European Perspective on Market Integration: Lessons from NAFTA

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INTRODUCTION

This chapter is entitled a "European perspective." The particular perspective presented here is European in the sense that: a) it is generated by an incurably European author, one who has experienced policy analysis on both sides of the Atlantic but whose native wit and empathies lie, by both nature and nurture, with the eastern seaboard of the fluid divide; b) it is conditioned by an appreciation of circumstance (sociogeography) and context (political history) which is, perhaps, missing from some North American (especially the US) perceptions. However, it is definitely a rather than the European perspective. The author makes no claims to be archetypical or representative, still less descriptive, of European perspectives and positions on market integration, or of the policy implications and imperatives that are consequent on these positions.

Where did the European idea of a "common market" come from, and what is the notion of market integration that underlies and rationalizes this action? The immediate aftermath of World War II generated a major surge of international cooperation and restructuring (e.g., the World Bank, the IMF, the GATT) as world leaders tried to secure the peace and immunize international relations from the plague of major war. This surge of internationalism and supranationalism was, perhaps, strongest in continental Europe, emerging from the second catastrophic war in 50 years, and determined to prevent such tragedy from occurring ever again. "Already during the Second World War, the conviction was growing that nationalism was at the roots of the disaster which fascism had wrought in Europe and that, therefore, Europe should be rebuilt in a sphere of increased international integration, especially in economic terms" (Molle, p. 44). "In the aftermath of the Second World War, *rapprochement* between France and Germany was a priority for many Western European statesmen" (Tracy, p. 248). By 1951, the European Coal and Steel Community, with a supranational High Authority, had already been formed, ensuring equal access by all participants (the Six[1]) to these critical strategic resources. The European Economic Community (1958), later the European Union (EU), was a natural successor, very much born of political imperative and determination to integrate. Molle identifies six major steps towards full integration: Free Trade Area; Customs Union; Common Market (free movement of labor and capital); Economic Union; Monetary Union; Political Union. Following the disaster of the Second World War, the western European countries, led by the Six, made rapid progress towards Economic Union, albeit that the later steps – especially the common or single market and monetary union took longer to develop, while full economic and political union remains an aspiration for some, and anathema to others. There has been a continual and fundamental contest within the EU between those seeking genuine political union (especially the leaders, though not necessarily the electorates of France and Germany) and those content with intergovernmental cooperation (led by the UK). Perhaps the major brake on progress has been the lack of enthusiasm, most obviously by the UK, for supranational authorities and for political union.

The primary objective of the formation of the Common Agricultural Policy (CAP) of the EU has been to integrate agricultural and thus food markets. The Treaty of Rome which established the European Economic Community in 1958 required that "The Common Market shall extend to agriculture and trade in agricultural products" (Article 38) and that "The Community shall be based on a Customs Union" (Article 9), requiring the elimination of all barriers to trade between Member States (Ritson). The Single European Act of 1985 substantially refined the EU's pursuit of market integration, and defined the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."[2]

The principles on which the Single European Market (SEM) is founded are: non-discrimination (Article 12), which prohibits "any discrimination on the grounds of nationality" (subsequently extended by the European Court of Justice to include discrimination on many other grounds); mutual recognition, by which domestic legislation within one Member

[1] The original six were, France, Germany, Italy, Belgium, Luxembourg, and Netherlands. The UK declined to join, refusing to participate in a Community of supranational character.

[2] This section, including the following paragraphs, summarizes the outline provided by the European Commission (2001).

State is treated as equivalent to domestic legislation in other Member States. However, the principle of mutual recognition has not proved sufficient. Common directives (Community legislation) have therefore been adopted to harmonize national rules. Harmonization directives generally focus on the demands of health, safety and environmental protection, and also on common standards. Indeed, official assessment of progress towards a genuine SEM typically centers on the extent to which Member States have implemented the succession of common directives emanating from the European Commission.

The SEM is aimed at establishing four major freedoms of movement: for *goods*; for *services*; for *people*; for *capital*. Freedom of movement for goods has been directed towards eliminating all barriers to trade. The European Court of Justice has played a key role in this respect, compensating for the absence of any reference in the Treaties by providing definitions of obstacles to trade. In the case of charges having equivalent effects to customs duties, it considered any duty, whatever its name or procedure, which is imposed on imported products but not on similar national products as having the same restrictive effect on the free movement of goods as a customs duty, because it alters the price. As for measures having equivalent effect to quantitative restrictions, the Court defined these as any trade regulation in the Member States likely to hinder Community trade, directly or indirectly, actually or potentially. Finally, in the 1985 White Paper on the completion of the internal market, and the implementation date of 1992, the EU eliminated physical barriers (border checks and customs formalities) and began to tackle the constantly increasing number of technical barriers via the principle of mutual recognition of standards and Community harmonization.

European citizenship means that all citizens of the Union have the right to move and reside freely within the territory of the Member States.[3] The Treaty of Amsterdam marked an important step bringing the provisions of the Schengen agreement within the framework of the EU's institutions and in providing for the creation of an "area of freedom, security and justice" without checks on persons on the internal borders of the EU, whatever their nationality. Denmark and, to a certain extent, the UK and Ireland have, however, chosen not to participate fully in these new initiatives on the free movement of persons. The Court of Justice has interpreted this Article broadly and extended the principle of freedom of movement to persons seeking employment. However, several Member States are delaying the full implementation of these

[3] This is subject to the limitations and conditions laid down by the EC Treaty of 1986, and the provisions taken for its application. Freedom of movement for persons may be subject to certain restrictions if they are justified on grounds of public policy, public security and public health.

freedoms to the Central European countries, arguing that to do so threatens to disrupt local labor markets and, perhaps, make crime prevention more difficult.

Freedom of movement for services allows nationals or Community businesses to provide services in another Member State to the state of residence. The right of establishment includes the possibility for self-employed persons and Community businesses to set up and perform their activity in another Member State.[4] Certain sectors such as transport, banking, and insurance have been subject to substantial regulation in the Member States and the application of the freedom of movement for services has not been achieved simply through mutual recognition of standards, necessitating the development of Community legislation and directives.

Freedom of movement for capital prohibits all restrictions on capital movements (investments) and all restrictions on payments (payment for goods or services). Member States are, however, authorized to take any measure justified by the wish to prevent infringements of their own legislation, specifically relating to fiscal provisions or prudential supervision of financial institutions. Moreover, Member States may lay down procedures for declaring capital movements for administrative or statistical information purposes in addition to measures associated with public policy or public security. However, these measures and procedures must not be a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments. Since 1 January 1999, the Articles relating to safeguard clauses to remedy crises in the balance of payments (Articles 119 and 120 of the EC Treaty) are no longer applicable to those Member States having adopted the single currency. On the other hand, they remain applicable to the Member States that do not yet belong to the euro zone.

These paragraphs indicate the general background to market integration within the EU. The emphasis is strongly on harmonization – the explicit and proactive development of common policies and laws (and consequent surrender or derogation of national sovereignty), as opposed to mere convergence or compatibility (Josling). The strong pressure towards a *de facto* if not *de jure* political union is self-evident in this emphasis. From this perspective, the greatest obstacle to continued market integration is the insistence amongst many Member States (notably the UK) on retaining national sovereignty over important matters, such as monetary policy and fiscal measures.

[4] Once again, this provision excludes services linked to the civil service and stipulates that restrictions on the freedom to perform services can be justified on grounds of public policy, public security, and public health.

The short answer to the question implicit in the title of this paper is that Europeans do not consider that market integration is possible without policy integration, and that the latter is a prerequisite for the former. Clearly, from a North American perspective, there is room for debate over this view, since the North American Free Trade Area (NAFTA) is not predicated on policy harmonization and integration. A typical European response to a question of why North American markets are not better integrated would therefore be: they cannot be expected to be so until and unless the relevant policies are integrated. However, it should be clear that political integration (either as explicit intergovernmental cooperation or as political union) has been the major European motivation for economic integration, in distinct contrast to that apparent in NAFTA. Economic integration is seen in Europe as a necessary, but not sufficient condition for political stability, rather than as a desirable end in itself. Indeed, in Europe market integration often seems to be regarded as a necessary evil, rather than an attractive aspiration.

MARKET INTEGRATION IN AGRICULTURE

The presumption of the formation of the customs union was that a common policy would necessarily lead to the integration of markets, following the law of one price (Thompson, Sul, and Bol). The three principles of the Common Agricultural Policy (CAP) sought to ensure that agricultural, and thus also food markets would become integrated: free trade within the community; community preference (i.e., a common external tariff); and common financing (by which the European budget is responsible for all revenues and expenditures generated by the policy, ensuring that policies operate similarly in all Member States). There is an obvious contrast between this European approach and that currently adopted in NAFTA, stemming from the critical fact that the former is a customs union, while the latter remains a free trade area, so far, without any ambition towards common policies and a customs union.

The early days of the CAP focused on the development of the common policy instrument package (dominated by variable import levies and intervention purchases) and the setting of the common prices (target, intervention, and threshold prices). These were established, first for cereals, at the Stressa Conference in 1967, well before the more general notions of the SEM became defined. Since these common (administered) prices were set in a common currency unit, their effects in each of the Member States depended crucially on the ruling market exchange rates. The objective of market integration within the CAP was clearly exhibited in the response to these exchange rate effects – Monetary Compensatory Amounts (MCAs). MCAs were quite simply border taxes and subsidies (borne at the expense of the EU's common budget rather than national budgets) set so as to preserve the protection levels in Member States at previous exchange rates, and clearly impeding free trade and genuine market integration. Although these MCAs were supposed to be temporary, and to be adjusted towards (rather than away from) market exchange rate prices, they rapidly became a major source of contention among the Member States. The conflicts only resolved as the Member States converged on monetary union, first through their exchange rate mechanism (ERM).

Since then, much of the resilience of the CAP to sensible reform has stemmed from differences of opinion amongst the Member States about the appropriate level of support and protection to be afforded to the agricultural sector, with the strong political tendency to gravitate towards the highest common factor rather than the lowest common denominator.[5] The underlying pressures for protection of national markets and producer constituencies have been well evidenced by the responses to the BSE crisis in the UK. No doubt the immediate prevention of beef trade between the UK and the rest of the EU was justified on objective scientific grounds of prevention of disease spread. However, France, in particular, preserved this trade restriction beyond the justified limits, and was only prevented from continuing protection by an appeal to the Court of Justice.[6] Now that the CAP has moved substantially from border protection and market intervention towards direct payments to farmers (justified, if that is the word, on the grounds of multifunctionality, Harvey, 2003), one can expect that future conflicts over the CAP will tend to focus on the competitive advantages offered by Member States' differing interpretations and applications of the these payments. Perhaps it is in these future conflicts that the general notion of decoupling will be most thoroughly tested.

Has Market Integration Happened?

Despite the difficulties of actually demonstrating the practical exhibition of the law of one price (Thompson, Sul, and Bol; Sanjuan and Gil; Zanias), it is generally assumed that well developed and serviced markets will find their own levels of integration, recognizing the difficulties of commodity differentiation and the costs of marketing. Market integration raises a complex set of questions. Relevant policy analysis needs to take

[5] An analysis of these pressures during the early days of the CAP can be found in Harvey (1982).

[6] See, for example, *Agra-Europe*. "France Re-Opens Battle over UK Beef Exports." September 29, 1999, and *Agra-Europe*. "EU Judge Rejects French Ban on UK Beef." September 21, 2001. However, as argued in *Agra-Europe*. "European Court Ruling on British Beef to France Has Little Meaning." December 14, 2001, market conditions still prevented a resumption of the pre-BSE beef trade from the UK to France.

account not only of the rigor of the analytical base (both evidential and theoretical) but also of the practical issues of political salience and constituent interest, and (ultimately) the real phenomena of socioeconomic interaction and public amelioration and judgment. In the interests of brevity and clarity, these questions are here subdivided into: the (traditional) economic questions; the real (practical) questions; and the ultimate (fundamental) questions.

What are the economic questions?

The traditional economic questions raised by the phrase "market integration" are at once trivially simple and specifically complex. The principle of the "law of one price" underlies virtually all "pure" economic analysis – it is taken as the perfectly competitive benchmark. Most policy-related analysis assumes that markets will integrate perfectly – that is, exhibit the law of one price (Fackler and Goodwin), unless they are subject to imperfect competition. This "law" says that under competitive free trade, and ignoring details of transactions, marketing and transport costs, the price of the same good will be the same in different locations. It follows from the fact that markets operate by traders pursuing profit opportunities (buying cheap and selling dear) and *arbitrage* between different markets until there are no further profit opportunities. The purchasing power parity theory of long run exchange rate adjustments follows directly from this arbitrage activity pursued through foreign exchange markets as well as through product markets.

Furthermore, the theory of contestable markets (Baumol, Panzer, and Willig) shows that the social efficiency of markets[7] does not depend on "assumptions about how incumbent firms behave *vis-à-vis* one another, but from models in which such assumptions are largely irrelevant" (p. xxi). In effect, this theory is an elaboration of the arbitrage idea outlined above. If firms are making large profits, then we would expect others to enter the business and compete for these profits, contesting the market, and thus reducing profit margins by both reducing prices charged and the costs of delivering the product or service. It follows that much of the work on apparently oligopolistic market structures and trade relationships is also largely irrelevant to the question of whether or not particular markets are capable of or exhibit economic integration. Even when the market is sufficiently concentrated among a few large firms that each will need to recognize the effect of its marketing and pricing decisions on its competitors, the contestable state of the market implies that none of these firms can dominate in the sense of earning excess

[7] Social efficiency is taken here to mean simply that no one person can be made better off without making at least one other person (business) worse off, including the possibility (at least) of compensation of the losers while still leaving the winners better off.

profits (above those necessary to persuade investors and suppliers to remain in the business). Makowski and Ostroy analyze perfect competition in a rather different fashion, but reach essentially the same conclusions.

Li and Barrett make the important distinction between market integration and market equilibrium. They define market integration as “the influence of one market by another through the Walrasian transfer of excess demand” and note that “when two markets are integrated, supply and demand in one market affect the price and/or the transactions volume in the other” (p. 2). As they also note, this definition is closely related to the concepts of tradability and contestability (Baumol, Panzer, and Willig). Markets can be integrated while not necessarily being in competitive equilibrium, i.e., arbitrage profits or (equivalently) rents can persist in integrated markets. The classic example is the effect of a tariff, which collects rent on the trade flow, but does not (except in the case of a prohibitive tariff) prevent market integration. On the other hand, competitive equilibrium can occur in two markets that do not trade, because the costs of trade are not covered by the price differential between the markets. In this case, competitive equilibrium is not equivalent to market integration. Li and Barrett identify perfect integration as a special case in which markets are both integrated and in long run competitive equilibrium. As they point out, it is this special condition on which existing market integration literature focuses (Goldberg and Knetter). Li and Barrett conclude: “tests of the law of one price (LOP) are a test of the perfect integration hypothesis, not a test of (perhaps imperfect) integration or of (perhaps segmented) competitive equilibrium” (p. 3).

Segmented markets are the rule rather than the exception – products in different markets and different locations are seldom viewed as completely identical (homogeneous) as LOP requires. If consumers have different tastes and preferences for the products from one location over another, they will exhibit different demand characteristics for each product, and the market will be segmented, and will thus tend to exhibit different prices for apparently similar products. This situation is normal in most advanced consumer markets. It can be expected to be the case in many markets for intermediate products (most of the food chain), since the logistics and management of supply chains (the transactions costs and risks associated with alternate suppliers) is likely to give an advantage to one source over another, from habit, in the short-term, if nothing else.

[8] See, for example, *Agra-Europe*. “Higher Beef Prices Not Just Seasonal.” April 20, 2001.

As an example, it is frequently observed that Scottish beef markets tend to exhibit a persistent price premium over their English counterparts.[8] Given the similarity of other conditions surrounding these markets and the freedom of trade between the two provinces of the UK, this premium has to reflect a customer preference for Scottish as opposed to English beef. The premium is often enough to encourage live feeder cattle trade from England into Scotland for finishing. Similar market integration is observed in the live lamb trade between the UK and France, where French consumers (at the encouragement of the French marketing cooperatives) place a premium on French lamb (i.e., lamb slaughtered in French abattoirs). However, public antipathy towards long haul transport of live animals serves to limit this market integration, as protestors argue for restrictions on this transport, and occasionally manage to close the major channel ports to this traffic. Indeed, the natural forces of market integration can frustrate the ambitions of public pressure groups in favor of more benign and civilized production and marketing systems. A case in point is the animal welfare lobby in the UK, which lobbied successfully for more stringent and earlier application of animal welfare legislation for pig production in the UK than elsewhere in the EU. One consequence was that pig production in the UK declined substantially, while consumers were content to eat pigs raised in less welfare friendly conditions on the continent.[9] Nevertheless, in spite of apparent disadvantages implied by traditional analysis of market situations, enterprising traders often find ways of developing markets and displaying market integration in spite of the odds (e.g., UK farmers exporting mutton and lamb to the French market against apparently adverse price differentials and exchange rate disadvantage).[10]

In short, it can be argued that markets do naturally integrate, although attempts to demonstrate this proposition formally by econometric techniques are almost bound to be fraught with difficulty, not least incorporating the detailed contextual and circumstantial evidence necessary to properly test the market integration hypothesis. Academic exercises in demonstrating the proposition are almost equivalent to the yachtsman's "man overboard" drills – perfectly adequate for demonstration of boat handling (econometric) abilities, but of limited practicality for actually rescuing people (demonstrating the proposition). All that is required for markets to integrate is that there are no significant barriers to entry or costs of exit over and above the economic costs of transferring ownership of the business assets. Hence, even natural monopolies are subject to contestable markets and, given reasonably operating capital markets, subject to competitive pressures

[9] See, for example, *Agra-Europe*. "GB Herd Figures Raise Concern for Pig Farmers." January 29, 1999.

[10] See, *Agra-Europe*. "Changes in EU Sheep Trade Balance Emerging." July 14, 2000.

through the normal workings of the market place for capital. Since any remaining barriers to entry and exit are, I assert, universally the result of policy or social intervention of some form, market integration can be taken as given in the absence of policy intervention.

The fundamental basis for this assertion is the proposition that markets are the social analogues of the natural evolutionary system of the survival of the fittest – the blind pursuit of better fits with the social environments and political climates in which people and their businesses find themselves, and for which they are partly responsible. Markets are the mechanisms through which we all seek to find appropriate balances between earning a living (replication) and having a life (survival). They are the mechanisms through which our individual and private decisions and choices on these two fundamental human (animal) activities are reflected and negotiated between us to achieve a satisfactory compromise and balance between competing objectives and ambitions.[11] On this basis, markets evolve (develop and progress) so as to achieve better fits and balances, and, in so doing, naturally become more integrated – just as their natural ecological counterparts do. Hence, as an important corollary, perfect competition (in which the goods and services are treated as homogenous and indistinguishable) is not the climax condition of natural markets. Natural markets will develop as monopolistic competition, where businesses will differentiate their products according to the willingness to pay exhibited by particular and distinct market segments. The richer economies become, the more differentiated (and integrated) their markets are likely to be.

However, there is a key difference between natural and social evolution. Humans think they decide the better fits through their social institutions (North) – their rules, codes and practices which govern social acceptability. The criteria for survival and successful replication in social evolution are determined endogenously, rather than being exogenously predetermined by biophysical processes and laws, as is the case in natural evolution. The establishment of the social criteria through which we decide on the justice, equity, and sustainability of our market outcomes is through policy (government control) and social mores. These are necessarily outside though obviously related to our market interactions. Harvey (2004a) explores these ideas in more detail.

However, actually demonstrating this proposition in specific instances is likely to be extremely complex, for three major reasons. First, as already noted (Antle) markets will naturally tend towards product differentiation and heterogeneity, some of which will be spatially (regionally) specific. For example, it is plausible to suppose that Japanese

[11] Again, the analysis of perfect competition provided by Makowski and Ostroy is consistent with this interpretation of the competitive process.

rice consumers will be willing to pay a substantial premium for domestically produced rice even under conditions of perfectly free trade. If so, then removing the considerable import protection from the Japanese rice market cannot be expected to lead to Japanese rice prices equaling the border price. Second, transactions costs (Williamson) and search costs will affect the extent to which observed prices can be expected to satisfy LOP. Since direct observation of these costs is typically practically impossible, empirical demonstration of LOP will be difficult if not impossible.[12] Third, the real world does not exhibit equilibrium conditions, but is always (in terms of the analytical frameworks economists use) in the process of moving from one conceptual (or virtual) equilibrium (at which it has never been) towards another virtual equilibrium that it will never reach. For all these reasons, attempts to explore the extent of market integration, either by looking at trade volumes or by comparing spatially separated prices, are almost bound to be impossibly difficult, and hence subject to alternative interpretations and dispute.

Nevertheless, markets work, unless they are actively prevented from doing so. Active prevention is what policies are about, so complete market integration depends on policy integration. This is not to say that markets will not integrate without policy integration. They will. However, inconsistent or incompatible policies will inevitably generate pressures for change on both sides of the divide, partly through inequitable rents arising from different policies, and partly through the inevitable side effects of inconsistent policies. Wheat and barley wars within NAFTA, for example, are to be expected, so long as policies supporting these sectors differ on either side of the 49th parallel.

What are the real questions?

The real questions – those that exercise the political debate and the resulting constitutional and legal frameworks of actual policy – concern the popular and constituency concerns about social and economic integration, and the consequences of and for policy integration. These questions typically revolve around the extent to which opening up trade between previously disconnected (disintegrated) markets is likely to hurt indigenous producers and their labor forces, or help previously disadvantaged groups and sectors. This important question is addressed by Penn and Taylor et al. in their contributions to this book.

Europeans, especially, have found the more general issue of integrating economies (as opposed to specific markets) a topic of considerable interest and confusion, especially in relation to the current accession of the

[12] See Li and Barrett for an example of this.

Central European Countries (CECs). Tangermann and Banse, prefacing a volume on the integration of CEC agriculture with that of the EU, conclude that "overall, the message is that determined policy efforts are still required in both Central Europe and the EU, and in the accession negotiations to make eastward enlargement a success in the agricultural and food sector" (p. x). The European Commission, as the guardian of the European ideal of integration, has appropriated, if not coined, the term "cohesion" to articulate the aspiration that economic integration (including as a necessary precursor, market integration) should lead to reduced disparities between countries, regions, sectors, and groups, leading to or associated with more social inclusion and opportunities for self-expression and determination, and hence social (as well as political) progression. The European Commission's *Third Report on Economic and Social Cohesion* spends 166 pages dissecting and attempting to measure and analyze cohesion amongst the present members of the EU and highlighting the challenges facing the Union as it expands to Central Europe in May this year. Among its conclusions are:

> *The enlargement of the Union to 25 Member States, and subsequently to 27 or more, will present an unprecedented challenge for the competitiveness and internal cohesion of the Union. As illustrated in this report, enlargement will lead to the widening of the economic development gap, a geographical shift in the problem of disparities towards the east and a more difficult employment situation: socioeconomic disparities will double and the average GDP of the Union will decrease by 12.5%.*
>
> *At the same time, the whole of the Union faces challenges arising from a likely acceleration in economic restructuring as a result of globalization, trade opening, the technological revolution, the development of the knowledge economy and society, an ageing population and a growth in immigration (p. 20).*
>
> *This report has shown that disparities in output, productivity and access to jobs which persist between countries and regions stem from structural deficiencies in key factors of competitiveness – inadequate endowment of physical and human capital, a lack of innovative capacity and regional governance, and a low level of environmental capital. The cost of not pursuing a vigorous cohesion policy to promote growth and tackle disparities is therefore measured not only in terms of a loss of individual and collective well-being but also in economic terms, in a loss of potential real income and higher living standards. Given the interdependencies*

> *inherent in an integrated economy, these losses are not confined to the less competitive regions or to individuals who are not working or who are in unproductive jobs but affect everyone in the Union.*
>
> *Strengthening regional competitiveness through well-targeted investment throughout the Union and providing economic opportunities which help people fulfill their capabilities will thus underpin the growth potential of the EU economy as a whole to the common benefit of all. By securing a more balanced spread of economic activity across the Union, regional policy helps to reduce the pressures of over-concentration, congestion and bottlenecks (p. 21).*

It is beyond the bounds of this paper to examine these questions in detail. However, it is clear that the role of the agricultural and food sector in the development process is a major part of the real questions about market (and hence policy) integration as countries come together in trading blocs, and as world trade is liberalized. It is certainly a major question as far as Europeans are concerned, especially at the time of Central European expansion of the EU.

One question, especially, is of central relevance to both the EU and NAFTA – the question of the extent and type of support available for the disadvantaged agricultural sectors of the less developed regions of the trading bloc. Hungary, Poland and Mexico are all in very similar macroeconomic, social, and political conditions to those being experienced in Western Europe and North America when they developed their protective agricultural policies. As economies develop, so there is a necessary reduction in the proportion of total incomes that can be earned from agriculture, and a necessary reallocation of labor (especially) from agriculture to other occupations and activities. The market signals for this reallocation are that incomes fall in agriculture relative to elsewhere. These signals, when combined with democratic politics and socioeconomic concerns have always led in the past to support and protection being provided for the declining agricultural sector. It is difficult to believe that these sociopolitical pressures will be any different in economies seeking to make the same development progress now.

Poland, Hungary, and Mexico need some way of satisfying these pressures with respect to their substantial and politically powerful agricultural lobbies, and to be able to do so without draining limited tax funds. In other words, although the global pressures, evident in the drive towards market liberalization and integration, are heavily antagonistic to agricultural support and protection, domestic political pressures (and hence social stability) are strongly supportive of such policies. Meanwhile, the residues of past support within the developed regions of both Europe and America (especially the rent capitalization in the agrifood chain and for land and farm capital, as well as the bureaucracies associated with these support systems) are keen to preserve their supported status. Here is a very convincing recipe for continued farm support policies – well evident in both Europe and North America. [13]

In short, while policy harmonization and integration seem fundamental to market integration, the apparently rational economic response of policy elimination is far from being socially or politically acceptable. Developed regions will argue for multifunctional or resource preservation support, which will naturally be interpreted as continued support under different rhetorical rationales. Developing regions will similarly argue for continued, if not enhanced, support as development assistance (or amelioration). These rather different pressures should rationally lead to rather different policy responses. However, these differing responses do not lead to policy or market integration. Developing regions will press for explicitly agricultural support. Developed regions, on the other hand, will search for resource protection and support, though will be obliged to resist (or ameliorate) considerable pressures to maintain or compensate for historic levels of agricultural support and the rents they have generated. The outcome, within communities of both developed and developing regions committed to policy harmonization, may well be very substantial continuation of past support policies. In those cases (NAFTA) not so committed to policy harmonization, policy differentiation will persist and even intensify. Associated markets will integrate so far as they are able, but will continue to show less than perfect integration, leading to continual dispute.

What are the fundamental questions?

The fundamental questions arise from considering the ways in which societies and communities collectively determine the most appropriate mix and balance of freedom for individuals and private concerns to pursue their incomes and life-styles with community ambitions and aspirations for more security and coherence. Figure 3.1 illustrates the problem.

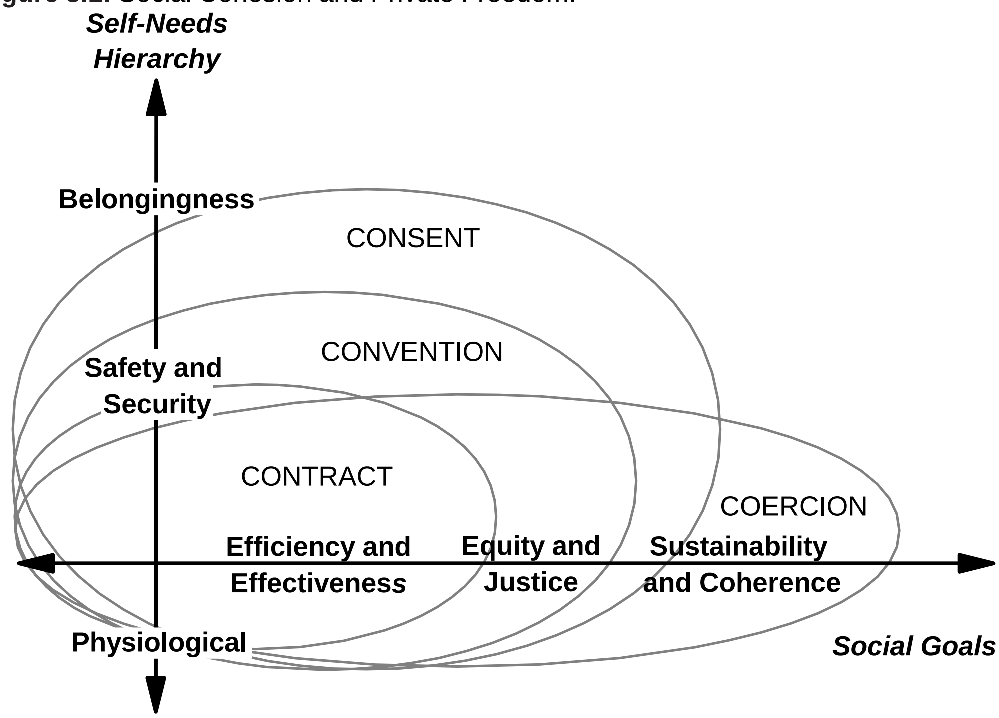
Here, private ambitions are characterized approximately on the vertical axis, while social or communal ambitions are characterized along the horizontal axis. Markets, as represented in traditional economics, are essentially founded on contract, and are well adapted to satisfy primitive or basic private and social needs, but are less able to meet the higher needs of equity and security, still less of belongingness or coherence. As

[13] Harvey (2004b) explores these arguments in more detail.

a consequence, societies evolve their own conventions and regulations (coercion) through their governments to seek to correct the "market failures", and policies and market interventions are the result. The long arm of the law is necessarily attached to Adam Smith's invisible hand. While the emergence of the democratic convention is supposed to provide popular legitimacy to these social adaptations of coercion, it is hard to believe that one cross on one piece of paper every four or five years is sufficient to provide genuine consent.

Hayami, for example, contrasts "community yoke", as the thesis that the free market will release peasants from their serfdom with the "evil market" antithesis that the market undermines the moral codes of the pre-market traditions on which the market is founded. His argument is that what he calls "village communities" rely on (community) consent as the set of pre-market social relations. It is consent of this form, according to this representation, which underlies the belongingness (and perhaps the cohesion) which such societies feel the western *common model* of free trade, common law, universal political franchise and democracy threatens to undermine. In a real sense, this can be seen as a different version of the Marxian antithesis that capitalism contains within it the seeds of its own destruction.

Figure 3.1: Social Cohesion and Private Freedom.

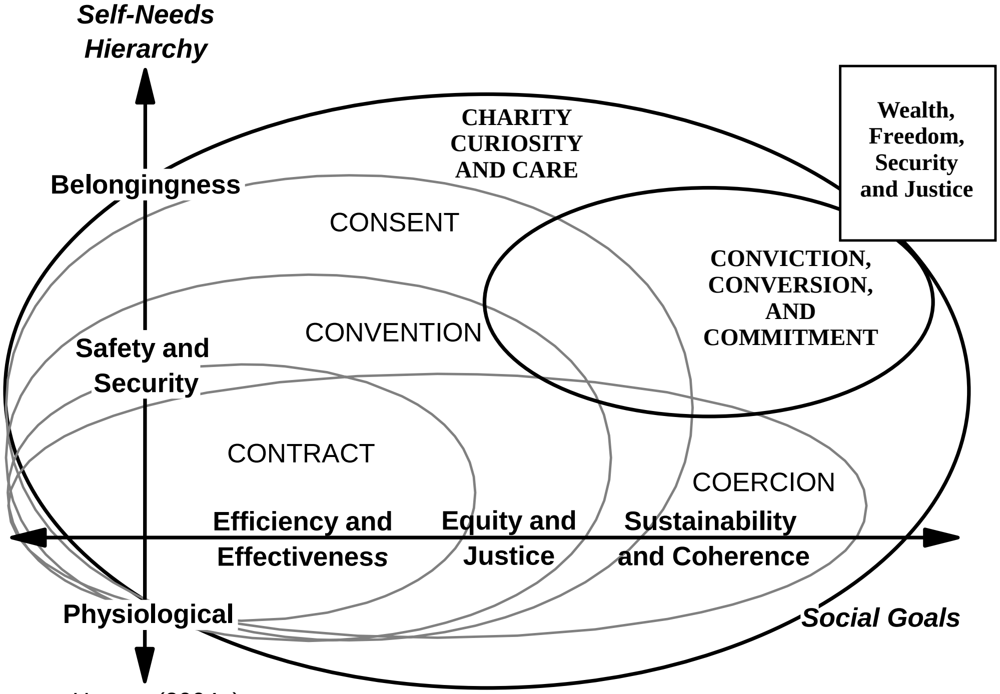


Source: Harvey (2004a).

Yet, following North, there are grounds for supposing that modern societies have yet to find and develop transactions and negotiations systems capable of fully harmonizing and integrating private ambitions with public aspirations. Our so-called common model is hardly up to the task. Of course, markets and societies are continuing to evolve. Business is taking increasing care to develop stakeholder involvement and commitment while governments are seeking 'third ways' (Giddens 1999, 2000). The fundamental questions, according to this outline argument, concern the identification of these missing transactions systems, and ways of encouraging and cultivating their development.

A conjecture of what the common model misses is illustrated in Figure 3.2. Harvey (2001) provides an outline explanation of why these particular transactions systems might be regarded as fundamental. Hofstede, on the basis of extensive empirical research, proposes that different cultures solve these fundamental social problems of harmonizing personal and social ambitions, with their associated attributions and transaction system mixes, in identifiably different ways. He detects five principal axes of cultural difference, where cultural differences can be measured according to the balance particular societies chose along these principal axes. The axes are: individual/collective, the major axis identified in Figures 3.1 and 3.2, and, as noted by Hofstede,

Figure 3.2: Conjecture of Transaction Systems and Private Versus Social Interests.



Source: Harvey (2004a).

"positioning itself between these poles is a very basic problem all societies face" (p. xx); uncertainty avoidance (the extent to which society tries to control the unknown and uncontrollable); power distance (the degree of inequality the society is prepared to accept and expect); male/female (the emotional dimension of society's accepted practices); and long term/short term (the extent to which society accepts delayed gratification of ambitions). The suggestion here is that these differences actually manifest through different framings and mixes of the basic social transaction systems.

CONCLUSIONS AND LESSONS FOR NAFTA

Given basic communications and transport connections, and reliable contract enforcement and exchange completion systems, markets will integrate and develop by themselves. However, the extent of their possible integration depends on interventions and regulations imposed by government policies. Hence, full market integration cannot be achieved without policy integration. But policy integration requires a consensus and commitment to social integration, which is unlikely without market integration. Changes, even improvements, in one part of this interactive system cannot be guaranteed to be sustainable, or even possible, still less optimal, without consideration of the forces and dynamics of the other parts. Markets are not independent of policy, while policy is not independent of either markets or the social systems within which policies are embedded and to which they respond.

The interactive, reflexive and recursive character of socioeconomic and political systems are complex. The nature of these systems means that any simple, unidirectional causality representation is partial, if not actually misleading. It is true that market integration is either prevented by or conditional on policy differentiation. However, the apparent implication that policy harmonization is therefore necessary for market integration should be treated with substantial caution. The simple economics of market integration and general equilibrium only make sense in the abstract, virtual world in which there are no politics, policies or society. Even then, the climax condition of a competitive economy is far more likely to involve extensive differentiation and segmentation, and thus major departures from the simplistic "Law of One Price." The richer economies become, the greater these departures will be.

In the real world, policies do exist, and not by accident but by design. Societies generate policies through their political systems in response to identifiable pressures and interactions, even if these are not always well understood. Policy harmonization and integration thus require social integration and coherence. The European idea is that this coherence can be encouraged through market integration and policy harmonization. The lesson of this idea for NAFTA is that policy harmonization is a necessary, if not sufficient step towards market integration.

However, this European idea is itself predicated on the assumption that the now traditional transactions systems [of contract, convention and coercion (with relatively minimal consent) – the western common model] are sufficient to generate social cohesion and commitment. There are strong intellectual grounds, backed up with (so far, casual) evidence, to believe that this assumption is also dangerously heroic. Economics' sister social sciences often concentrate on social interactions outside both formal government and economic exchange, and criticize economic ideas of rationality devoid of any human emotion, perception, attribution or aspiration. The behavioral assumptions on which conventional economics is constructed frequently miss important elements of human behavior, and are often contradicted by observation (especially in the areas of risk and uncertainty, and tradeoffs between the present and future). One way in which conventional economics might be able to relate to these critical omissions is through the concepts of transactions systems (and their associated costs and benefits). Pursuit of these ideas is both warranted and, according to these arguments, of high priority on both sides of the Atlantic. Without integration of the social sciences themselves, further investigation or pursuit of market integration seems likely to be both frustrated and frustrating. Meanwhile, the real world will continue its blind pursuit of better fits between private and public lives and livelihoods, and will generate such integration as this hunting and gathering, and associated adaptation, can achieve. If we wish to cultivate better societies than are possible through blind pursuit, then we all need to take much more care than is evident in the past in understanding what it is we are trying to do, and in understanding the natures and nurtures of the cultures we seek to cultivate.

No soybean grower, for example, would dream of trying to grow soybeans without the support of a sophisticated understanding of the needs and requirements of the soybean, and of the effects of competitors and pests on the crop. This is difficult enough. Cultivating markets and societies is even more difficult. Here, the "plants" not only mind and respond to what is done to them, they also care and reply, as do their competitors and pests – and generate new behaviors and responses as a result. Until or unless we can develop our social sciences to more fully understand these systemic interactions, and develop new ways of channeling and guiding them, we will continue to rely on happy accident and chance for the development of more genuine integration, both of markets and of the societies which underlie them.

There is little doubt that the current enlargement of the EU to include the Central European countries represents a major challenge. Although not the most substantial enlargement the Union has taken on, in proportional terms, the current enlargement involves a more substantial dispersion between the rich and the poorer members than previously. Some regard this enlargement as presenting a major opportunity for the Union to become more liberal and competitive (*The Economist*). Others, however, (perhaps especially some of the Western Member States) consider that the obvious economic and social divisions may prove too difficult to bridge without straining existing conventions and institutions beyond their fracture points. It remains to be seen whether the socioeconomic realities of modern mixed economies are capable of matching the laudable political imperative that, in common with the previous history of the Union, has driven this enlargement.

More prosaically, the lessons to be learned by NAFTA from the European experience are likely to be limited. As emphasized in the introduction, the fundamental motivation for integration in Europe has been, and continues to be political rather than strictly economic. Having, it is fervently to be hoped, learned the lessons of the two world wars on their own territories, Europeans are driven by the imperative of immunizing themselves against any repeat occurrence. Market and economic integration are necessary, but neither sufficient nor necessarily even locally desirable, steps in this immunization process. Conditions on the other side of the Atlantic are rather different, where economic integration is seen (from the perspective of this author at least) as being inherently desirable in and of itself. It would be surprising if these distinct and very different motivations led either naturally or socially optimally to the same sorts of institutions and organizations of markets.

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