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Session 4: Regional co-operation and integration as a contribution to mastering globalization in the economic field

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1. An introduction to globalization

Globalisation as a phenomenon is not yet well understood. It is surrounded by myths and misconceptions, so I would like to start by presenting some facts and demystifying some assumptions.

A first myth is that globalization is an unprecedented phenomenon. The fact is that the share of international trade in world output is about the same today as it was a century ago. For example, in 1993, United States' imports were 10 % of its GDP, as compared to 8% in 1890. And at the end of the 19th century some other countries were indeed quite open economies: Great Britain for example exported some 40 percent of its GDP in the 1850s, even more than the corresponding share today[1]. These similarities extend to financial flows: indeed, in 1907 some 40% of British national saving was invested abroad, which is even more than the share today.[2]

A second myth is that globalization has made country borders irrelevant. It is true that the volume of cross-border trade and investment flows has increased substantially in recent decades. Still, when measured against the benchmark of national markets, international markets remain highly fragmented. For instance, it has been calculated that the volume of trade between two Canadian provinces is 20 times larger than trade between a province and an equidistant U.S. state across the border[3]. So, by all measures, claims about the demise of the nation-state definitely are an exaggeration.

A third myth is that globalization is gaining momentum in the absence of an adequate system of checks and balances. The paradox of markets is that they need strong institutions to thrive. To take another example from the past, Venice at the height of its wealth and power was in fact subject to a careful bureaucracy and it was the quality of its public institutions that made it the epicenter of international trade and finance of 17th century Europe. The same could be said of London in the 19th century and of New York in the second half of the 20th.[4]

Nevertheless, today the world is increasingly interdependent. Just one reason is the significance of international supply chains. In the past, international trade was dominated by commodities trade, whereas the present wave of globalization is based primarily on trade in manufactures, and especially, vertically specialized trade[5]. More specifically, the system of

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1 See "What Globalization?" by Paul Krugman. Available at: http://www.pkarchive.org/

2 Howard Davies: "How Should Financial Market Regulators Respond to the New Challenges of Global Economic Integration?" Available at: http://www.frbkc.org/publicat/sympos/2000/S00davi.pdf.

3 John McCallum, "National Borders Matter: Canada-U.S. Regional Trade Patterns," The American Economic Review, Vol. 85, No. 3. (Jun., 1995), pp. 615-623, quoted in Dani Rodrik: "Feasible globalization" NBER Working Papers, N. 9129.

4 Dani Rodrik, op.cit.

5 Please see: Nicholas Crafts "Globalization and Growth in the Twentieth Century" IMF Working Paper n. 44, pages 25 and following and Sergio L. Schmukler and Pablo Zoido-Lobatón: "Financial Globalization: Opportunities and Challenges for Developing Countries", Background paper for the

international trade now depends on the secure availability of spare parts and materials that are crucial to the completion of extremely complex manufacturing processes. Indeed, manufactured goods often contain parts from so many countries that it is not possible to attribute their origin to any one country.
For example, Skoda, as part of the Volkswagen automotive group, receives parts and components or services from more than 6,000 sources[6]. Indeed, according to the company's managers, "bringing suppliers up to their standards was the biggest wave of change in Skoda." VW has so far encouraged many of western suppliers to establish joint venture with Czech manufactures or to build green-field plants – and new component-makers are still arriving. This process ensured Skoda's modernization reached deep into the Czech economy and contributed to fostering relations between Eastern and Western Europe [7].

This brings an interesting corollary. Before the first World War, as trade was conducted largely as exchanges between raw materials and manufactured products, the ensuing consumers' and producers' surpluses were large. Today the bulk of trade is intra-industry and even intrafirm trade of strikingly similar manufactured products for which these surpluses are much smaller. In these circumstances, first of all the failure by any of the suppliers to comply with increasingly stringent standards can quickly make a transaction simply not economical. Secondly, the potential damage from the elimination of trade is far bigger, because it might be very difficult for the final producer to find a way to swiftly replace the supplier of the spare parts that he needs in order to complete the production process on schedule. [8]

2. The need for standards and security in trade relations

This brings me to emphasize two key aspects of trade relations: on the one hand the increasing importance of standards, and on the other the potential disruptions coming from the threats to security since the recent terrorist attacks in the United States and elsewhere.

It is clear from the facts presented thus far that - in an increasingly independent world – harmonized standards are essential for companies to be able to source internationally materials that are needed for their supply chain. When economic operators move away from their domestic markets to compete internationally, their success or failure often depends on how familiar they are with the regulations and standards in export markets. For instance, significant differences between national and international standards do not only shield local producers from foreign competition, they also make it more difficult for local companies to sell in foreign markets.

Where harmonization is not possible immediately, UNECE experience shows that Governments and national bodies should try to create a simple and transparent framework for adopting and applying their national technical regulations and standards and keep foreign companies informed on how to meet these requirements. Mutual confidence can be further increased by mutual recognition of conformity-assessment bodies in accordance with the requirements of an importing country. These international standardization activities are carried out by a large number of international organizations, both governmental and non-governmental, which vary widely in structure, procedures, and basis for participation, coordinating their activities in UNECE, which is one of the five regional commissions of the

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Policy Research Report of the World Bank on Globalization, Inequality and Poverty, available at http://www.worldbank.com/wbi/globalizationandmacro/schmuckler_zoido.pdf

[6] Vratislav Kulhanek, "The impact of Trade Facilitation on Global Supply Chains", in Carol Cosgrove-Sacks and Mario Apostolov (eds), *Trade Facilitation: The Challenges for Growth and Development*, United Nations, 2003.

[7] Financial Times, VW brings Skoda up to speed, 03/09/2002

[8] Paul Streeten: "Integration, Interdependence, and Globalization" in *Finance and Development*, June 2001, Volume 38, Number 2., http://www.imf.org/external/pubs/ft/fandd/2001/06/streeten.htm

United Nations. Given the fact that the UNECE Member States together account for two thirds of global trade, it follows that UNECE standards tend to become global in their effect.

As regards security, the recent terrorist events have created a new level of awareness of the potential dangers that may come from participation in international trade. The increased security controls that have become necessary in the present security environment have resulted in changes in supply chain management, leading also to an increase in regional trade.[9]

Both standards and security measures are – you will agree – expressions of national sovereignty. As I mentioned in the introduction, the importance of national borders cannot be downplayed. In fact, economic operators in order to function efficiently need a range of non-market institutions which help regulate, stabilize, and legitimate markets[10]. Mostly, these institutions are rooted at the level of the nation-state, while some others are multilateral and descend from obligations that countries take at the global level. However, and increasingly, a number of institutions are regional, the most notable example being the European Union.

3. Regional integration in the UNECE region

Regional integration may be a promising form of governance in areas where there is strong case for coordination and harmonization of national policies[11], especially to assist dealing with global trends. Integration within a regional context of countries at the same level of economic development and sharing a system of common values can shield companies from international competition while at the same time giving them a sufficiently big market that would allow them to reap gains from economies of scale and to attract foreign direct investment from firms that would not be attracted to countries with too small an internal market.

In the UNECE region, there have been a number of regional initiatives, which are important for at least two reasons. First, regional agreements are generally concluded between major trading partners and therefore have an immediate and significant impact on imports and exports. Second, regional commitments often go much further than those taken at the multilateral level. With regard to import tariffs, for instance, many of the preferential trade agreements actually require a complete dismantling of import tariffs; this is not the case in the WTO negotiations.

Let me now give you a brief overview of existing regional trade arrangements in the UNECE region. Over the last decade, a large number of preferential agreements have been formed among the countries of Central and Eastern Europe and the Commonwealth of Independent States.

Perhaps the most far-reaching initiative is the CEFTA free trade area, formed in 1992 by the Czech Republic and Slovakia, Hungary and Poland, and later joined by Slovenia, Bulgaria and Romania. Under the terms of this agreement, trade in industrial products was completely liberalized (with the exception of selected sensitive products) and trade in agricultural products was significantly liberalized. Five members of CEFTA (the Czech Republic, Hungary, Poland, Slovakia and Slovenia) announced at a CEFTA meeting in Ljubljana in

[9] Dawn Russell: "Attacks Affect Supply Chains and the Supply Chain Management Profession", *Newswise*, Penn State University Smeal College of Business Administration, available at http://www.newswise.com/articles/2001/9/SUPPLY.SCB.html
[10] See D. Rodrik, op.cit.
[11] M. N. Jovanovic, "Local vs. Global Location of Firms and Industries", *Journal of Economic Integration*, March 2003.

March 2003 that they would leave the free trade area, citing their future EU membership as the reason for their departure.

In the CIS region, nearly all countries have signed bilateral Free Trade Agreements (FTAs) with each other. However, not all of these agreements are implemented or enforced. The table below shows the existing bilateral agreements between CIS countries and those which are actually in force and operating.

Table 1: Bilateral FTAs between CIS countries

	Arm	Aze	Bel	Geo	Kaz	Kyr	Mol	Rus	Taj	Tur	Ukr	Uzb
Armenia				x		x	x	x	x		x	
Azerbaijan				x			x	x			x	
Belarus							x	x			x	
Georgia	x	x			x		x	x		x	x	x
Kazakhstan						x	x	x	x		x	
Kyrgyz Republic	x				x		x	x			x	x
Moldova	x	x	x	x	x	x		x		x	x	x
Russia	x	x	x	x	x	x	x		x	x	x	x
Tajikistan	x				x			x				
Turkmenistan				x			x	x			x	
Ukraine	x	x	x	x	x	x	x	x		x		
Uzbekistan				x		x	x	x				
	x		Signed									
	x		in force									

Source: TACIS, http://www.aris.ru/WIN_E/TACIS/TACIS_2001/b/4.html

It should be noted that even in the case of those FTAs that are actually in force, the number of products excluded from free trade is usually rather large, and many obstacles still hamper trade among signatory countries.

A number of plurilateral trade agreements have also been created and involve a subset of the countries of the region. Like the bilateral agreements, most of these agreements are more political in nature than economic. Some of the agreements that are in force among the countries of the CIS region are detailed in Table 2 below.

Most recently, in February 2003, Russia, Ukraine, Belarus and Kazakhstan announced their decision to create a "joint economic space" under which the four countries will take measures to coordinate their economic policies and legislative environments and liberalize trade and tariffs.

These regional initiatives have produced markedly different results. Clearly, many of these agreements were political – rather than economic or commercial – in nature. What's more, not all of these agreements are implemented or enforced. It should be noted that - even in the case of those FTAs that are actually in force - the number of products excluded from free trade is usually rather large, and many obstacles still hamper trade among signatory countries.

These difficulties are compounded by the fact that after the fall of the Soviet Union, trade among the countries of the region declined significantly due in part to the deliberate redirection of exports away from CIS markets to non-CIS markets. Sluggish intra-CIS trade was also a result of non-transparent and protectionist trade policies of CIS countries towards each other.

Table 2: Plurilateral agreements among CIS countries

Organisation	Date of Establishment	CIS states involved
GUUAM	1996	Georgia, Ukraine, Azerbaijan, Moldova, Uzbekistan
The Central Asian Economic Union (CAEU)	1995	Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan
Eurasian Economic Union	1995 - 2000	Russia, Kazakhstan, Belarus, Kyrgyz Republic and Tajikistan
Commonwealth of Independent States	1991	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Economic Union of the CIS	1994	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Agreement on the Common Agrarian Market	1998	Armenia, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Ukraine, Uzbekistan

Source: TACIS, http://www.aris.ru/WIN_E/TACIS/TACIS_2001/b/4.html

This experience contrasts with the successful integration of the EU, which was at the same time deepening the ties among its members and widening its zone of influence. After growing successfully from 6 to 15 members, the EU is now preparing for its biggest enlargement ever in terms of scope and diversity. The EU has approved the accession of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia for 1 May 2004. It is anticipated that Romania and Bulgaria will join the EU in 2007. The situation with Turkey will be reviewed at the end of 2004. Recently, Croatia submitted its application for the EU membership and some other countries, especially from the South Eastern European region will be eligible for membership when they fulfill the accession criteria. At the same time, the EU has developed its bilateral relations through Association Agreements with its Eastern European partners, Partnership and Co-operation Agreements (PCAs) with the CIS, and finally with its partners in South East Europe through Stabilisation and Association Agreements.

The implications of EU enlargement for those countries in the region who will, at least for the present, remain outside, depends to a large extent on whether they benefit from a trade creating effect or rather, suffer from trade diversion. The general view is that if enlargement boosts economic performance in the EU as a whole, and especially, if it increases the rate of economic growth in the acceding East European countries it will have a generally expansionary impact on imports from the non-acceding countries, and therefore on their levels of GDP. How large that impact will be, will depend on the strength of the boost to

European economic performance, the share of the non-acceding countries in total EU imports and on the ability of those countries to respond to the pattern of increased demand.

Overall the EU common external tariff is generally lower than the individual tariffs of the accession countries. To be specific, on average the tariffs of Estonia, Latvia and Lithuania will rise modestly but average tariff levels in Poland and Hungary (the two largest economies to join the EU in 2004) will be reduced significantly. In particular, tariffs on agricultural products will decline, in Hungary from 31 per cent and in Poland from 34 per cent both to 16.2 percent. However, regarding fisheries, the majority of accession countries will have to raise their market access tariffs on joining the EU, although both Poland and Hungary will have to reduce them. This could have a negative impact on some exporting countries.

In addition, existing bilateral preferential trade arrangements between acceding EU member states and non-acceding countries will have to be terminated. These include, for example, Ukrainian-Estonian, Ukrainian-Latvian, Ukrainian-Lithuania, and Hungarian-Yugoslav free trade agreements. EU enlargement will also disrupt cross-border trade in a number of cases, due to the introduction of the new EU visa regime, for example that between Poland and Ukraine, between the Kaliningrad province and Lithuania and Poland, between Belarus and Poland as well as that between Russia and Estonia, Latvia and Lithuania.

Meanwhile, negotiations are continuing between the EU and Russia regarding the Common European Economic Space (CEES), which could perhaps serve as a major instrument of further integration process within the European region aimed at supporting stability and long-term economic growth for the benefit of all countries in the region.

In order to focus attention on the opportunities that enlargement brings, UNECE has launched the "wider Europe" programme consisting of sectoral workshops, covering topics such as energy, trade, transport and environment. Each workshop intends to explore the future shape and direction of economic integration in the region in the next decade and provide an opportunity for member States, the business community, civil society and academic and research institutions to come together to look "beyond enlargement" and assess how economic cooperation could be strengthened in the enlarged Europe region for the mutual benefit of all stakeholders. The objective is to promote a better understanding of the positive contribution of the EU's enlargement for prosperity and stability in the region; of the prospect for cooperation in a wider Europe; and of the UNECE's evolving role in the region, as a potential bridge to ensure open communication and cooperation between all countries of the region.

4. Conclusions

I have presented briefly how globalization and regionalism have progressed – mutually reinforcing each other – in the UNECE region. Before I conclude, I would like to emphasise on the one hand the importance of coordinating among different on-going negotiations and on the other the contribution that globalization and regionalism have made to transition in Central and Eastern Europe.

First of all, it is essential to ensure that commitments taken at different levels were mutually supportive, coherent and non-contradictory. For example, if a group of countries decided to form a Customs Union with a Common External Tariffs (CET), this common tariff had to be compatible with the level of tariffs required by WTO for each member of the Customs Union. Another related problem are rules of origin requirements, which might not be compatible at the bilateral, regional and plurilateral levels.

Second, the challenge for many of the countries in the UNECE region was informing the business community of the engagements undertaken at the different negotiating tables.

Indeed, commercial and financial operators must be able to make use of these agreements if they are to become effective trade promotion instruments. This requires more dynamic interaction between the private and the public sectors in many of the emerging market economies in the UNECE region.

A third and perhaps more fundamental challenge resulting from the proliferation of trading agreements is capacity building to ensure that both negotiators and the business community are conversant with the issues under negotiation so that they can defend and promote their own interests. The simultaneous negotiation of different agreements has often meant that scarce human resources in the public service were spread even more thinly, sometimes preventing participating countries from securing their major interests.

Let me now make a final comment on how globalization and regionalism have pushed the transition process forward. It is important to emphasize that in Eastern Europe the transition to a market economy has happened while the external environment in which the region was working was completely transformed. This transformation – which culminated with the collapse of COMECON – had been in the making for a long time as trade was gradually reoriented from the East to the West.

This situation marked a dramatic change in the position of these countries in the world economy. From having been a relatively developed periphery of an under-developed centre (the Soviet Union), they suddenly came into the position of an under-developed periphery of a developed centre (the European Union). The former share of labour meant that Central and Eastern European countries were suppliers of technology and machinery to the Soviet Union in exchange for energy and raw materials, whereas the latter means exporting low-tech, labour-intensive mass products to Western Europe and importing technology and machinery[12].

This compelled the restructuring of national economies in their entirety within a very short period. Massive structural change of the last decade has led to a structure of manufacturing industry in most candidate countries that is quite close to European patterns. The countries which will join the EU in 2004 are now effectively integrated into the regional and global system of exchange.

This integration led to a flow of foreign direct investment from Western Europe to Central and Eastern Europe and especially to the candidate countries of which the restructuring of Skoda under Volkswagen management is an example. This contributed to providing the capital to finance the rapid and simultaneous changes over a broad front which affected property, production factors, financial markets, the legal framework and the structures for economic development, which were carried out by the public authorities in the various countries at their own speed and in their own way."[13]

The business sector – especially in low-income transition economies – is deeply affected by the rapid progress of globalisation and it is essential that economic operators are prepared to meet both the challenges posed by the new emerging market economies and the associated risks. Promoting linkages among enterprises, among East and West, especially through the harmonization of standards which effectively allows companies to work together, represent effective ways of diffusing skills, knowledge and technology.

[12] Dr Béla Galgóczi, "Social and economic cost of the EU enlargement from the point of view of the new member states", presentation for the "Workshop on Business and Investment in a wider Europe", UNECE, 2003.

[13] International Labour Organization, *The Role of Labour Inspection in Transition Economies*, Chapter 1, available at www.ilo.org/public/english/dialogue/govlab/admitra/papers/1998/labins/ch1.htm

Overall, the experience of the region suggests that regional integration has been a positive contribution to responding to the challenges of globalization and economic interdependence. Both OSCE and UNECE work together and independently to support regional integration and participation in the global system of exchange, in practical and concrete ways, for the benefit of their common Member States.

Thank you for your attention.

--Carol Cosgrove-Sacks

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