Economic Integration and institution-building: NAFTA and the EU

Presentation at the NAFTA-EU Workshop, El Colegio de Mexico, April 19, 2017

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The discourse of Globalization had its peak in the 1990’ies. A very broad concept¹, the notion of a “globalizing” world appealed to optimists and pessimists, the political Left and the political Right – but most analysts expected it to be an unstoppable force, the main feature of societal development for the foreseeable future. Lots of criticism was heaped upon the concept, but until recently, it was rarely questioned if the world might be moving towards less globalization instead of more. That, however, is happening in the second decade of the new millennium.

This paper is about regional integration, looking at it as a version of globalization. Those two processes have a lot in common: they are both about more trade and more communication across national borders – and the institutions and technologies that enable and are enabled by those flows. Globalization points toward a universal process, regionalization towards a regional one, but they rest on the same assumption: that the growth of cross-national trade and communication is or can be a source of economic growth, thus a possible way to improve living conditions for the people involved.²

In 1999, our volume on economic integration in NAFTA and the EU (Appendini and Bislev, eds., 1999) was published, looking at a constituent aspect of globalization: the development of institutions for economic and societal integration. Globalization is, to a large extent, about eliminating barriers to trade and communication, but that doesn’t mean that it only eliminates existing institutions. The development of new ones is necessary if those flows are to grow and develop – first, to enable the very activity; creating media, establishing standards, protecting participants against abuse, etc. Second, to soak up or accommodate the changes that emanate from increased volumes and ranges of international trade and communication: the dissemination of tools, gadgets, germs and ideas that disrupt individuals and communities and change societies all over.

¹ The “globalization” literature is enormous and definitions abound. In this paper, “globalization” refers to increasing international transport and communication, happening in a broad range of geographical and social spaces.
² Regional integration can be seen as limiting globalization and excluding non-participating countries from the benefits of integration. But it can also, at least in principle, enable negotiations towards more universal arrangements.
NAFTA and the EU were very much children of the globalizing wave. The North American Free Trade Area that came into being in 1994 was originally intended to be an American Free Trade Area that would harvest the benefits of the huge diversity of the American continent. Political and economic interests came in the way, and even the three-party NAFTA was a hard sell to populations and politicians wary of the effects of lowering protection. Preceding NAFTA, the European Union was established in 1993 on the basis of European integration schemes developing since 1955. It was built partly on the same neoliberal assumptions, strongly championed by the USA through the post-war cooperation on economic and industrial policy. It retained, however, also a second leg: the European tradition of industrial and social protection would be continued through active industrial policies, partially harmonized through the European Economic Community. The USA being hegemonic in North America, social and industrial policy was not allowed to be part of NAFTA’s agenda.

In Karl Polanyi’s The Great Transformation (1947), a clash between market-liberal policies (that he calls the establishment of a “market economy”) and the social foundations of a society is seen as the cause of the disastrous developments in Europe, 1914-1945. He criticizes the dominant economic philosophy, where “labor, land and money” are theorized as commodities in a market. To Polanyi, that is a mistake; they are societal preconditions for markets, institutions that support and enable the market mechanisms, and protect societies from the ravages of unfettered competition. In his analysis, the Gold Standard is the powerful politico-economic tool that forces societies to adapt their social and institutional reproduction to a global dynamic that does extensive damage to the fabric of society and exposes the institutions of democratic capitalism to a number of dangerous forces.

Inspired by Polanyi’s analysis – and the obvious, if superficial, parallels to things happening after the financial crisis from 2008 - we look at the institutional developments of the EU and NAFTA as a struggle between the forces that reproduce civil society (“labor”), the natural habitat (“land”) and the systems for exchange and distribution (“money”) – and the powerful neoliberal interventions of the two regional economic agreements. This paper is mostly about the EU, the comparison with NAFTA still needs to be developed.

**Institutions**

Institutions are the conditions that shape the possibilities for social action. And when social forces (movements, governments, politicians…) decide to shape or re-shape society, they need to build institutions that can embody the desired changes and direct the development towards intended goals.

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3 Social science has known several types of theories that assumed the existence of impersonal mechanisms, even “laws of nature”, that would decide on the path of development. Theories of market economics are perhaps the most prominent, and the contestation between radical liberalists (recommending the elimination of as many regulations,
The two integration schemes, NAFTA and the EU, aimed at affecting societal development through institutional change: NAFTA is explicitly about “free trade”, and would eliminate as many national trade regulations as possible: the EU, coming from the industrial cooperation of the EEC, ventured on a more liberal course, the “Single Market”, where national regulations would be eliminated. In the Union, however, cooperation would include science and technology. The main focus was to enhance efficiency and productivity, and in the EU’s vision, “free markets” were not sufficient to do that.

Institutions can thus be analyzed as the independent variable in an analysis of the trajectories of societal development in North America and Europe: if NAFTA does not attain its declared goals, or their side effects tend to overshadow the improvements achieved, one can look to the institutions that constitute NAFTA to see what it is that has been wrong or insufficient. Likewise, if the complicated institutional build-up of the EU fails in reaching the most explicit goals, one can ask what it is in the EU institutional structure that has failed.

Thinking like that, institutions become independent variables, and economic and social performance the dependent ones. This, of course, is too simplistic: economic and social developments very much affect the workings of institutions. The interplay between agency, institutions and objectives is complicated. The main thesis of this paper is that the liberalist ideologies that dictated economic and social regulations be eliminated, were a causal factor in the failure of integrating institutions. But it was of course not the only failure, and possibly not the deciding one. Instead, what one may be able to conclude, is that they had negative effects on the lives of people in North America and the EU, and should have been supplemented with advances in social protection and democratic procedures.

**NAFTA**

The unique challenge to NAFTA at the very inception was to embark on a trade agreement between extremely unequal partners – economically, socially and politically. The asymmetric structures of the three countries were hotly debated by future stakeholders and civil society, prior to the final agreement. There was no doubt that the US would be dominant, and Canadians feared for their welfare state, while Mexico feared the effects of the enormous economic powers of the US. In the US, fears of undercutting labor standards were broadly voiced. NAFTA added two extra agreements, right from the beginning - on the environment, NAAEC, and on labor, NAALC. While the NAAEC led to the establishing of committees to harmonize environmental protection, the NAALC, aiming at securing the rights of workers and unions, had very few effects. Apart from these two agreements, the notion of protecting existing national structures and institutions was aired by protesters and critics, but with little effect.

i.e. institutions, as possible) and institutional economists is still ongoing. Another example of non-institutional social science is Karl Marx and his most revolutionary followers; they believed that after a revolution, society would be led by spontaneous decision-making by an essential mass of “people”.

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Mexico was still a developing country; most economists would recommend some element of “infant industry” protection to be established, to allow time for the development of competitive industry. Even before NAFTA, Mexico was on the liberalizing road, eliminating a large part of its extensive complex of social and industrial protection measures: the ownership of land was vested in traditional communities, and there was a large sector of publically owned and controlled businesses. The immediate effect of liberalization as a consequence of NAFTA was not very large (Puyana, 2010), but the ambitions were high: The neoliberal ideology of the NAFTA agreement assumed that the very elimination of traditional institutions was not only necessary to enhance efficiency; it would automatically and immediately lead to the establishment of modern institutions, and a thriving market economy. Mexico had to make profound reforms of its fundamental institutions, such as articles of the Constitution which ruled property rights over land and natural resources, labor rights, and foreign investment. New institutional settings were created to implement policy changes in order to facilitate a full-fledged market economy. The inherited government institutions of the Mexican state were overtaken by the challenges that followed.

The expectation was for Mexico to be a major supplier of industrial and agricultural goods to the US; traditional trade theory has it that this will benefit both parties – Mexico increasing its exports, the US getting cheaper goods. And both happened, initially – although the effect was limited. However, the other side of such advantageous changes is often neglected: the dynamics of change that affects the social order and thereby alters its own preconditions. Mexico was achieving a permanent status as a supplier of cheap goods to the huge neighboring market. That meant an influx of investment and export income to Mexico, but it also affected sectors of the Mexican economy that were unable to compete with the powerful US companies. The maquiladoras attracted American (and other) capital, but the special conditions provided for investments there might lock the local economy in a situation where it played the role of providing cheap labor and industrial sites and not much else.

The low-cost situation created tension, but Mexico also initiated industries higher up in the value chain: high tech industries, car production and other sophisticated industries grew at a brisk rate (Puyana, 2010). A series of economic crises, however, put a stop to the positive development. One reason was that much of the supply of industrial goods and materials shifted to China as the new dominant supplier. The presumptions of NAFTA – that the massive liberalization of the Mexican institutional landscape would lead to growth and development – did not foresee the structural shifts that are endemic in any market economy. The growth of Chinese global engagement gradually choked off the growth impulse from US demand, as more and more industrial goods were sourced from China (Peters and Gallagher, 2013).

NAFTA did not support the Mexican government in its struggle to support the reproduction and development of social standards, natural environment and systems of exchange. Instead, a feeble
and unstable Mexican government fought and fights an uphill battle with societal problems that were and are intensified by globalization.

**EU**

The institutions of the **EEC** were, already from the beginning (1957), loaded with the difficult task of constant adaptation to industrial and social conditions. The EEC was not merely a free trade area – like the EFTA, established 1960 as an alternative for the less integration-minded - but a more ambitious agreement, where the huge industrial and social challenges emanating from the rebuilding of war-torn Central Europe, were addressed. It aimed at creating a customs union and common policies on agriculture, transport, trade and nuclear power. From the beginning, the implications for political issues related to national sovereignty were discussed, but the existence of such implications were taken for granted: in the original EEC treaty the words “working towards an ever closer union” were already included, meaning that arguments for more integration were automatically stronger than arguments for less.

The European “Economic Community” changed its name to “**European Union**” in 1993, when the Treaty of Maastricht was approved. It created the foundations for a more consistent philosophy of integration, an “Internal Market”. This was not only a neoliberal project of “freedom of movement for people, capital and commodities”. It also contained clauses for more political and social cooperation, in continuation of European traditions for welfare states and the social market economy.

Unlike NAFTA, that never managed to expand free trade to more American states, nor widened its areas of cooperation into labor issues as planned, the EU fulfilled its purpose of expanding cooperation, both in terms of new members and new policies. Those expansionary ambitions have been contested, of course: lots of interests are vested in any status quo regarding economic regulation. The next section details some of the trajectories leading to more integration – and towards the current crisis of the EU: the aggregation of contested issues has led to the current situation (2017), where most of the EU’s policies are viciously contested and the support for European integration, though broadly held and distributed, is retreating from the public eye.

The introduction of the Euro and the “Schengen” system (abolition of border controls) in 1999 strained the legitimacy of the EU, and both could only be agreed upon for a subset of member states. After that, the vast expansion of EU membership in 2004 (with additions in 2007 and 2013), raised even more doubts about the progress of integration, and the global finance crisis from 2008 put the cap on. The Greek Euro crisis from ca. 2012, the immigration debacle in 2014-15, and the UK exit referendum in 2016 epitomized the institutional crisis, but were somehow expected
and/or explainable: the Euro was established with the weakest of political superstructures, hardly enough to maintain a common currency in such a diverse group of countries. And the weakly founded migration policy broke down when migrations assumed a size never foreseen in EU deliberations. Perhaps more surprising was it when in 2016, Hungary and Poland openly questioned the liberal-democratic values that have been the cornerstone of the EEC and EU all the way through – from the Brussels Treaty through Maastricht and the Copenhagen Criteria, established in 1993-95 and confirmed in 2002 at the time of the big East European opening.

**The EU Institutions**

The decision mechanisms of the EEC and EU were always – and are still – quite complicated, and quite unlike anything familiar to political science. When Schmitter asked, in 1998, “How closely will it resemble the forms of political domination that we are used to dealing with, i.e. the national state and the intergovernmental organization?” he immediately answered that it will not end up being a “rerun” of familiar forms of political institutions (Schmitter, 1998). In the late nineties, it was evident that the growth of membership and functional coverage the EEC was undergoing, would lead to a growth in its bureaucracy and changes in the division of labor among the different parts of the decision mechanism. From the beginning, the Commission and the Court were the foremost actors in developing and deciding on EU policies, reflecting the thinking of the dominant figures in the establishment of the EEC: the involved diplomats, jurists and ministers (and the occasional Count) saw the professional deliberation in policy-making (Commission) and adjudication (Court) as the core processes in an institution with a clear purpose and a complicated task.

The tendency of institutions to lag behind the development of new challenges to the governance process may be a general one:

“Unless we assume that a political environment is stable, it is likely that the change in the environment will exceed the rate of adjustment to it....By constraining political change, institutional stability contributes to regime instability.” (March & Olsen, 1989).

In the case of the EEC / EU, this seems to fit the way EU institutions struggle to catch up with environmental challenges.

Over the years, the Parliament and especially the Council of Ministers have grown in importance, much beyond what anyone imagined in the nineties. The reason is not only the growth of coverage and complexity, but also the increasing range and impact of the “popular” side of politics – the media, the elections, the parties and movements. The business and government elites can
no longer decide policies based on economic and political goals that they define; the representations of popular opinion are persistently intervening in decision processes. One persisting problem is the double nature of a federation\textsuperscript{4} like the EU: the political process at member state level is intensely “popular”, with political parties, aggressive campaigns, intense media coverage, and regular and frequent elections at several levels. Parliaments either select governments or have the mandate to topple them. The political process at the Union level, on the other hand, is exclusive, with political quasi-parties that differ from the national ones and work together in pragmatic alliances, rare elections with low-key campaigns, and no direct influence from parliament on the Executive. In this way, the EU polity does not harvest legitimacy from the popular political process, and one result is that most populist movements in the EU have criticism of the EU as one of their key campaign issues. This has become a major problem now that populism seems to be on the rise\textsuperscript{5}.

In a similar fashion, the European Court does not work as a national Supreme Court – although it has succeeded in establishing itself as the uppermost court in the EU. Both the EU court and national Supreme Courts are founded on a constitution, legitimizing their existence and providing the fundamental clauses for the legal system. However, where Supreme Courts in nations acquire their body of precedents from the whole body of national jurisprudence, built through several layers of courts, the EU Court is mainly building its own precedents working from the “still closer union” and the “three freedoms” precepts. This creates an asymmetry in EU policy-making, where negative integration (abandoning regulations) nearly always wins, while positive integration (creating new laws and institutions) has a very hard time to get through. Negative integration can frequently be decided by the Court, while positive measures have to work their way through the heavy machinery of Commission, Council and Parliament.

As argued by Scharpf (2010), this emphasis on “negative” integration is a strong (neo)liberal stance, supporting the notion that free exchange of everything is fundamentally beneficial to society. This meant that many of the protections that citizens of EU nations enjoyed were scrapped, and new ones were rarely established. In welfare state debates, what is usually argued pro EU is gender equality and equal treatment of people of different ages. Both have a positive social effect, but typically, both are negative freedoms: the Court has managed to more or less outlaw gender discrimination and discrimination against the old and the young. Positive measures (new support mechanisms for the unemployed, industrial support for regions in crisis, etc.) are the

\textsuperscript{4} In EU parlance, the word “federation” has acquired a specific, contestable meaning: a sort of arrangement that impinges on national sovereignty and that only the most eager integrationists, the “federalists”, wish for. Here, the word is used to mean just an ambitious agreement of nations sharing power, cooperating in practically everything and bound together permanently, as the case is (or was – until Brexit).

\textsuperscript{5} “populism” is not easily defined, nor are the causes of the “populist wave” simple. The precise way of putting this development is that a break-up of traditional party structures and alignment gradually occurs in all Western nations after the ‘seventies, and that the new political parties have agendas that often go across the inherited divides of class and occupation. This coincides with the development of the Internet and the proliferation of communication channels that are making political issues more volatile and politics possibly more adversary, less prone to compromises.
responsibility of the other institutional elements – Commission, Parliament, Council – where things are much more difficult and veto points are numerous.

Along the way, the EU Court has decided that it must be above national courts in all issues touching upon EU regulations. This position is not directly prescribed in the treaties, but has been deducted by the Court itself as a logical implication of its role in the fulfilment of the goals of the EEC/EU (Slaughter e.a. 1998). This means that national governments cannot legislate to protect their domestic population, even if economic dynamics is harmful to them – the same regulations must apply to all EU citizens. This stance is logical in terms on integration, but felt by many governments (and citizens) as strongly limiting national autonomy.

These integrationist steps taken by the European Court are not unanimously accepted (Stone Sweet and Burnham, 2012), nor opposed. The EU institutions never initiated a serious discussion of the principles involved, not even when the EU “constitution”, the Maastricht Treaty, was deliberated. The balance between the EU center and the constituent states being in flux, things happened in 1999 that accelerated the integration and thus – because of the fluid situation - exacerbated the tensions: the common currency, the Euro, was established; and the Schengen agreement (free movement for people) became valid for the whole EU, systematizing the free movement of individuals. These two “freedoms” – for money and people – were institutionalized in The European Central Bank and the Europol. None of those, however, had the necessary power to manage their very heavy and wide-ranging responsibilities. Especially the freedom for capital was a burning issue, as the national Finance ministries, together with the large private banks, still controlled the main levers of the money supply. And both reforms were for only subsets of EU members – perhaps the first sign of a breakup of the assumed unity of purpose that the EU had been built on.

In none of those recent instances of crisis were the EU institutions sufficient to put out the fires and initiate the developments necessary to create a constructive climate in the decision processes. The wave of populist, media-driven politics that gradually engulfed the Western world, found ample material for contesting the “elites” and the “established order” in those open conflicts. As a recent volume on the EU after the latest financial crisis has it:

“The lack of domestic ownership, the misrepresentation of the benefits of reform, and the association with policies that deepened the crisis may erode public support for further reform....and for further European integration...” (Caselli, F. e.a. (eds.), 2016)

The authors of that volume see the outcome of a double project: an effort at structural, supply-side based, reforms (i.e., elimination of barriers to interchange) – and a widening and deepening of integration. The latter made the EU large and diverse, exacerbating the economic inequality of member nations. Comparing with the USA, analyses of household income distribution show larger inequalities in the US – but less inequality between US regions than between EU member states. In
the EU, poverty is concentrated in the South and the East, making member nations very different – while the national tax and spending systems are redistributive, making households of one nation less diverse (Caselli e.a., 2016). Thus, the tensions in the EU tend to be between nations and not so much between social classes.

The EU redistributive tax and expenditure systems are one set of institutions that to some extent compensate for the inequalities produced by the free markets. Redistribution, of course, is never perfect, and the last couple of decades have shown an increasing inequality between the rich and the poor (Piketty, 2014). And one serious weakness of social protection in the EU is that it isn’t one institution – but 27-28 different ones. While some redistribution exists in all EU countries, the form and extent of redistribution varies widely. And between member states, any step towards redistribution is countered by jealous national interest representatives. As the EU Court eliminates still more possibilities for discrimination against foreigners, “social migration”, where citizens of a country with weak social support trek to countries with more generous systems, becomes more of a reality, and the negative image of the Union in the wealthier countries intensifies.

The free trade among the EU countries, cemented with the “Inner Market” institutions of the early nineties, is another set of institutions to ensure and promote the benefits of the EU: the union-wide harmonization of technical standards, of trade agreements with the outside world, and of financial and legal standards, enables an extensive exchange of people, goods and services. That has a double function: the stimulus to economic growth following from the efficiencies gained by exchange; and the satisfaction of those people who wish to take part in the innovative economic and social developments by migrating to the more interesting places. Migration, however, can be an equalizing force if the poor are migrating to richer areas; or a diversifying force if the elites are flocking to meet the attractive locations where wealth and innovation are growing.

Comparing NAFTA and the EU, 2000-

This paper is an introduction to a project that will take a comparative look at the integration processes in North America and Europe. At the end of the last millennium, we were still looking at regional integration as a self-propelling process, driven by the ubiquitous forces of globalization. Now, almost two decades later, globalization has been questioned – not just by academics looking for a good fight on concepts and quotes (Hirst & Thompson, 1996), but also by powerful political forces promoting some form of Nationalism as the answer to the social and political issues of the

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6 A huge literature exists on this comparative European social policies issue. Leibfried and Pierson, eds., 1995, is one of the early and more encompassing treatments.
day. And in this situation, both NAFTA and the EU are seriously challenged, their strategic aims and economic policies disrupted by the anti-global, even anti-liberal forces.

We propose to develop the understanding of integration dynamics (from now on, including disintegration dynamics) by discussing some of the key processes on the integration agenda in both regions, seen from an institutional perspective. The last two decades have been a period of both important achievements, large failures and increasing tensions. Both regional integration projects were looking for progress in all three fields of economics, social affairs and politics:

- A primary goal of economic benefits was common to both, but viewed differently: Mexico and Southern and Eastern Europe expected to catch up with the wealthier North, while USA, Canada and most of Europe aimed at staying at the top through the gains from trade and cooperation. Europe feared it was losing out on the productivity race, and needed a boost of efficiency. The US needed a stable source of cheap raw materials, interim goods and labor. All participants got some of what it wished for, but none got all, and problems emerged along the way.

- Social progress was also a goal - for Europe, explicitly: social progress in the poorer regions was always an objective, and economic growth was as much an enabler as a cause of social progress. NAFTA took the radical path of ‘hard’ neo-liberalism: in the US, industries fled the high-cost areas in the North and went south in search of cheap inputs, without a safety for those left behind. In Mexico, the liberal reforms took away the traditional protection of workers, farmers and small industries, and social betterment was supposed to be an effect of economic growth; the needs for new institutions to secure the progress were largely ignored.

- Both arrangements also looked to progress in political processes: NAFTA had no explicit common political objectives, but for Mexico progress in stabilizing democracy was necessary to enable both economic and social progress. It did not work out well – the effects of social and economic disruption were felt almost from the beginning: the 1995 financial crisis, the persistence of poverty, migration and more recently, the violence of organized crime. In Europe, while economic growth was thought to immediately underpin democratic regimes including the marginal populations and regions in the European community, there was also a manifest declaration of intent to advance liberal democracy – the Copenhagen Principles. Recently, the new “populism” seeks to challenge the whole liberal construct.

These broadly formulated issues can be studied from numerous angles; a few broad examples:

1. Macro-economy: the economic impact of integration: trade, investment, GNP, etc., and the development of macro-economic institutions (national, federal, regional and global)
2. Industrial economy: structural shifts, competitiveness and concentration, regional integration of industries, worker displacement.
3. Social and political issues: migration, shifts in migration patterns, poverty, social and political security, political processes, governmental institutions.
4. Agriculture: structural change, policy, concentration and exclusion, enhanced inequality between producers and regions.
5. Global concerns: the roles of China and Russia, NATO, UN, WTO – in trade, in environmental issues, in political matters.

The present proposal aims at setting an agenda for the discussion of key subjects or themes in these areas, maintaining the institutional focus. The proposal follows up on a Conference organized by CBS in February 1997 (papers published in Appendini and Bislev, eds., *Economic Integration in NAFTA and the EU. Deficient Institutionality*. MacMillan/St.Martin’s Press, 1999). Twenty years later, the integration processes in both regions are facing economic and social uncertainty, and the necessity of developing an understanding of the process seems evident.

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