


International Business
Global Edition

By Charles W.L. Hill
(adapted for LIUC2016 by R.Helg)

Copyright © 2013 by The McGraw-Hill Companies, Inc. All rights reserved.



Chapter 9

**Regional Economic
Integration**



Introduction

After the II WW there have been two major approaches to trade liberalization:

- The **multilateral-non discriminatory approach** (GATT-WTO)
- The **discriminatory approach** (Preferential or Regional Trade Agreements)

Notwithstanding their differences, these two approaches managed to cohabit well for a long period (GATT allows various exception to the non-discrimination principle).

Is this now finished?

8-33

What Is Regional Economic Integration?

- **Regional economic integration** - agreements between countries in a geographic region to reduce tariff and non-tariff barriers to the free flow of goods, services, and factors of production between each other
- **Question:** Do regional trade agreements promote free trade?
 - In theory, yes, but the world may be moving toward a situation in which a number of regional trade blocks compete against each other

9.4

What Are The Levels Of Regional Economic Integration?

1. A **free trade area** eliminates all barriers to the trade of goods and services among member countries
 - **European Free Trade Association (EFTA)** - Norway, Iceland, Liechtenstein, and Switzerland
 - **North American Free Trade Agreement (NAFTA)** - U.S., Canada, and Mexico
 - **ASEAN Free Trade Agreement (AFTA)** - between South East Asian countries

9.5

What Are The Levels Of Regional Economic Integration?

2. A **customs union** eliminates trade barriers between member countries and adopts a common external trade policy
 - **Andean Community Nations** (Bolivia, Colombia, Ecuador, and Peru)
3. A **common market** has no barriers to trade between member countries, a common external trade policy, and the free movement of the factors of production
 - **MERCOSUR** (Brazil, Argentina, Paraguay, Uruguay and Venezuela)

9.6

What Are The Levels Of Regional Economic Integration?

4. An economic union has the free flow of products and factors of production between members, a common external trade policy, a common currency, a harmonized tax rate, and a common monetary and fiscal policy
 - European Union (EU)
5. A political union involves a central political apparatus that coordinates the economic, social, and foreign policy of member states
 - the EU is headed (?) toward at least partial political union, and the U.S. is an example of even closer political union

9.7

What Are The Levels Of Regional Economic Integration?

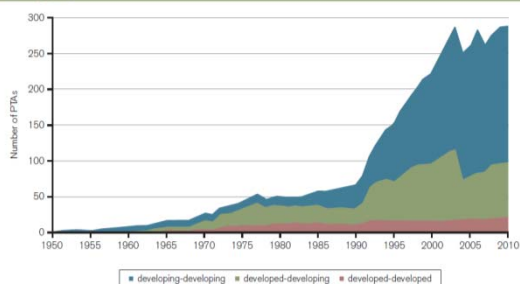
Levels of Economic Integration



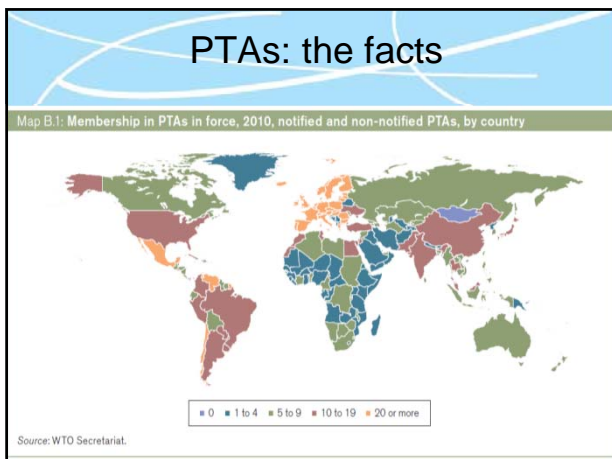
9.8

PTAs: the facts

Figure B.1: Cumulative number of PTAs in force, 1950-2010, notified and non-notified PTAs, by country group



Source: WTO Secretariat.



Why Should Countries Integrate Their Economies?

- All countries gain from free trade and investment
 - regional economic integration is an attempt to exploit the gains from free trade and investment
- Linking countries together, making them more dependent on each other
 - creates incentives for political cooperation and reduces the likelihood of violent conflict
 - gives countries greater political clout when dealing with other nations

9.11

What Limits Efforts At Integration?

- Economic integration can be difficult because
 - while a nation as a whole may benefit from a regional free trade agreement, certain groups may lose
 - it implies a loss of national sovereignty
- Regional economic integration is only beneficial if the amount of trade it creates exceeds the amount it diverts
 - **trade creation** occurs when low cost producers within the free trade area replace high cost domestic producers
 - **trade diversion** occurs when higher cost suppliers within the free trade area replace lower cost external suppliers

9.12

An overview of existing PTAs

- Before presenting existing agreements, let's present three new not in force mega deals: :
- - **TPP**: Trans-Pacific Partnership: at the moment the negotiations involve 12 countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States and Vietnam). Already signed, but not yet in force.
- - **TTIP**: Transatlantic Trade and Investment Partnership. Between the US and the EU. Not yet signed.
- - **RCEP**: Regional Comprehensive Economic Partnership. FTA between the 10 ASEAN countries and the six countries with which Asean has an existing FTA (Australia, China, India, Japan, South Korea and New Zealand). Not yet signed.

9.13

An overview of existing PTAs

- These new possible free trade areas requires an economic integration among member countries which is deeper than the one characteristic of old FTA.
- Typically, negotiations in these cases try to reduce also behind-the-border non-tariff barriers

9.14

What Is The Status Of Regional Economic Integration In Europe?

- Europe has two trade blocs
- 1. The **European Union (EU)** with 28 members (waiting for Brexit....)
- 2. The **European Free Trade Area (EFTA)** with 4 members

9.15



What Is The European Union?

- The devastation of two world wars on Western Europe prompted the formation of the EU
 - Members wanted lasting peace and to hold their own on the world's political and economic stage
- Forerunner was the European Coal and Steel Community (1951)
- The European Economic Community (1957) was formed at the **Treaty of Rome** with the goal of becoming a common market

9-17

What Is The European Union?

- The **Single European Act (1987)**
 - committed the EC countries to work toward establishment of a single market by December 31, 1992
 - was born out of frustration among EC members that the community was not living up to its promise
 - provided the impetus for the restructuring of substantial sections of European industry allowing for faster economic growth than would otherwise have been the case

9-18

What Is The Political Structure Of The European Union?

- The main institutions in the EU include:
 1. The **European Council** - the ultimate controlling authority within the EU
 2. The **European Commission** - responsible for proposing EU legislation, implementing it, and monitoring compliance with EU laws by member states
 3. The **European Parliament** - debates legislation proposed by the commission and forwarded to it by the council
 4. The **Court of Justice** - the supreme appeals court for EU law

9.19

What Is The Euro?

- The **Maastricht Treaty** committed the EU to adopt a single currency
 - created the second largest currency zone in the world after that of the U.S. dollar
 - used by 19 of the 28 member states
 - Britain, Denmark and Sweden opted out
- since its establishment January 1, 1999, the euro has had a volatile trading history with the U.S. dollar

9.20

Is The Euro A Good Thing?

- **Benefits of the euro**
 - savings from having to handle one currency, rather than many
 - it is easier to compare prices across Europe, so firms are forced to be more competitive
 - gives a strong boost to the development of highly liquid pan-European capital market
 - increases the range of investment options open both to individuals and institutions
- **Costs of the euro**
 - loss of control over national monetary policy
 - EU is not an **optimal currency area**

9.21

Should The EU Continue To Expand?

- Many countries have applied for EU membership
- Ten countries joined in 2004 expanding the EU to 25 states
- In 2007, Bulgaria and Romania joined bringing membership to 27 countries
- In 2012 Croatia joined
- Turkey has been denied full membership because of concerns over human rights

9.22

EU has signed many free trade agreements.

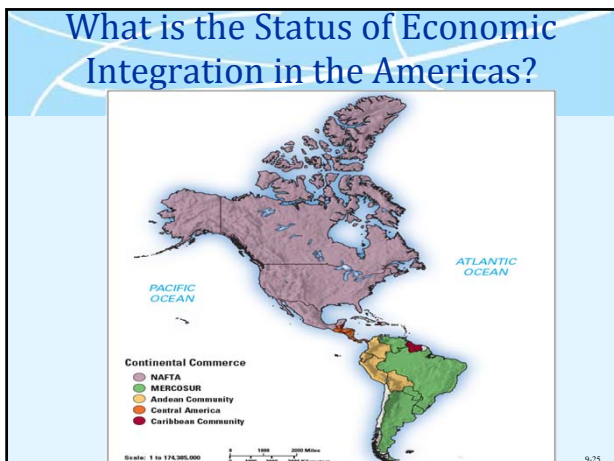
At the moment EU is negotiating with the US a free trade agreement: the Transatlantic Trade and Investment Partnership (TTIP)

9.23

What Is The Status Of Economic Integration In The Americas?

- There is a move toward greater regional economic integration in the Americas
- The biggest effort is the North American Free Trade Area (NAFTA)
- Other efforts include the Andean Community and MERCOSUR
- A hemisphere-wide Free Trade of the Americas is under discussion

9.24







Is The North American Free Trade Area Beneficial?

- Critics of NAFTA claimed that
 - jobs would be lost and wage levels would decline in the U.S. and Canada
 - pollution would increase due to Mexico's more lax standards
 - Mexico would lose its sovereignty

9.28

Who Was Right?

- Research indicates that NAFTA's early impact was subtle, and both advocates and detractors may have been guilty of exaggeration
- NAFTA is credited with helping create increased political stability in Mexico
- Other Latin American countries would like to join NAFTA

9.29

What Is The Andean Community?

- The Andean Pact
 - formed in 1969 using the EU model
 - had more or less failed by the mid-1980s
 - was re-launched in 1990, and now operates as a customs union
 - renamed the **Andean Community** in 1997
 - signed an agreement in 2003 with MERCOSUR to restart negotiations towards the creation of a free trade area

9.30

What Is MERCOSUR?

- **MERCOSUR**
 - originated in 1988 as a free trade pact between Brazil and Argentina
 - was expanded in 1990 to include Paraguay and Uruguay and in 2005 with the addition of Venezuela
 - may be diverting trade rather than creating trade, and local firms are investing in industries that are not competitive on a worldwide basis
 - initially made progress on reducing trade barriers between member states, but more recently efforts have stalled

9.31

What Is The Central American Trade Agreement And CARICOM?

- There are two other trade pacts in the Americas
 - the **Central American Trade Agreement** –(CAFTA, 2005) - to lower trade barriers between the U.S. and members
 - **CARICOM** (1973) - to establish a customs union
- Neither pact has achieved its goals yet
- In 2006, six CARICOM members formed the **Caribbean Single Market and Economy (CSME)** - to lower trade barriers and harmonize macro-economic and monetary policy between members

9.32

What Is Free Trade Of The Americas?

- Talks began in April 1998 to establish a **Free Trade of The Americas (FTAA)** by 2005
- The FTAA was not established and now support from the U.S. and Brazil is mixed
 - the U.S. wants stricter enforcement of intellectual property rights
 - Brazil and Argentina want the U.S. to eliminate agricultural subsidies and tariffs
- If the FTAA is established, it will have major implications for cross-border trade and investment flows within the hemisphere
 - would create a free trade area of 850 million people who accounted for nearly \$18 trillion in GDP in 2008

9.33

What Is The Status Of Economic Integration In Asia?

- Various efforts at integration have been attempted in Asia, but most exist in name only
 - Association of Southeast Asian Nations (ASEAN)
 - Asia-Pacific Economic Cooperation (APEC)

9-31

What Is The Association Of Southeast Asian Nations?

- The Association of Southeast Asian Nations (ASEAN, 1967)
 - currently includes Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, Myanmar, Laos, and Cambodia
 - wants to foster freer trade between member countries and to achieve some cooperation in their industrial policies
- An ASEAN Free Trade Area (AFTA) between the six original members of ASEAN came into effect in 2003
 - In January 2010, ASEAN and China signed an FTA to create ACFTA a free trade area of 1,9 billion people

9-33

What Is The Association Of Southeast Asian Nations?



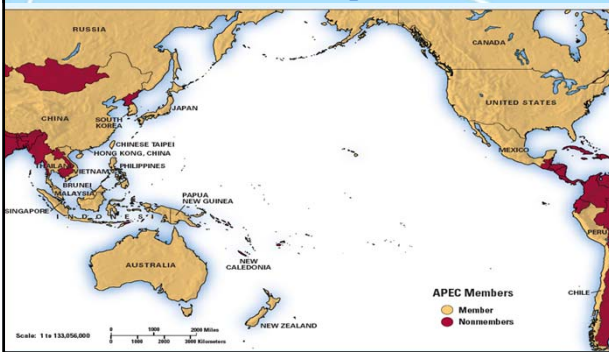
9-35

What Is The Asia-Pacific Economic Cooperation?

- The Asia-Pacific Economic Cooperation (APEC)
 - has 21 members including the United States, Japan, and China
 - wants to increase multilateral cooperation
 - member states account for 55% of world's GNP, and 49% of world trade

9.37

What Is The Asia-Pacific Economic Cooperation?



TPP: already signed, but not yet in force



9.39

RCEP

(Regional Comprehensive Economic Partnership): not yet signed

It is a proposed FTA between the 10 ASEAN countries and the six countries with which Asean has an existing FTA (Australia, China, India, Japan, South Korea and New Zealand)

9-40

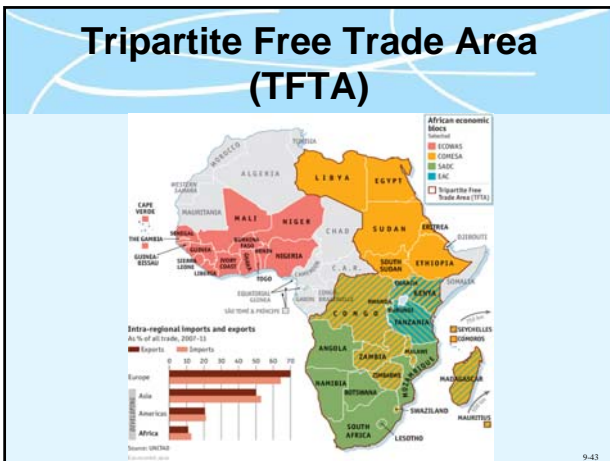
TPP and RCEP are overlapping

9-41

What Is The Status Of Economic Integration In Africa?

- Many countries are members of more than one of the 17 agreements in the region
 - but, since many countries support the use of trade barriers to protect their economies from foreign competition, meaningful progress is slow
- The **East African Community (EAC)** was re-launched in 2001, however so far, the effort appears futile
- It is a more recent creature the TFTA (Tripartite Free Trade Area), which is a free trade area among 3 already existing agreements: COMESA, SADC and EAC: It has not yet being signed by all countries

9-42



What Does Economic Integration Mean For Managers?

- Regional economic integration
 - opens new markets
 - allows firms to realize cost economies by centralizing production in those locations where the mix of factor costs and skills is optimal
- But
 - within each grouping, the business environment becomes competitive
 - there is a risk of being shut out of the single market by the creation of a "trade fortress"
