope with such challenges that lie ahead in the near future: they will need to cut costly subsidies and ineffective expenditures, make the state apparatus more efficient as well as put forward good economic policies in order to reduce the actual unemployment rate and so the need for social transfers.

Despite these difficulties, the Euro is challenging the leadership of the US Dollar as a reference currency, in the sense that it has become attractive for international investors and borrowers, which increases Europe's potential as an even more important and growing global player (Steinherr, 2002 pp. 151-159). This has occurred partially because central bankers around the world have viewed the strength of the European economic and financial system as an opportunity to spread the risks related to their foreign currency reserves among a few currencies without relying exclusively on the US Dollar. In 1996, the Dollar accounted for approximately two-thirds of the world's foreign exchange reserves, and around 50 percent of international financial transactions. Its displacement by the Euro would have a dramatic economic impact. By one estimate, the portfolio switch could be as large as US$ 1 trillion. Some scholars believe that such a change would entail a major shift in the international balance of economic and political power (Gilpin, 2000 pp. 223-224).

In addition, Europe surely has the actual means to become a source of inspiration for developing countries, although not necessarily due to exclusive European merits, but also because the Washington consensus policies for less developed countries have largely failed to prove effective and so drawing the attention to Europe as a successful story. In the future, it is possible to see some countries in Asia, Africa, Latin America and the Middle East seeking for a deeper regional economic and monetary cooperation in order to avert the financial and economic risks of globalization (Steinherr, 2002 pp. 159). The experience of the Economic Community of West African States (ECOWAS) provides a good example of Europe's institutional appeal (Viot, 2007 interview). As declared on its official website, ECOWAS, which was founded in 1975, comprises sixteen nations and its main objective was to achieve economic integration and shared development so as to form a unified economic zone in West Africa. Later on, the scope was increased to include socio-political interactions and mutual development in related spheres (ecowas.info). The fact that ECOWAS is following the same institutional setting of the EU and has even adopted a single currency, i.e. the ECO, indicates the attractiveness of the European model for groups of vulnerable states that intend to realize common interests and collect absolute gains from regional cooperation, while building a protection shield from the threats of global financial instability.

It has been argued and pointed out that Europe has a real potential to become an important global player in the near future. Samuel Huntington pointed out the following argument:

> A cohesive Europe would have the population resources, economic strength, technology, and actual and potential military strength to be the preeminent power of the 21st century (cited in Nye, 2004 p. 30).

In fact, the size of the European economy is approximately equal to the American, its population and its share of international trade is even larger, so that Europe definitely has the economic means and the man-power in order to finance its future global role. In this sphere, Europe has already reached a point that has enabled it to challenge the US in different occasions such as in trade negotiations within the WTO, where Europe enjoys a powerful status equal to that of America (Stacher, 2007 interview). At the same time Europe offers a widely recognized cultural appeal as a source of soft power that could serve to create a more positive environment for the EU's international relations (Nye, 2004 pp. 29-30). Therefore, Europe's high potential to play a crucial global role soon could materialize, although the road towards that success will not be very smooth, as the further development of Europe as a single political entity seems to be problematic.

Over the past sixty years after the Second World War Europe has been hesitant to assume more responsibilities in the promotion of a global model of reference, as it was mainly occupied with the inward economic and political integration, i.e.

Europeanization and thus it was not ready to play a significant role in the global arena yet. As developing countries are performing well and catching up with the industrialized world, this inward attitude of Europe might change because of the likely interest of growing regions to increase regional economic and political cooperation. Provided that this occurs, Europe might become an exporter of institutional designs, so that Europeanization may be the future (Aggarwal and Dupont, 2002 pp. 135-138).

As Nye points out, the central question is whether Europe will develop enough political unity and consistency to act as one entity on a wide range of international issues, or whether it will remain a confederation of countries with distinct national policies and interests (Nye, 2004 p.30). In this sense, European states will have to work together in order to cope effectively with the challenges and the disequilibria posed by higher global competition in order to find common grounds for shared positions.

Given the increased consciousness by countries of global competitiveness and the high speed of the globalization process, Europe will soon need to update its institutional framework to the rapidly changing environment, define precisely its interests and so avoid internal competition and conflicts over trade and markets. For European countries in order to have a global impact there is definitely only one way to go: a stronger Europe. Furthermore, from the point of view of economically and politically more vulnerable European countries, it makes sense to integrate into the EU, as there is no regional hegemon that would utilize regional regimes and institutions in order to change the current distribution of power for its benefit. The EU represents an organization that is qualitatively different from NAFTA in this respect. As Cujovic points out, there were multiple reasons for Slovenia to join the EU. In addition to obvious historical and economic reasons, there was definitely the feeling that smaller states would be considered equal to stronger ones. The EU provided a platform, where Slovenia could increase its individual leverage vis-à-vis more powerful players (Cujovic, 2007 interview).

In sum, within this chapter, the main hypothesis of the thesis has been attested through wide use of a large number of sources, such as historical analysis, economic indicators, and evaluation of key agreements and their objectives. The position of European regionalism in a time of global instability has been studied with regard to political, economic and technological developments. Special attention was dedicated to the examination of the EMS crisis as an example of the financial risks of globalization and its effects on European regional integration.

It may be concluded that in the aftermath of 1945 Europe was comprised of countries that soon realized their weakness in the international system vis-à-vis the global hegemons of the US and Soviet Union. In addition to the macro level concern of regaining a significant role in world affairs, which European states decided to achieve by the means of uniting their power, European statesmen acknowledged the existence of common interests and mutual economic dependence on a regional basis or at a micro level. This dimension became even more relevant during the 1980s and 1990s in the midst of critical political, economic, and technological developments that forced Europe to accelerate the process of integration in order to decrease its exposure to external threats deriving from globalization. For this set of reasons, it may be stated that throughout the whole chapter the usefulness of the selected double-layered theoretical framework has been widely demonstrated.

CHAPTER IV

THE CASE OF ASEAN

This chapter will include a second case study, i.e. a study of Southeast Asian regionalism, which will further contribute to a better understanding of the main hypothesis of the thesis. The case of ASEAN will be presented and analyzed by the means of a number of different sources and data. Starting from a historical perspective, the analysis will then be directed toward the objectives of ASEAN exemplified by explicit regional agreements and the formation of respective regional institutions. At a further step, economic indicators will shed light on the relevance of Southeast Asian economic regionalism as opposed to a multilateral approach. The historical and economic perspective of ASEAN is regarded as relevant in order to demonstrate the prevalence and increase of interdependence among Southeast Asian nations since its foundation. Finally, considerations regarding Southeast Asian regionalism in a time of global instability will be provided. Within this part, the Asian financial crisis (AFC) of 1997-1998 will be overviewed as an example of the external threats deriving from the process of globalization. Throughout the whole chapter, critical insights into the history, reasons, dynamics and future of Southeast Asian regionalism will be provided by sessions of interviews with a representative of the Embassy of Indonesia to Egypt and knowledgeable scholars from related fields of study.

Prior to a detailed in-depth analysis, it needs to be underlined that special attention will be paid to the effects of the economic and financial instability in the form of AFC, which is interpreted as a key event correlated to the opening of space for a more inclusive, deeper and integrated regional movement. Indeed, it is argued that this disrupting event has not doomed the stability of ASEAN. Conversely, it has had the effect of increasing the regional awareness of the centrality of cooperation among members in order to deal directly with economic and financial weaknesses shown during the crisis. As the foreign minister of Indonesia at the time put it:

> We have now come to realize because of the crisis how interdependent we are……we must be able to show the world that we are able to cooperate even more closely with each other (Haji and Ghoshal, 1999 pp. 759-762).

In the aftermath of the crisis, regionalism gained a clear momentum in Southeast Asia, as measures for knitting members together more closely were taken and others such as the idea of a common currency were accurately examined (Haji and Ghoshal, 1999 pp. 759-762).

Furthermore, ASEAN seems to suit perfectly the focus of analysis of the thesis, as it is comprised of weaker and more vulnerable states, while no regional or global hegemon has entered the organization yet. Thus, it will be possible to analyze the dynamics of regionalism in Southeast Asia from the perspective of the conceptual framework chosen for the thesis.

History and Causes of Southeast Asian Regionalism

The Association of Southeast Asian Nations, ASEAN is widely regarded as the most successful case of regionalism outside of Europe (Buszynski, 1998 pp. 555-556). It offers a comparable development to the European case, as both regional organizations have survived the old wave and joined the new wave of regionalism, thus going through a similar transition from security to economic regionalism. Such shift reflects the changed global environment after the end of the Cold War and the advent of deep technological progress. These developments brought about a substantial change in the priorities for ASEAN, as economic interdependence became to be regarded as the engine for further and deeper integration within the region (Buszynski, 1998 pp. 565-570 and 575-577). This view is confirmed by Waskito, a representative of the Embassy of Indonesia to Egypt, who states that it is true that ASEAN was promoted by the West in order to confront the Soviet Union. Over time, however, the core and focus of the regional organization has shifted from security to economic matters (Waskito, 2007 interview).

Founded on 8 August 1967, the Association of Southeast Asian Nations was conceived as a regional response to the threat of the spread of communism. Within the logic of the Cold War, the cohesion and drive toward more integration was galvanized by the rise of a united Vietnam in 1975. As Singapore's Minister of Information and Arts put it:

> Without the Vietnamese threat, it is doubtful that ASEAN would have become the regional grouping it is today (Buszynski, 1998 p. 555).

It is clear from such statement that the nature and objectives of ASEAN as an organization changed over time. The security challenge facing Southeast Asian countries helped them consolidate their diplomatic and political ties, thus laying down the basis for further development and functions. Because of the end of the Cold War and the simultaneous virtual victory of the Western model of capitalism over communism, the international context, in which ASEAN was acting and interacting with other forces, took a different shape. With the decline of the Soviet ability to project power in other regions of the world, ASEAN underwent a period of self-redefinition. Thanks to the positive results achieved in the security realm, members of the organization found it fruitful to build on the past experience of close cooperation and extend it to the area of economic integration.

In other words, in the past fifteen years ASEAN has gone through a transitional phase and a shift from old to new regionalism. The former, as has been previously described, was mainly related to the issues of economics and security interpreted in traditional terms as security among sovereign states as unitary actors. The latter view of regionalism is outward-looking, non-exclusive and multidimensional in function. In new regionalism, international and transnational overlapping linkages are established within the region. In sum, this new form of regionalism responds to the demands of state as well as non-state actors such as business groups and non-governmental organizations, whose needs and interests have expanded beyond the borders of the nation-state (Buszynski, 1998 pp. 555-556). Such definition fits well into the theoretical framework adopted for this thesis. Indeed, it is argued that countries within a specific region experience an interrelation of high mutual dependence that makes it beneficial for them to participate in regional coordination of policies at various different levels and dimensions. Keohane's interdependence theory affirming that cooperation among states is possible at a micro or regional level in the presence of mutual dependence and interests would explain the shift from the old to the new form of regionalism.

In this context, the challenge posed to the question of regional cohesion needs to be taken into account. One could argue that economics knows no regional loyalties and unilateral decisions of single ASEAN members could thus undermine the objective of increasing the level of regional integration and eventually lead to a gradual disempowerment of the organization itself (Buszynski, 1998 pp. 556-557). It is in fact possible that individual states might look for economic alliances that go beyond the framework of ASEAN. However, such move does not automatically imply that the project of knitting members together is threatened. Furthermore, the relatively high degree of institutionalization of international and transnational relations within the regional association would deliver strong disincentives against any decision that could jeopardize the benefits deriving from ASEAN. Any state will evaluate a cost and benefit analysis of its actions and their consequences on the integrity of ASEAN. Thus, in this thesis it is maintained that the presence of mutual interests among members and their durable institutionalization offer solid sufficient grounds for supporting the opinion that ASEAN will be able to cope with the challenges originating from the shift toward the new form of regionalism.

Treaties and Objectives of ASEAN

The Association of Southeast Asian Nations was established in August 1967 in Bangkok by the five original members: Indonesia, Malaysia, Philippines, Singapore, and Thailand. After a series of enlargements in the 1980s and 1990s, it now comprises ten countries, among which Brunei Darussalam, Cambodia, Lao, Myanmar, Vietnam have been added to the founding members. The Bangkok Declaration recites as follows:

> *Mindful* of the existence of mutual interests and common problems among countries of South-East Asia and convinced of the need to strengthen further the existing bonds of regional solidarity and cooperation;
> *Desiring* to establish a firm foundation for common action to promote regional cooperation in South-East Asia in the spirit of equality and partnership and thereby contribute towards peace, progress and prosperity in the region;
> *Conscious* that in an increasingly interdependent world, the cherished ideals of peace, freedom, social justice and economic well-being are best attained by fostering good understanding, good neighborliness and meaningful cooperation among the countries of the region already bound together by ties of history and culture;
> *Considering* that the countries of Southeast Asia share a primary responsibility for strengthening the economic and social stability of the region and ensuring their peaceful and progressive national development, and that they are determined to ensure their stability and security from external interference in any form or manifestation in order to preserve their national identities in accordance with the ideals and aspirations of their peoples (asean.org).

Within this preamble of ASEAN foundation's declaration, the key elements pertaining the main argument and theoretical framework of the thesis can be identified. In fact, there is a clear reference to the existence of common interests in the region as a reason for a tighter cooperation at the micro level. At the same time, an explicit remark is made in relation to the need for economic stability and security from external interference. Furthermore, it is noteworthy that the term "spirit of equality and partnership" was included, which indicates the awareness of the absence of a regional hegemon within the organization.

The ASEAN Declaration includes the following purposes and aims of the association as well as the necessary institutional arrangements:

- to accelerate economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership;
- to promote regional peace and stability through abiding by mutual respect for independence, sovereignty, equality, territorial integrity, and national identity of all member states (aseansec.org).

The fundamental changes occurring in the world during the 1980s and 1990s encouraged ASEAN to make some important adjustments to the scope and scale of regional cooperation. Based on the Declaration of ASEAN Concord, signed in Bali, Indonesia on 24 February 1976, which provided that member states shall cooperate in the field of trade in order to promote development and growth of production and trade, the Agreement on the Common Effective Preferential Tariff Scheme (CEPT) for the ASEAN Free Trade Area (AFTA) was deliberated in Singapore, on January 28, 1992 (aseansec.org). Such decision definitely represented the beginning of the expansion of intra-ASEAN trade rather than adopting a multilateral approach, which is illustrated by the following extract from the preamble of the agreement:

> *Recalling* that the ASEAN Heads of Government, at their Third Summit Meeting held in Manila on 13-15 December 1987, declared that Member States shall strengthen intra-ASEAN economic cooperation to maximize the realization of the region's potential in trade and development;
>
> *Convinced* that preferential trading arrangements among ASEAN Member States will act as a stimulus to the strengthening of national and ASEAN Economic resilience, and the development of the national economies of Member States by expanding investment and production opportunities, trade, and foreign exchange earnings;
>
> *Determined* to further cooperate in the economic growth of the region by accelerating the liberalization of intra-ASEAN trade and investment with the objective of creating the ASEAN Free Trade Area using the Common Effective Preferential Tariff (CEPT) Scheme (asean.org).

As a result of extraordinary political, economic, and technological events shaking the very foundation of the international system, ASEAN leaders realized the need for further integration and strengthening of intra-ASEAN trade relations. This clearly reflects the objective outlined in the Declaration of 1967 asserting that ASEAN should serve as a protection from external threats to internal stability. As the focus shifted from narrow security to economic matters, the formation of the AFTA can be explained as a shield mechanism linked to economic instability and external interference.

The agenda of the ASEAN Vision 2020, which was adopted by the members in 1997, on the 30th anniversary of the foundation of ASEAN, confirms the establishment of a shared idea for the organization's position and role in the international system. It is described as a concert of Southeast Asian nations living in peace, stability and prosperity in a joint partnership for dynamic development (aseansec.org).

Specifically for the purpose of this thesis, it is important to examine the Declaration of ASEAN Concord II – or Bali Concord II – signed in Bali, Indonesia on October 7, 2003. This agreement includes the formal decision of ASEAN leaders to build the structure of the association around three main pillars: a Security Community, an Economic Community, and a Socio-Cultural Community (asean.org). Such architecture can be viewed as a close reminder of the European Union and its institutions, which served as a model of inspiration. The preamble of the Bali Concord II includes the following relevant points:

> *Recognizing* that sustainable economic development requires a secure political environment based on a strong foundation of mutual interests generated by economic cooperation and political solidarity;
>
> *Cognizant* of the interdependence of the ASEAN economies and the need for ASEAN member countries to adopt "Prosper Thy Neighbor" policies in order to ensure the long-term vibrancy and prosperity of the ASEAN region (asean.org).

It seems apparent that the awareness of the existence of mutual interests and a strong economic interdependence among on a regional basis has become an essential recurring feature of any ASEAN formal document. Furthermore, as the official text of ASEAN Vision 2020 asserts, the Economic Community should be considered as the end-goal of economic integration creating a single market and production base with a free flow of goods, services and investment. Its primary goal is to promote an economically stable and prosperous region generating opportunities for business complementation and enhancing ASEAN's competitiveness in the global economy. According to Waskito, the Economic Community is considered a crucial step toward a deeper integration that might include the formation of a single currency sometime in the future. Furthermore, he affirms that one of its primary goals is to tackle the question of how to increase intra-ASEAN trade. However, there are some difficulties on the road, as many countries have the same commodities: for example, both Indonesia and Malaysia focus on agriculture and mining. In this case, ASEAN serves as a platform for exchanging opinions about the strategy to be adopted and for coordinating policies among member states (Waskito, 2007 interview). This section has been extremely valuable in outlining the importance of economic interdependence and the widely spread perception among ASEAN statesmen of the prevalence of common interests at a regional level.

Economic Indicators of Southeast Asian Integration

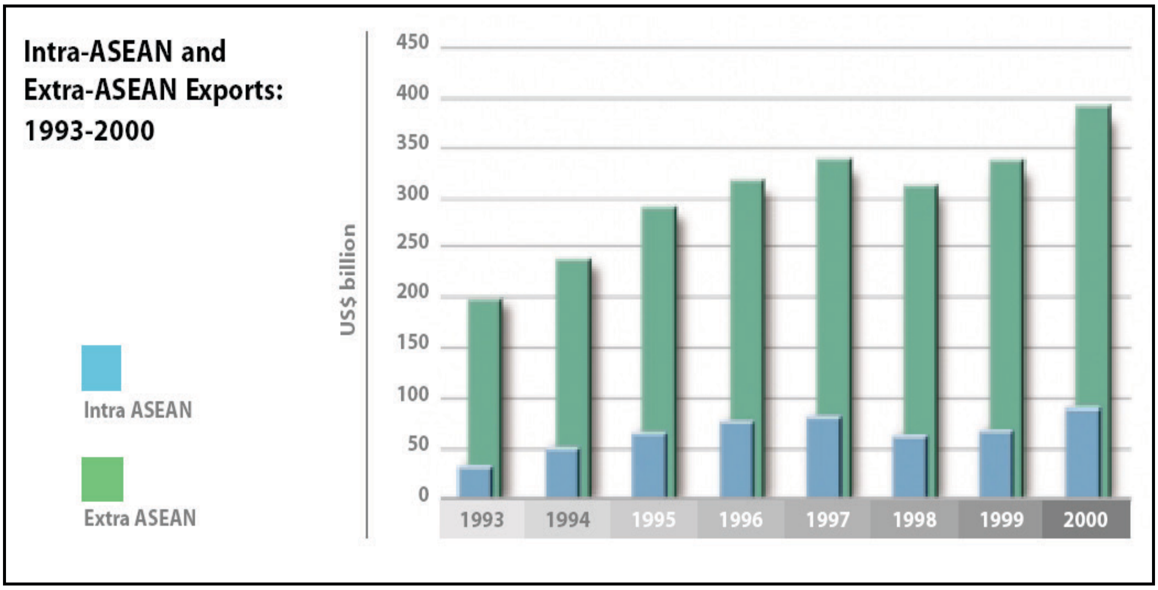
The ASEAN region has a population of approximately 500 million, a combined gross domestic product of US$ 700 billion, and a total trade of roughly US$ 850 billion (aseansec.org). In this section, economic indicators will be presented and evaluated as to their explanatory content with regard to regional economic integration among members.

It can be noticed that the economic cooperation being promoted in the ASEAN Vision 2020 is comprehensive, i.e. encompassing businesses as diverse as air travel, agro-based products, automotives, e-commerce, electronics, fisheries, healthcare and others. The strengthening of the institutional mechanism of ASEAN can be viewed as a critical aspect of the self-redefinition process of the association. This has been partially achieved by the means of the creation of the ASEAN Free Trade Area (AFTA). Launched in 1992, this institution was designed to improve the region's competitive advantage as a single production unit via the Agreement on the Common Effective Preferential Tariff (CEPT), i.e. the elimination of tariff and non-tariff barriers on intra-regional trade. Indeed, at the beginning of 2005, tariffs had been completely abolished on 60 percent of the products in the CEPT Inclusion List, while 99 percent showed tariffs of no more than 5 percent. The current average tariff on goods traded under such mechanism is about 3.8 percent. ASEAN leaders have reached a consensus on removing all import duties by 2010 for the founding nations and by 2015 for the new members (aseansec.org).

The creation of AFTA has had remarkable impacts on the level of economic interconnectedness among members. It increased efficiency in production and long-term competitiveness of businesses. More importantly, as a direct result of the creation of AFTA, trade among ASEAN countries has more than doubled from US$ 44.2 billion in 1993 to US$ 95.2 billion in 2000. In the same year, intra-regional exports accounted for almost 23.3 percent of total ASEAN exports. Before the financial crisis of 1997-1998, intra-regional trade had been increasing by 29.6 percent. As illustrated in figure 13, this was substantially higher than the growth rate of extra-ASEAN exports, which rose by 18.8 percent during the same period (aseansec.org).

These economic indicators are highly valuable for understanding the crucial role ASEAN has played in fostering regional economic integration since 1992. The realization of AFTA can be viewed as an important step toward building a cohesive regional bloc that will be able to receive consideration from economically more powerful industrialized countries and members of the G8. It goes without saying that in the absence of such institution it would be extremely difficult for single countries such as Thailand or Malaysia or others to raise demands and shape the economic architecture of the global economy in their favor.

Figure 13. Intra-ASEAN versus Extra-ASEAN Exports, 1993-2000



Source: ASEAN

Figure 13 and the available empirical data indicate a relative increase in the weight of intra-ASEA trade, although external trade still constitutes the largest part of the total amount of exports. As Waskito points out, the process of economic regionalism or regionalization represents the conscious decision of ASEAN leaders to reduce the exposure to external forces and possible threats (Waskito, 2007 interview). This also reflects the assumed centrality of economic power in the international system.

The East Asian Financial Crisis and Regionalism

In this crucial section of the chapter, the financial crisis that occurred in the late 1990s in East Asia will be presented. An analysis will be provided with regard to causes of the AFC and its dynamics. In this context, economic data and financial graphs will be made accessible in order to simplify the understanding of the magnitude of the AFC. Furthermore, its implication and impact on ASEAN will be more closely studied, as according to the main hypothesis of the thesis it is argued that financial instability is connected to the fact that weaker states seek protection mechanisms in order to avert the risks of globalization in the form of a tighter regional economic cooperation. In following subsection of the chapter, the prospects, possible future developments, risks and opportunities for Southeast Asian regionalism will be evaluated. Finally, a brief comparison of the main characteristics of European and Southeast Asian regionalism will be drawn and partial conclusions regarding the main argument of the thesis will be put forward.

The Causes and Dynamics of the Crisis

There are a number of good reasons for investigating into the causes and looking at the dynamics of the AFC: firstly, it is the sharpest financial crisis to strike the developing world since the 1982 debt crisis. Secondly, it is the one of the least anticipated crises in a long time. In fact, in the immediate pre-crisis period, the five most severely hit economies, i.e. Thailand, Malaysia, Indonesia, South Korea, and the Philippines, had low inflation rates, budgets in surplus and declining government foreign debt. Thirdly, it is the third-largest economic collapse in the twentieth century after the 1929 crash and the 1973 first oil shock. Finally, it follows the same pattern of financial crises that arose after the breakdown of the Bretton Woods Agreement in 1972 and the adoption of financial liberalization measures throughout the world during the 1980s and 1990s. As has already been shown, this brought about a skyrocketing effect on the amount of daily transactions at the main international stock markets increasing from US$ 900 million in 1992 to US$ 1.3 billion in 1995. Since much of this money is speculative, it can move rapidly with sometimes unanticipated consequences (Dittmer, 2000 pp. 32-33).

There has been a lively debate over the real causes of the crisis. Of course, there is no single reason for the occurrence of such massive financial disruption. On the contrary, there are a set of motives that can be held responsible. The first symptoms of disturbances in East Asian economies were the failures of certain large South Korean conglomerates causing the spread of uncertainty in the markets. In the meantime, in Thailand, Samprasong Land, a large finance company missed its February deadline for payment of its foreign debt, which in the end caused its collapse. Following this event, Finance One, the biggest finance firm of Thailand at that time went bankrupt. At this point, foreign investors started withdrawing their money from the country and caused a downward movement of the Thai currency, the Baht, which the central bank could not sustain for a prolonged time-span. As the foreign reserves shrank, the Thai Baht came under a speculative attack resulting in its rapid plunge in July 1997 (Dittmer, 2000 pp. 33-35).

It is argued that the hypothesis of “Downfall of Asian Exceptionalism” endorsed by the IMF, which views financial cronyism and serious weaknesses in the Asian economies as the prime causes of the rise of the AFC cannot be fully supported. As a matter of fact, this explanation blaming the Asian capitalist model cannot account for such regional crisis, because not all countries were equally affected by it. Furthermore, lack of transparency in the banking system, as advanced by the IMF, cannot be a reliable risk indicator, as currency crises have also occurred in situations of high transparency, such as in the Scandinavian economies of the early 1990s (Dittmer, 2000 pp. 36-37).

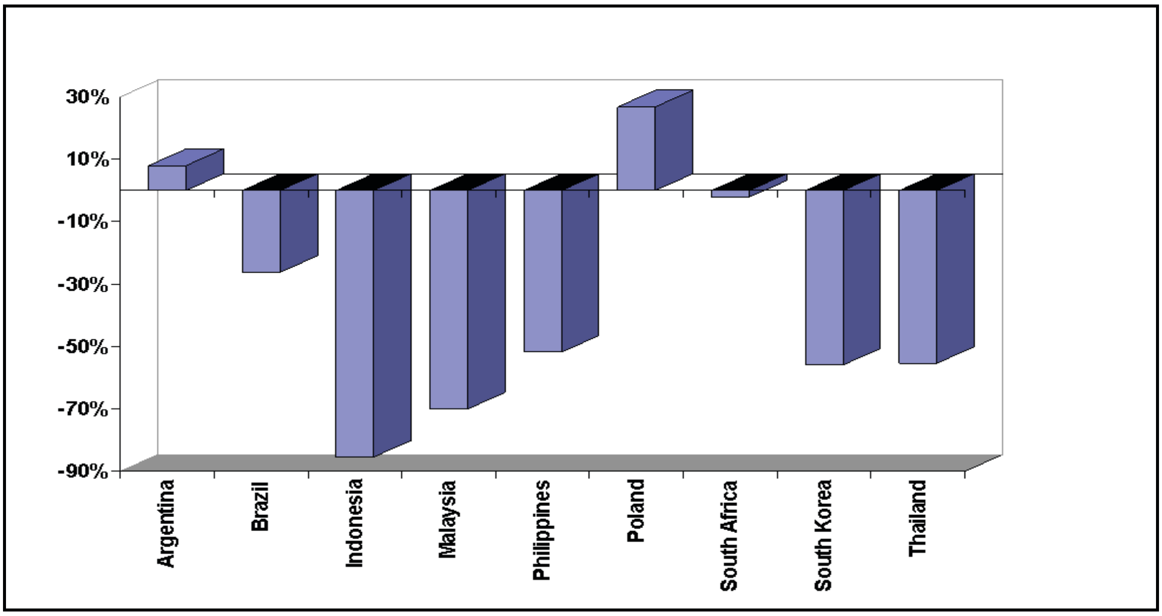
On the contrary, the AFC can be regarded as a demonstration of the dangers of financial globalization. Indeed, the proliferation of international funds focusing on emerging markets in the US in the 1990s resulted in the availability of increasing amounts of short-term investment capital. According to the World Bank, in 1995, East Asia received two thirds of total FDI outflows to developing nations, while net capital inflow to the five most afflicted countries had grown at an average rate of 20 to 30 percent per year during the period of time from 1992 to 1996 (Dittmer, 2000 p. 39).

Because a considerable portion of this inflow came in the form of highly liquid and volatile portfolio investment, it was able to take flight just as swiftly when the crash occurred. Between 1997 and mid-1998, there was a net outflow of US$ 16 billion accounting for approximately 11 percent of the GDP of the countries involved. In terms of the value of listed companies' shares, the market capitalization of Southeast Asia decreased by around 72 percent from US$ 565 billion in January 1997 to US$ 160 billion in 1998. As a consequence, the rapid withdrawal of short-term foreign private capital made it impossible for central bankers to sustain their currencies, which had then to be allowed to float. At the same time, as the Bank of Thailand announced that it would allow the Baht to fluctuate, speculators launched an attack that led to a sudden 25 percent drop of its value. The high degree of uncertainty and panic soon spread around the region and the negative spillover effects developed a real and full contagion that hit most of the regional currencies. The most severely hit was the Indonesian Rupiah that lost 83 percent of its value against the US Dollar by late January 1998 (Dittmer, 2000 pp. 39-40).

In sum, as financial globalization has facilitated the transmission of information, capital, and other resources across national boundaries, it can be concluded that it has greatly contributed to the AFC in the following two respects. First, it made it possible for foreign capital to be invested in Asia in higher quantity and speed. By doing this, it provided a big portion of the speculative asset bubble. Second, when the bubble burst, financial globalization allowed a swift and precipitate withdrawal of that capital.

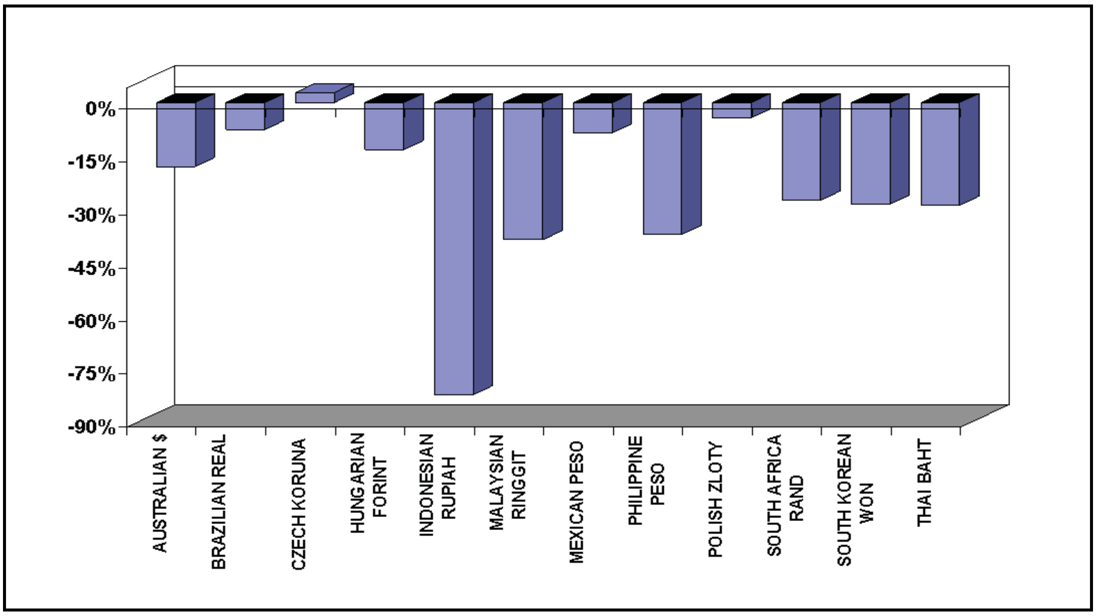
The following figures 14-18 and table 5 help visualize the dynamics of the crisis and realize the consequences of the abrupt, sudden, and unanticipated shift that occurred in 1997 in terms of the currency devaluation and collapse in the value of stock market capitalization. The first aspect is an indicator of the effect of taking out capital causing a huge wave of selling orders on the foreign exchange market. The second directly shows the impact on the value of East Asian companies listed on stock markets as a measure of disinvestment by investors and portfolio funds. It is clear that financial market liberalization reforms of the 1980s and 1990s played a key role in amplifying the consequences of the removal of capital from Asia.

Figure 14. Changes in Stock Market Capitalization, July – December 1997



Source: Federation Internationale des Bourses de Valeurs

Figure 15. Emerging Currencies to the US Dollar, July 1997 – July 1998



Source: Federation Internationale des Bourses de Valeurs

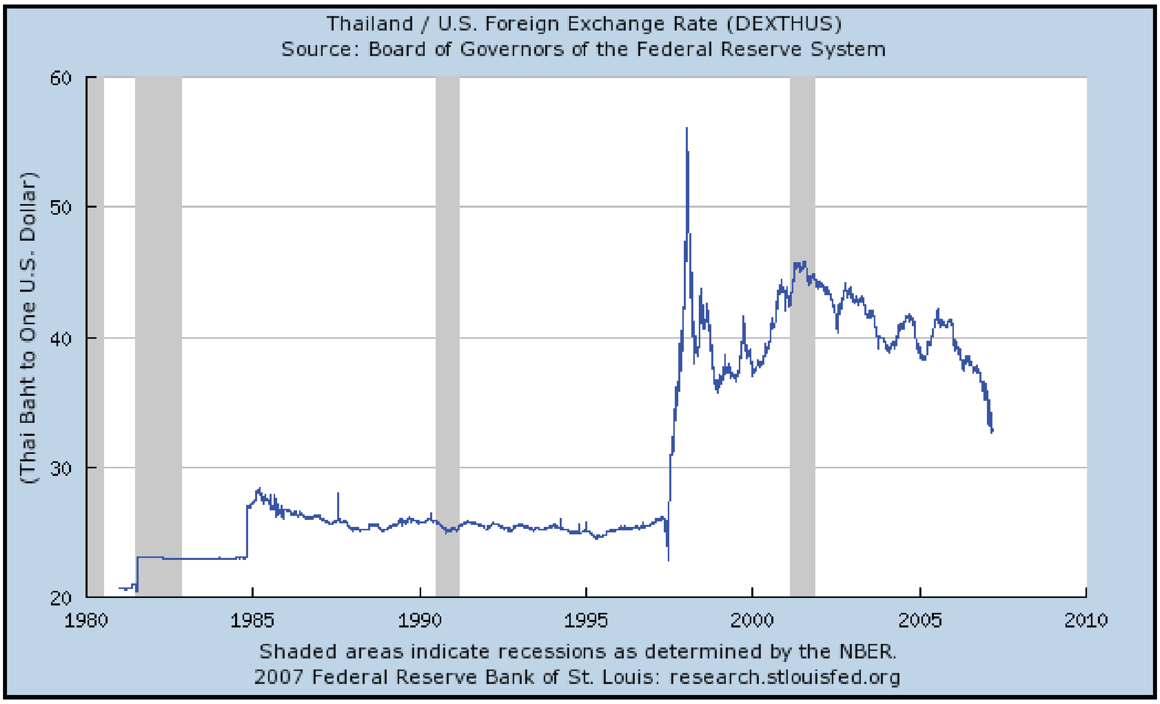
Table 5 in specific, provides a useful summary of the empirical data concerning the five most severely affected countries during the AFC. It is apparent that the effects have been disastrous on these economies; the case of Indonesia is emblematic with its approximately 80 percent drop in both currency and capital market value. Figure 16-18 illustrated the course of selected exchange rates over a time-span of 27 years.

Table 5. Devaluations and Share Price Collapse, July 1997 – February 1998

	% depreciation of currency vis-à-vis the dollar	% change in the share price index
Thailand	87.09	– 48.37
Malaysia	55.46	– 58.41
Korea	83.04	– 63.06
Philippines	51.37	– 49.17
Indonesia	231.00	– 81.74

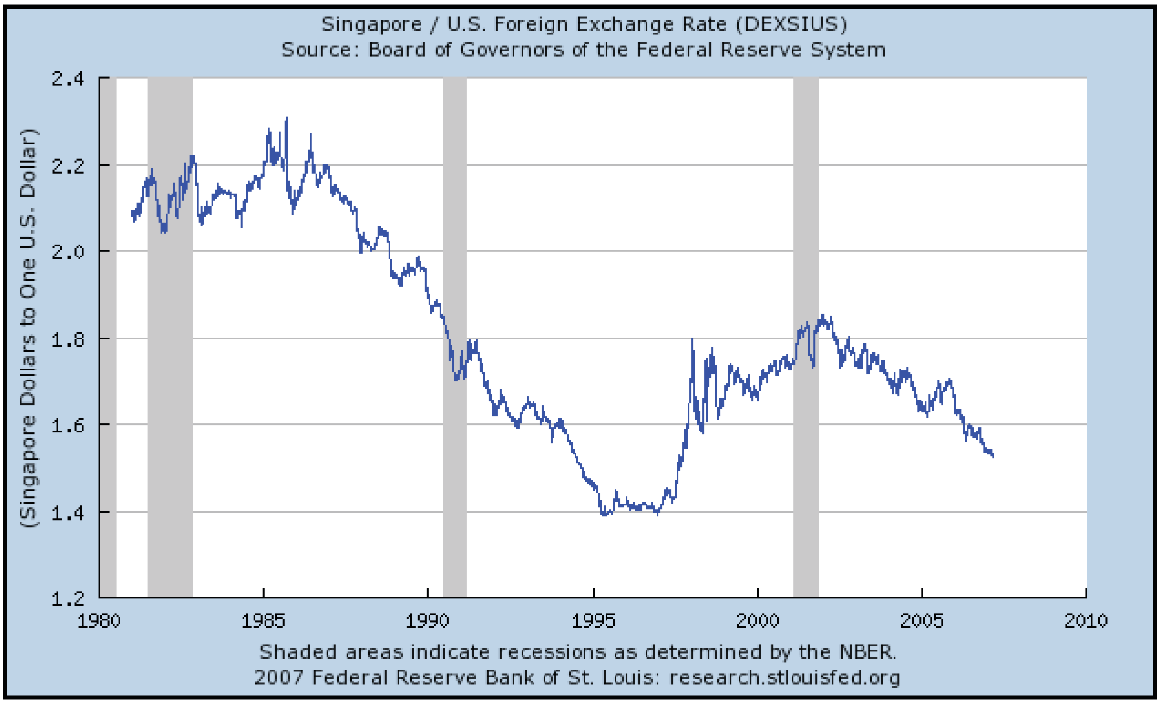
Source: Basu, 2003 p. 888

Figure 16. Number of Thai Bahts for 1 US Dollar, 1980-2007



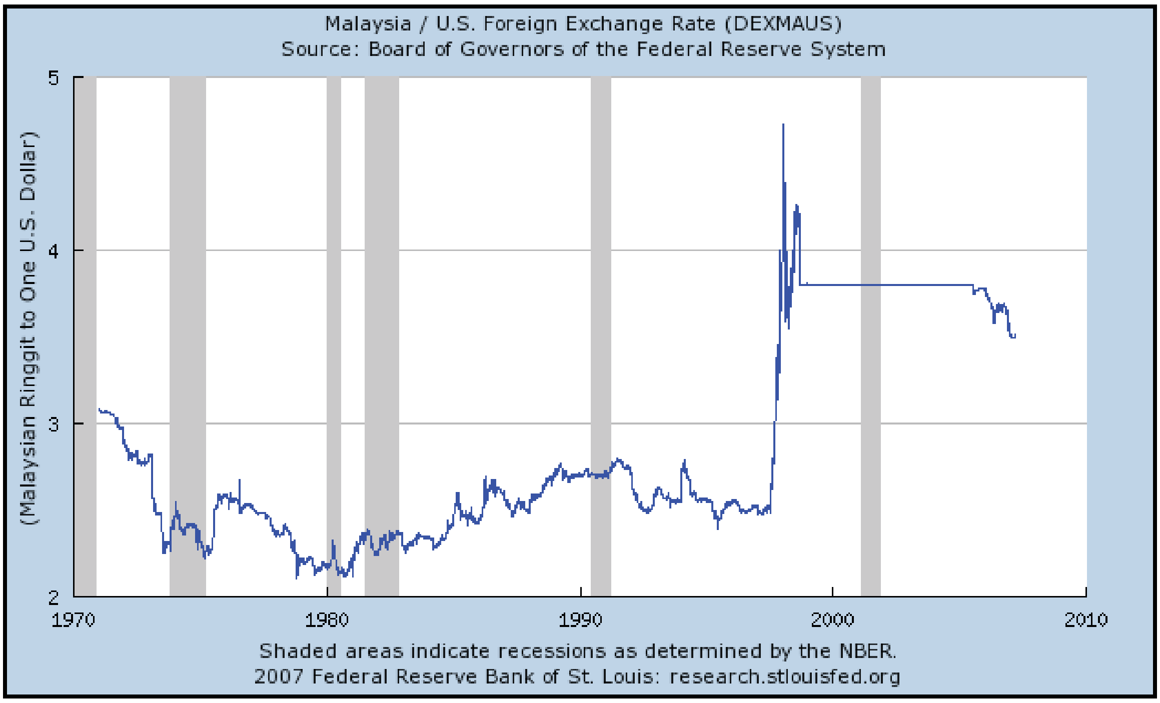
Source: Federal Reserve Bank of St. Louis

Figure 17. Number of Singapore Dollars for 1 US Dollar, 1980-2007



Source: Federal Reserve Bank of St. Louis

Figure 18. Number of Malaysian Ringgits for 1US Dollar, 1980-2007



Source: Federal Reserve Bank of St. Louis

Thus, it can be maintained that there was a set of causes at the root of the emergence of the AFC. The effects of unchecked financial liberalization coupled with massive short-term external debt of both the private sector and the state made the East Asian economies vulnerable to external speculative attacks. Not enough attention was paid to limiting the risks of capital volatility and uncontrolled borrowing. As previously outlined, the crisis had a particularly severe impact on all ASEAN founding members in real terms exemplified by a declining gross domestic product, a weaker currency, and reduced purchasing power. Thus, ASEAN as a whole suffered (Haji and Goshal, 1999 p. 760). This is best demonstrated by the stunning decrease in private net capital flows to economies such as Indonesia, Korea, Malaysia, Thailand and the Philippines from US$ 93.8 billion in 1996 to US$ 69.2 billion in 1998. Such sudden decline caused grave damages to the socio-economic condition of the ASEAN's population in the form of shrinking per capita income and purchasing power as well rising inflation and unemployment leading to a dramatic increase in poverty (Haji and Goshal, 1999 pp. 764-766).

The Implications for Southeast Asian Regionalism

The most evident implication of the AFC has definitely been the internal redistribution of power among member states. According to Waskito, the respected position of Indonesia within the organization was largely reduced as an effect of the crisis, which affected this country more severely than others. Figures 14-15 clearly indicate the higher intensity of the AFC regarding Indonesia, which diminished its economic power in relative terms to other ASEAN countries (Waskito, 2007 interview).

Perhaps the single most significant consequence of the AFC has been to reconfigure the political economic role of the nation-state in East Asia. In fact, insofar as the AFC was almost from the start a regional crisis – as opposed a national crisis – it definitely highlighted the weaknesses of the nation-state in an unprecedented manner.

As Surin Pitsuwan, Thailand's foreign minister, affirmed at a conference in Singapore in 1999:

> The effects of globalization and the region's economic and financial crisis have not only caused outsiders to doubt our efficacy, but also forced us to rethink our role (cited in Haji and Goshal, 1999 p. 759).

Without question, ASEAN suffered considerably from the crisis, as its members were facing harsh times. However, instead of becoming irrelevant, the association gained momentum and began to be seen as a vital protection mechanism against external vulnerability. As the ASEAN Secretary General Severino declared in a conference in Singapore in 1999, there were only two alternatives to supporting regionalism: the first would be domination by more powerful states, while the second would be a return to nationalism in a divided region. He then observed that the region's economic problems encouraged members to cooperate more closely. Ali Alatas, foreign minister of Indonesia at the time, declared:

> We have now come to realize because of the crisis how interdependent we are, how interconnected our problems are. Now we see that it cannot remain Thailand only having a problem, it inevitably would infect us. So our problems are interconnected, our interdependence toward one another has grown, and we realize in times of crisis we must be able to show the world that we are able to cooperate even more closely with each other (Haji and Goshal, 1999 p. 761).

> There was a strong realization of the need to be more regional because of the nature of economic problems. We cannot operate any more as individual states (Haji and Goshal, 1999 pp. 761-762)

Most scholars point out the unique window of opportunity for reform in the form of increased regional economic cooperation in a situation, where a large number of countries face similar problems within the same region. There are two points that need to be underlined in this context. First, although each ASEAN nation possesses its own peculiarities and specific constellation of difficulties and differing abilities to handle the situation, the region as a whole was confronted with similar policy recommendations ranging from improving transparency in financial transactions, establishment of new regulatory frameworks, and increasing intra-regional trade. In fact, the very core characteristic of financial globalization makes it nearly impossible for nation-states to take effective unilateral actions. Recently, an international panel of experts has urged ASEAN countries to adopt concerted fiscal and monetary policies (Eliassen and Borve Monsen, 2001 pp. 127-128).

The second point deals with the effect of AFC on the level of institutionalization of regional cooperation. The formation of a regional monitoring mechanism would make it easier for member states to be informed and exert pressure in a timely fashion in order to cope with eventual threats. The creation of preventive measures was at the core of the discussions among the ASEAN finance ministers in December 1997, which resulted in the establishment of the so-called Manila Framework, by which member countries would undertake mutual surveillance of each others' economies.

The degree of institutionalization was then further increased, when in October 1998 the establishment of another joint monitoring system was announced, which would provide early warning of future economic risks in the region. This agreement entailed the exchange of information regarding various issues, such as interest rates, exchange rates, and capital flows. The advantage of regional institutions is that their function might be facilitated by a sense of regional identity against the pervasive and penetrative power of the IMF and the West. In this sense, the AFC could be considered as a "blessing in disguise", as it forced Southeast Asian nations to foster closer links and deepen regional integration (Eliassen and Borve Monsen, 2001 pp. 128-129).

Prospects of Southeast Asian Regionalism

The higher level of institutionalization and the remarkable boost experienced in the aftermath of the AFC might contribute substantially to the further consolidation of ASEAN as a political and economic entity in the international system. It is therefore possible to expect this regional association to become even more present in negotiations over political and economic issues. This tendency is proved by the December 4, 2006 unanimous decision of the United Nations to grant observer status to ASEAN (aseansec.org). Thus, the prospects for a further development of the roles and functions fulfilled by ASEAN are positive. However, it is highly debatable whether it will be given the necessary space to gradually become a supranational organization.

Although the future might look bright, the path is not going to be short of challenges. There are several threats posed to the nature and integrity of ASEAN that will need to be addressed. Firstly, since the shift from old to new regionalism, economic integration has become the driving force. As regional cooperation pushes for greater openness, this might undermine the specific criteria of regional identity, since additional business opportunities may arise from broader agreements and the development of external linkages. In this context, the Asia-Pacific Economic Cooperation (APEC) could pose a significant threat to ASEAN, as it is going to be problematic to deal with economic coalitions that cut across members (Buszynski, 1998 pp. 565-567).

Secondly, the involvement in the Southeast Asian region of global and regional powers such as the United States of America, Japan, and more importantly China will necessarily require an adjustment in the bilateral relations with ASEAN. As is best illustrated by the example of China, more powerful actors will attempt to weaken the regional association in order to promote their own interests in the region. For instance, because of Vietnam's membership in ASEAN, its dispute with China over the South China Sea has become a regional issue. However, due to the importance to some countries of their economic ties with China, it will be complicated for ASEAN to reach a common stance against the regional power and in support of Vietnam. Hence, the influence of powerful states such as China that attempt to play the role of the regional hegemon will probably be destabilizing (Buszynski, 1998 pp. 558-560). As Waskito points out, these regional hegemons will endeavor to offer economic advantages to single ASEAN countries, thus undermining its cohesion in order to gain individual influence spheres within the region at the expense of a multilateral approach. An example is provided by the evident political struggle that arose between Japan and the US, when ASEAN proposed to set up a regional equivalent to the IMF in late 1997, i.e. an Asian Monetary Fund (AMF). Japan, which at that time was already studying the feasibility of a single Asian currency under its guidance, promptly promised to underwrite the fund to be initially capitalized at US$ 100 billion. But, both China and the US immediately opposed the idea, which was then abandoned (Dittmer, 2000 p. 45). This type of external involvement could potentially threaten ASEAN’s unity. However, according to Waskito, this also poses a positive challenge to ASEAN by encouraging its further internal development. In fact, he asserts, this regional organization helps single Southeast Asian nations increase their individual leverage in relations with third parties and hegemons in particular. As a matter of fact, until now every ASEAN country shares the view that ASEAN represents the most important organization for their future (Waskito, 2007 interview).

Despite such challenges, the fact that the economic and security community are both integral parts of ASEAN points out that the association is willing to cooperate economically with third parties, but that the positive experience of cohesion and mutual respect since its foundation offers a considerable incentive for keeping the security structure in a globalized world, in which regional powers might still act in a realist manner. In this sense, the realist principle of “divide et impera” may be still implemented in various occasions, as it is the relative strength of one country in relation to another that matters to potential regional hegemons.

Comparison between EU and ASEAN

In this brief section, the patterns of European and Southeast Asian regionalism will be compared with regard to a few essential aspects. The focus will be merely shifted to those differences that are additional to the ones previously outlined throughout both chapters III and IV. Meanwhile, the key similarities will be summarized in the conclusion of the thesis, where an overall evaluation of the case studies and their relevance will be provided.

The first important difference between the EU and ASEAN deals with the distinct role that America played in Asia compared to Europe in the aftermath of the Second World War. In fact, American hegemonic power in Asia was relatively far greater than in Europe due to the weakness of these former European colonies, and US policy in Asia did not pursue the principle of multilateralism as it did in Europe. Because American diplomacy in the Pacific region has mainly been bilateral and not multilateral, this has made it far more complicated for Asian states for develop broad, interconnecting and institutionalized regional agreements (Eliassen and Borve Monsen, 2001 p. 125).

A second difference can be identified with the high political heterogeneity of the ASEAN region. While European countries are all democratic polities, there are more substantial differences as to the depth of democracy in Southeast Asian nations. This obviously may constitute a major barrier to the development of institutional economic cooperation. In addition, this heterogeneity is problematic, when it comes to formal economic cooperation, as it raises the transaction costs of institution-building (Eliassen and Borve Monsen, 2001 p. 126). As Waskito underlines, ASEAN is a rather loose organization compared to the EU (Waskito, 2007 interview). For this reason, many authors regard ASEAN more comparable to the EU of the 1970s than to today's EU.

A third relevant dissimilarity lies in the considerable economic disparity within ASEAN, which represents the single most important obstacle to formal economic cooperation. For instance, at the end of the 1990s, there was an enormous divergence in per capita income among member states ranging from about US$ 1,086 in Indonesia to US$ 20,400 in Brunei (Eliassen and Borve Monsen, 2001 p. 126).

The final noteworthy point is related to the cultural heterogeneity in the Pacific region, which also has the potential to increase transaction costs. In fact, within ASEAN there are six main religions – Buddhism, Taoism, Hinduism, Christianity, Islam, and Confucianism – while in the EU Christianity can definitely be considered as the major religion, as the least for the time being (Eliassen and Borve Monsen, 2001 p. 127).

In order to complement the analysis provided so far, this short section has served to shed light on additional variables that have affected or might influence the trend toward regionalism. An overall assessment will be delivered in the conclusion.

CONCLUSION

With regard to the future of regionalism there are three possibilities: weakening, stabilization, or strengthening. It is argued that basically all three variations are possible, but the least probable is definitely a weakening of regional integration, since this would have enormous costs of re-adaptation after having spent time and efforts at building solid and effective regional institutions. In this sense, a cost and benefit analysis would probably prove the choice of abandoning a regional bloc as ineffective and more costly. It is argued that institutions become more valued and relevant, as their duration increases.

On the contrary, as has been widely and deeply described within the thesis by the means of the case studies of the EU and ASEAN, the historical data on regional groupings shows a clear pattern and dynamics toward an enlargement and deepening of regional integration. It is maintained that the fact that weaker countries seek tighter regional cooperation as opposed to multilateralism is correlated to the destabilizing threats deriving from economic and financial globalization. Building on the successful stories of the EU and ASEAN that have signified many benefits for their members, the trend has already started spreading around the world generating an astonishing proliferation of regional agreements. In this context, regional organizations as a platform for smaller and more vulnerable states to increase their individual leverage need to be considered as full-fledged players interacting with global, regional hegemons in the international system.

With respect to the specific challenges of financial globalization and its inherent dangerous legacies, it is possible to experience the rise of regional currencies. This would also fit the assumption that economic power has gained great importance in international relations, as every actor in the international system attempts to increase its power in relation to its competitors. From a financial point of view, a world of international or regional currencies would be more stable and safer for capital mobility. Long-term interest rates would be expected to decline and become less volatile, thus making it easier for governments to cut budget deficits and promote growth. Moreover, this would eliminate currency and maturity mismatches by denominating debts in the same currency as a firm's cash flow. The risk of unfavorable devaluations leading to a payment crisis would be removed. It would also enable countries to take out long-term loans. Hence, there are many advantages accruing from regional monetary integration. As a matter of fact, the current system of over one hundred different currencies is unlikely to be stable or compatible with globalization. As emerging economies will follow the example of the EU, a scenario of fewer monies will necessarily foster the establishment of respective monetary institutions. As the IMF was created in a US Dollar-centric world, such system is unlikely to survive in its present form in a world dominated by regional currencies (Hausmann, 1999 pp. 76-78). As has been shown by the example of the AMF, there is evidence that such change is already occurring.

The combination of lower incidence of financial crises in emerging economies of weaker states and more stability within regional organizations resulting from the creation of regional currencies would definitely benefit the global economic system as a whole. For this reason, resistance to a regionalized monetary system will be abandoned sometime in the future (Dornbusch, 2001 p. 242).

In sum, the great complexity of the topic of the thesis has been tackled by applying a double-layered theoretical framework consisting of complementary parts to validate the main argument put forward here. The large amount and variety of data have enabled the analysis to raise its relevance and its explanatory strength.

In the first part of the thesis, its foundations, structure, modus operandi, and context have been defined and described by the means of a sufficient set of theoretical references and practical examples. On the other hand, in the second part, the focus of the research has been directed to the study of two case studies and future prospects of regionalism, while always drawing a connection line between the main argument and conceptual framework of the thesis, on one side, and the additional empirical information delivered by the case studies on the other. In particular, within chapter III and IV, an in-depth analysis of the rise of regionalism in Europe and Southeast Asia has been provided, which can be seen as representative cases of a general trend of international political change. They have been selected because of their high applicability with respect to the main purpose of the thesis. In each case, a number of sources have been studied and evaluated. These have encompassed a historical perspective on the causes and dynamics of regionalism; a closer examination of formal agreements and their objectives; an evaluation of economic indicators of regional integration illustrated by related charts; and finally, an assessment of the correlation between financial globalization and regionalism by the means of the emblematic effects of instability in the form of financial crises. Such comprehensive methodology has made it possible to gather sufficient empirical data to support the main hypothesis of the thesis.

Both the EU and ASEAN are to be considered as the most significant examples of the shift from the old wave of predominantly security-based regionalism to the new wave of mainly economy-oriented regionalism. After a difficult start, the respective leaders realized the relevance of common interests and regional interdependence. Both regional organizations have built upon their successful experience in the narrow sphere of security matters and have slowly expanded cooperation to other issue-areas, which confirms the value of the theory of international regimes adopted here.

During a period of substantial political, economic, and technological changes in the international political economic system in the 1980s and 1990s, both organizations made the critical decision to concentrate on regional integration rather than embrace a multilateral approach. It has been clearly demonstrated that the potential threats of financial instability originating from the advent of globalization and the higher global interconnectedness have been closely related to the deepening of political and economic regional integration in both cases of the EU and ASEAN. In this regard, the economic dimension of regional cooperation exemplified by intra-regional trade and closer economic and financial coordination is to be considered as the most significant aspect of power in the era of globalization. The positive, “regionalist” approach of these regional organizations to financial crises is a clear demonstration of the primary point of the thesis: financial instability as a phenomenon linked to regionalism interpreted as a mechanism to avert eventual risks and dangers for the countries’ economic power.

Within an environment that is characterized by financial instability and is still dominated by anarchy at the macro level, states that could not exert a considerable amount of influence on world affairs on an individual basis decide to unite their power into one single body in order to confront regional and global hegemons and attempt a systemic change for their benefit.

APPENDIX I

TARIFF AVERAGES, 1980s-1990s

The following table shows the substantial drop in tariff levels during the last two decades of the twentieth century. It indicates the general tendency toward more economic openness starting in the 1980s given critical political, economic, and technological changes.

A. Countries with the highest tariffs

1980s		1990s	
Bangladesh	94.5%	Pakistan	56.8%
India	91.0%	India	50.5%
Pakistan	72.2%	Bangladesh	39.8%
Burkina Faso	60.8%	Rwanda	38.4%
Sudan	53.6%	Cambodia	35.0%
Brazil	46.7%	Thailand	33.9%
Benin	42.8%	Sudan	33.5%
China	42.4%	Bahamas	32.0%
Egypt	41.6%	Egyp	31.4%
Suriname	40.0%	China	31.2%

B. Countries with the lowest tariffs

1980s		1990s	
Hong Kong	0.0%	Hong Kong	0.0%
Singapore	0.3%	Singapore	0.4%
Oman	2.6%	Estonia	1.9%
United Arab Em.	2.9%	Brunei	2.7%
Qatar	3.0%	Bahrain	3.5%
Kuwait	3.9%	Iceland	3.9%
Bahrain	4.4%	United Arab Em.	4.0%
Switzerland	4.4%	Switzerland	4.1%
Saudi Arabia	5.7%	Lithuania	4.6%
Norway	5.8%	Oman	4.7%

Source: Dollar and Kraay, 2004.

APPENDIX II

INWARD FDI STOCK RANKING, 1990-2002

This table consists of a comprehensive list of countries ranked by the amount of FDI stock that they receive from abroad. It shows the dominance of the North compared to the South.

		Value				Value				Value	
Rank	Economy	1990	2002	Rank	Economy	1990	2002	Rank	Economy	1990	2002
1	United States	395	1 351	65	Costa Rica	1.4	6	128	Guyana	-	1
2	United Kingdom	204	639	66	Bahrain	0.6	6	129	Saint Lucia	0.3	1
3	Germany	120	452	67	Croatia	0.0	6	130	Bosnia and Herzegovina	-	1
4	China	25	448	68	Algeria	1.4	6	131	Mauritius	0.2	1
5	Hong Kong, China	202	433	69	Brunei Darussalam	0.0	5	132	Aruba	0.1	1
6	France	87	401	70	Ukraine	0.0	5	133	Moldova, Republic of	-	1
7	Netherlands	69	315	71	Azerbaijan	0.0	5	134	Seychelles	0.2	1
8	Brazil	37	236	72	Slovenia	0.6	5	135	Armenia	-	1
9	Canada	113	221	73	Cyprus	1.1	5	136	Georgia	-	1
10	Spain	66	218	74	Jamaica	0.8	4	137	Mali	-	1
11	Belgium and Luxembourg	58	204	75	Estonia	0.0	4	138	Benin	0.2	1
12	Ireland	34	157	76	Guatemala	1.7	4	139	Swaziland	0.3	1
13	Mexico	22	154	77	Lithuania	0.0	4	140	Saint Kitts and Nevis	0.2	1
14	Australia	74	129	78	Bulgaria	0.1	4	141	Congo, Democratic Rep. of	0.5	1
15	Italy	58	126	79	Côte d'Ivoire	1.0	4	142	Togo	0.3	1
16	Singapore	30	124	80	Myanmar	-0.3	3	143	Antigua and Barbuda	0.3	1
17	Switzerland	34	118	81	Macau, China	2.7	3	144	Gibraltar	0.3	1
18	Sweden	13	110	82	Malta	0.5	3	145	Lao People's Democratic Rep.	-	1
19	Bermuda	14	78	83	Latvia	0.0	3	146	Lesotho	-	1
20	Argentina	9	77	84	Sri Lanka	0.7	3	147	Saint Vincent and the Grenadines	-	1
21	Denmark	9	72	85	Sudan	0.1	3	148	Niger	0.3	0.5
22	Japan	10	60	86	Zambia	1.0	3	149	Madagascar	0.1	0.4
23	Malaysia	10	57	87	Oman	1.7	3	150	Grenada	0.1	0.4
24	Indonesia	39	56	88	Iran, Islamic Republic of	2.0	3	151	Kyrgyzstan	-	0.4
25	South Africa	9	51	89	Qatar	0.1	3	152	Vanuatu	0.1	0.4
26	Chile	10	46	90	Liberia	2.6	2	153	Kuwait	-	0.4
27	Poland	0.1	45	91	El Salvador	0.2	2	154	Belize	0.1	0.4
28	Portugal	11	44	92	Jordan	0.6	2	155	Barbados	0.2	0.3
29	Korea, Republic of	5	44	93	Equatorial Guinea	0.0	2	156	Eritrea	-	0.3
30	Austria	10	43	94	United Republic of Tanzania	0.1	2	157	Mongolia	-	0.3
31	Czech Republic	1.4	38	95	Congo	0.6	2	158	Dominica	0.1	0.3
32	Finland	5	36	96	Syrian Arab Republic	0.4	2	159	Guinea	0.1	0.3
33	Taiwan Province of China	10	33	97	Papua New Guinea	1.6	2	160	Anguilla	-	0.3
34	Norway	12	33	98	Serbia and Montenegro	0.0	2	161	Gambia	0.2	0.3
35	Venezuela	2	32	99	Botswana	1.3	2	162	Rwanda	0.2	0.3
36	Thailand	8	30	100	Bahamas	0.6	2	163	Haiti	0.1	0.2
37	Cayman Islands	2	29	101	Honduras	0.4	2	164	Occupied Palestinian Territory	-	0.2
38	New Zealand	8	29	102	Uganda	0.0	2	165	Cape Verde	-	0.2
39	India	2	25	103	Mozambique	0.0	2	166	Burkina Faso	-	0.2
40	Saudi Arabia	23	26	104	Nicaragua	0.1	2	167	Malawi	0.2	0.2
41	Israel	4	25	105	Lebanon	0.1	2	168	Tajikistan	-	0.2
42	Hungary	0.6	24	106	Belarus	0.0	2	169	New Caledonia	0.1	0.1
43	Nigeria	8	23	107	Ghana	0.3	2	170	Maldives	-	0.1
44	Russian Federation	-	23	108	Chad	0.3	2	171	Nepal	-	0.1
45	Egypt	11	21	109	Cambodia	0.0	2	172	Mauritania	0.1	0.1
46	Colombia	4	19	110	Cameroon	1.0	1	173	Solomon Islands	0.1	0.1
47	Turkey	11	19	111	United Arab Emirates	0.8	1	174	Central African Republic	0.1	0.1
48	Viet Nam	0.3	17	112	Yemen	0.2	1	175	Montserrat	-	0.1
49	Kazakhstan	-	15	113	Uzbekistan	0.0	1	176	Cuba	-	0.1
50	Tunisia	8	14	114	Uruguay	1.0	1	177	Netherlands Antilles	0.4	0.1
51	Peru	1	13	115	Fiji	0.4	1	178	Samoa	-	0.1
52	Greece	6	12	116	Turkmenistan	0.0	1	179	Guinea-Bissau	-	-

Source: UNCTAD, World Investment Report 2003.

APPENDIX III

OUTWARD FDI STOCK RANKING, 1990-2002

The following table consists of a comprehensive list of countries ranked by the amount of FDI stock that they invest abroad. It shows the dominance of the North compared to the South in this regard.

		Value				Value				Value	
Rank	Economy	1990	2002	Rank	Economy	1990	2002	Rank	Economy	1990	2002
1	United States	431	1 501	64	Morocco	0.5	0.9	127	Nicaragua	-	-
2	United Kingdom	229	1 033	65	Cyprus	-	1	128	Netherlands Antilles	-	-
3	France	110	652	66	Peru	0.1	1	129	Guinea	-	-
4	Germany	148	578	67	Egypt	0.2	1	130	Cape Verde	-	-
5	Hong Kong, China	12	370	68	Côte d'Ivoire	-	1	131	Namibia	0.1	-
6	Netherlands	107	356	69	Papua New Guinea	-	1	132	Yemen	-	-
7	Japan	201	332	70	Estonia	-	1	133	Rwanda	-	-
8	Switzerland	66	298	71	Trinidad and Tobago	-	1	134	TFYR Macedonia	-	-
9	Canada	85	274	72	Pakistan	0.3	1	135	Haiti	-	-
10	Spain	16	216	73	Ethiopia	-	1	136	Madagascar	-	-
11	Italy	57	194	74	Ghana	-	0.5	137	Mauritania	-	-
12	Belgium and Luxembourg	41	181	75	Kazakhstan	-	0.5	138	Equatorial Guinea	-	-
13	Sweden	51	146	76	Algeria	0.2	0.5	139	Burundi	-	-
14	Australia	31	91	77	Lebanon	-	0.4	140	Cambodia	-	-
15	Denmark	7	75	78	Slovakia	-	0.4	141	Comoros	-	-
16	Singapore	8	71	79	Qatar	-	0.4	142	Tonga	-	-
17	Finland	11	69	80	Kenya	0.1	0.3	143	Grenada	-	-
18	Taiwan Province of China	13	60	81	Gabon	0.2	0.3	144	Mozambique	-	-
19	Brazil	42	53	82	Ecuador	-	0.3	145	Saint Vincent and the Grenadines	-	-
20	Korea, Republic of	2	43	83	Cameroon	0.1	0.3	146	Saint Lucia	-	-
21	Austria	4	40	84	Zimbabwe	0.1	0.2	147	Lesotho	-	-
22	Norway	11	38	85	Uganda	-	0.2	148	Solomon Islands	-	-
23	Ireland	12	36	86	Lao People"s Democratic Republ	-	0.2	149	Kiribati	-	-
24	China	2	36	87	Uruguay	0.2	0.2	150	Guyana	-	-
25	Portugal	1	32	88	Paraguay	0.1	0.2	151	Saint Kitts and Nevis	-	-
26	South Africa	15	29	89	Malta	-	0.2	152	Maldives	-	-
27	Virgin Islands	-	24	90	Brunei Darussalam	-	0.2	153	Myanmar	-	-
28	Malaysia	3	20	91	Swaziland	-	0.2	154	Mongolia	-	-
29	Cayman Islands	1	20	92	Seychelles	0.1	0.2	155	Dominica	-	-
30	Argentina	6	19	93	Costa Rica	-	0.2	156	Viet Nam	-	-
31	Russian Federation	-	18	94	Romania	0.1	0.2	157	Angola	-	-
32	Chile	0	13	95	Ukraine	-	0.2	158	Sudan	-	-
33	Mexico	5	12	96	Mali	-	0.1	159	Zambia	-	-
34	Israel	1	11	97	Senegal	-	0.1	160	United Republic of Tanzania	-	-
35	Panama	4	8	98	Niger	0.1	0.1	161	Congo	-	-
36	Bermuda	2	8	99	Macau, China	-	0.1	162	Syrian Arab Republic	-	-
37	New Zealand	6	8	100	Mauritius	-	0.1	163	Serbia and Montenegro	-	-
38	Greece	3	7	101	Bulgaria	-	0.1	164	Honduras	-	-
39	Venezuela	2	7	102	Togo	-	0.1	165	Uzbekistan	-	-
40	Iran, Islamic Republic of	-	5	103	Sri Lanka	-	0.1	166	Turkmenistan	-	-
41	Hungary	0.2	5	104	Dominican Republic	-	0.1	167	Korea, Democratic People's Repu	-	-
42	Nigeria	3	5	105	Albania	-	0.1	168	Georgia	-	-
43	Turkey	1	4	106	Chad	-	0.1	169	Congo, Democratic Republic of	-	-
44	Colombia	0.4	4	107	Latvia	-	0.1	170	Antigua and Barbuda	-	-
45	United Arab Emirates	0.1	3	108	Belize	-	0.1	171	Gibraltar	-	-
46	Thailand	0.4	3	109	Lithuania	-	0.1	172	Vanuatu	-	-
47	Indonesia	0.1	3	110	Benin	-	0.1	173	Eritrea	-	-
48	India	0.3	2	111	Armenia	-	0.1	174	Anguilla	-	-
49	Bahrain	1	2	112	Bangladesh	-	0.1	175	Occupied Palestinian Territory	-	-
50	Saudi Arabia	2	2	113	Gambia	-	-	176	Tajikistan	-	-
51	Kuwait	4	2	114	Kyrgyzstan	-	-	177	New Caledonia	-	-
52	Czech Republic	-	1	115	Barbados	-	-	178	Nepal	-	-
53	Libyan Arab Jamahiriya	1	1	116	Central African Republic	-	-	179	Montserrat	-	-
54	Bahamas	1	1	117	Bosnia and Herzegovina	-	-	180	Cuba	-	-
55	Philippines	0.2	1	118	El Salvador	0.1	-	181	Samoa	-	-
56	Liberia	0.5	1	119	Tunisia	-	-	182	Guinea-Bissau	-	-
57	Poland	0.1	1	120	Guatemala	-	-	183	Djibouti	-	-
58	Botswana	0.4	1	121	Bolivia	-	-	184	Sierra Leone	-	-
59	Iceland	0.1	1	122	Aruba	-	-	185	Afghanistan	-	-

Source: UNCTAD, World Investment Report 2003.

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