

INTERNATIONAL BUSINESS ENVIRONMENT (Political Economy of International Business)

Session 4
Regional Trade Blocs



Today's questions

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1. What is a regional trade bloc?
2. What are the various types of regional trade blocs?
3. What are the pros and cons of trade blocs? What are their business implications?
4. What makes the European Union unique among trade blocs?



Section 1

REGIONAL TRADE BLOCS: GENERAL ISSUES

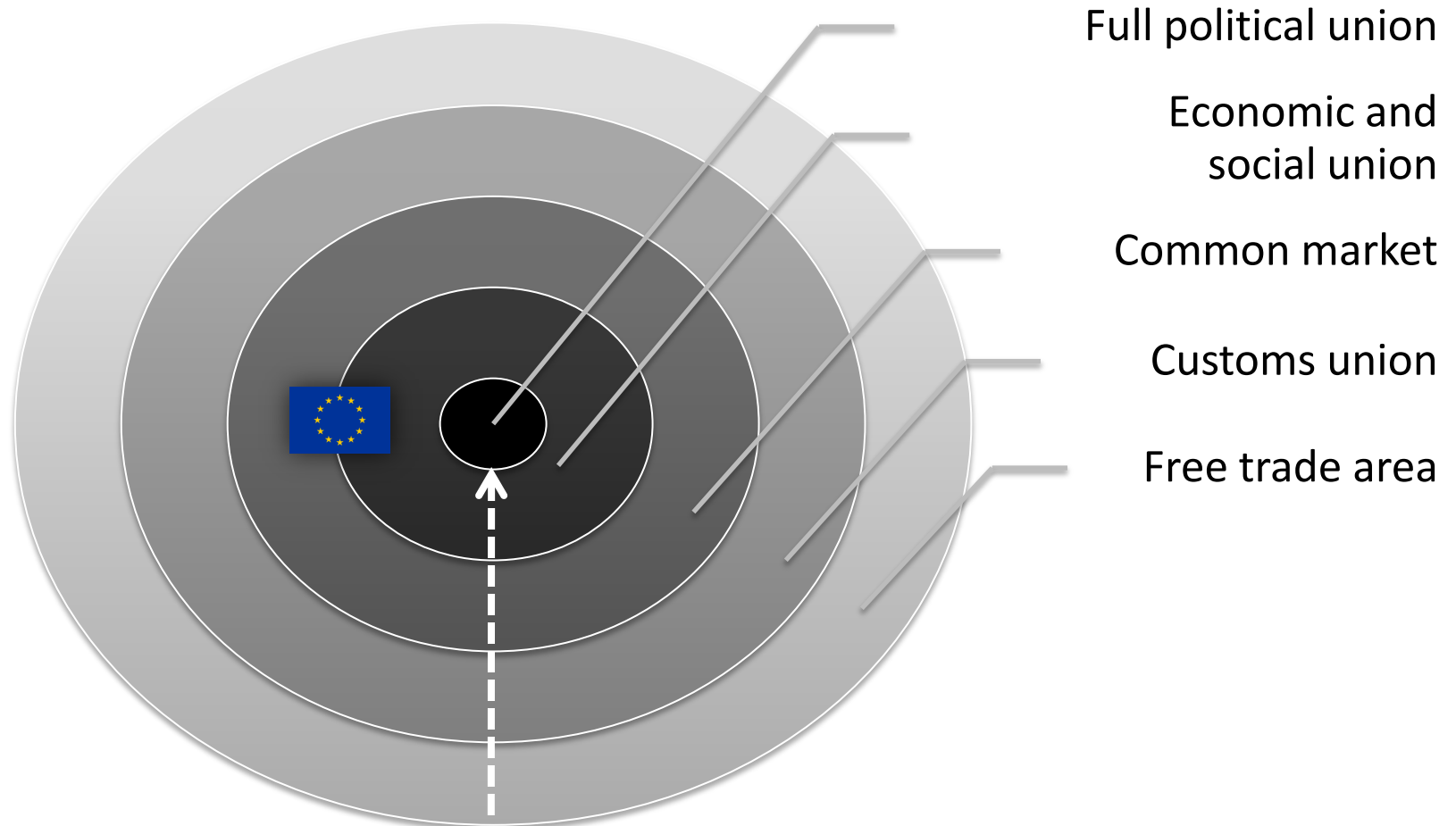
Regional trade blocs: definition

- A trading bloc is defined by four characteristics:
 1. It participates in a special trade relationship established by a formal agreement that promotes and facilitates trade within that group of countries in preference to trade with outside nations by discriminating against nonmembers
 2. It has attained or has as a stated goal the deepening of trade liberalization or integration with the objective of establishing a free trade area, customs union, or common market
 3. It strives to reach common positions in negotiations with third countries, with other trade blocs, or in multilateral forums
 4. It attempts to coordinate national economic policies to minimize disruption to intra-bloc economic transactions

<http://www.stanford.edu/class/e297b/Progress%20of%20the%20European%20Union.htm>

Regional integration stages

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Main regional blocs: the EFTA



- The European Free Trade Association (EFTA) was founded in 1961 by Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK to promote of free trade and economic integration
- It is currently made up of Iceland, Norway, Switzerland and Liechtenstein
- The Agreement on the European Economic Area (EEA), which entered into force on 1 January 1994, brings together the 27 EU Members and 3 EFTA countries* — Iceland, Liechtenstein and Norway — in a single internal market, referred to as the "Internal Market"

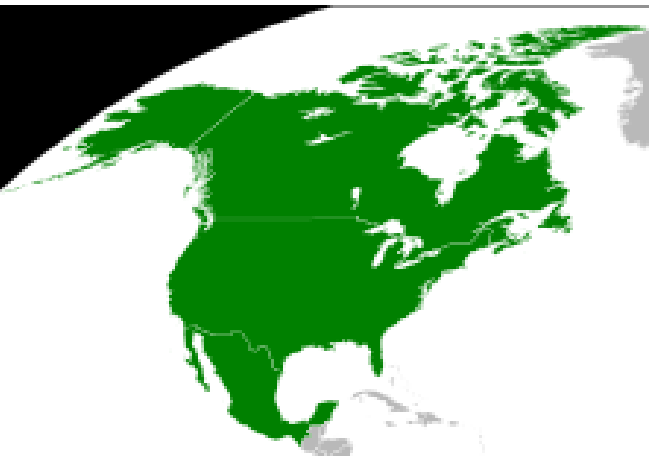
* *Switzerland is not part of the EEA Agreement, but has signed bilateral agreements with the EU*

Main regional blocs: the NAFTA

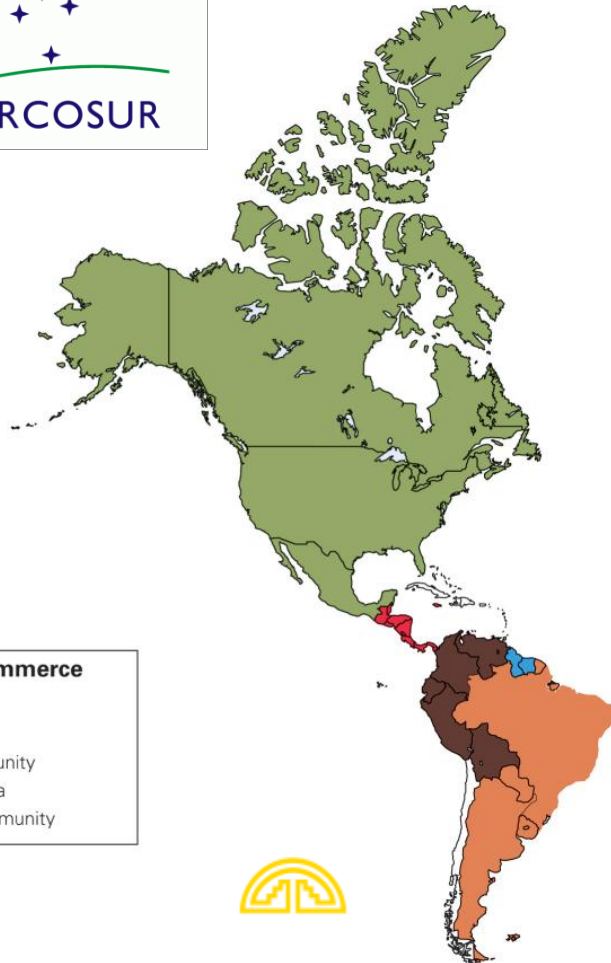
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- The North American Free Trade Area (NAFTA) became law on January 1, 1994
- NAFTA's participants are the United States, Canada, and Mexico
- NAFTA's outcomes:
 - Abolished tariffs on 99% of the goods traded between members
 - Removed most barriers on the cross-border flow of services
 - Protects intellectual property rights
 - Removes most restrictions on FDI between the three member countries
 - Allows each country to apply its own environmental standards, provided such standards have a scientific base
 - Establishes two commissions to impose fines and remove trade privileges when environmental standards or legislation involving health and safety, minimum wages, or child labor are ignored



Other American blocs



Continental Commerce

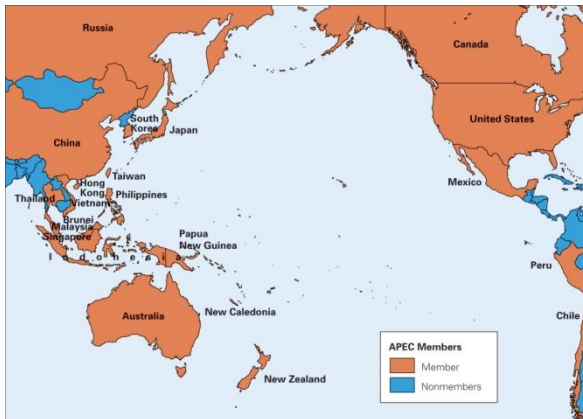
- NAFTA
- MERCOSUR
- Andean community
- Central America
- Caribbean community

- Andean Community of Nations (former Andean Pact): formed in 1969 using the EU model, more or less failed by the mid-1980s, was re-launched in 1990 and now operates as a customs union
- MERCOSUR: originated in 1988 as a free trade pact between Brazil and Argentina, was expanded in 1990 to include Paraguay and Uruguay
- Central American Trade Market (CAFTA) : aims to lower trade barriers between the U.S. and members
- CARICOM: aims to establish a customs union
 - ▶ 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
- Talks began in April 1998 to establish a Free Trade Area of The Americas (FTAA) that have not yet led to any tangible development

Main regional blocs: Asia-Pacific

1. The Association of Southeast Asian Nations (ASEAN)

- ▶ Formed in 1967 to foster freer trade between member countries and to achieve some cooperation in their industrial policies
- ▶ Current members: Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, Myanmar, Laos, and Cambodia
- ▶ An ASEAN Free Trade Area (AFTA) between the six original members of ASEAN came into effect in 2003



2. The Asia-Pacific Economic Cooperation (APEC)

- ▶ Established in 1989 to increase multilateral cooperation in view of the economic rise of the Pacific nations and the growing interdependence within the region
- ▶ 21 members incl. the United States, Japan, and China

ASEAN members: key indicators

Table 1
Selected basic ASEAN indicators
as of 17 July 2009

ASEAN Statistics

Country	Total land area	Total population ^{1/}	Population density ^{1/}	Annual population growth ^{1/}	Gross domestic product ^{2/} at current prices	Gross domestic product per capita at current prices		International merchandise trade ^{4/}			Foreign direct investments inflow ^{5/}	
	km ²	thousand	persons per km ²	percent	US\$ million	US\$ ^{2/}	US\$ PPP ^{3/}	Exports	Imports	Total trade	US\$ million	US\$ million
	2008	2008	2008	2008	2008	2008	2008	2008	2008	2008	2007	2008
Brunei Darussalam	5,765	397	69	1.8	14,146.7	35,622.6	50,234.8	8,754.2	3,106.0	11,860.2	260.2	239.2
Cambodia	181,035	14,656	81	2.0	11,081.6	756.1	1,794.0	4,249.2	4,476.3	8,725.5	867.3	815.2
Indonesia	1,860,360	228,523	123	1.3	511,174.4	2,236.9	3,705.0	137,020.4	129,197.3	266,217.7	6,928.3	7,918.5
Lao PDR	236,800	5,763	24	2.8	5,289.0	917.8	2,237.3	827.7	1,803.2	2,630.9	323.5	227.8
Malaysia	330,252	27,863	84	2.3	222,673.6	7,991.7	13,192.1	194,495.9	144,298.8	338,794.7	8,401.2	8,053.0
Myanmar	676,577	58,510	86	1.7	27,182.0	464.6	1,082.9	6,620.6	3,794.9	10,415.4	257.7	714.8
The Philippines	300,000	90,457	302	2.1	166,772.8	1,843.7	3,421.1	49,025.4	56,645.6	105,671.0	2,916.0	1,520.0
Singapore	707	4,839	6,844	5.5	184,120.4	38,046.1	50,347.1	241,404.7	230,760.3	472,165.0	31,550.3	22,801.8
Thailand	513,120	66,482	130	0.7	273,666.1	4,116.4	7,889.7	174,966.7	177,567.5	352,534.2	11,238.1	9,834.5
Viet Nam	331,212	86,160	260	1.2	90,700.8	1,052.7	2,595.2	61,777.8	79,579.2	141,357.0	6,739.0	8,050.0
ASEAN	4,435,827	583,651	132	1.5	1,506,807.4	2,581.7	5,007.1	879,142.6	831,229.1	1,710,371.7	69,481.6	60,174.7

Sources: ASEAN Finance and Macro-economic Surveillance Unit Database, ASEAN Merchandise Trade Statistics Database, ASEAN Foreign Direct Investment Statistics Database (compiled/computed from data submission, publications and/or websites of ASEAN Member States' national statistics offices, central banks and relevant government agencies, and from international sources)

Symbols used

- not available as of publication time
n.a. not applicable/not available/not compiled
Data in *italics* are the latest updated/revised figures from previous posting.

Notes

- 1/ Refers to based on mid-year total population based on country projections
- 2/ 2008 data on GDP at current market prices is preliminary. Brunei Darussalam's 2008 annual figure is based on estimate published in the Brunei Darussalam Key Indicators, 2008. 2008 annual figures for Cambodia, Lao PDR and Myanmar are taken from the IMF WEO Database October 2008. Viet Nam's 2008 annual figure is based on country estimate from the General Statistical Office's website as of January 2009.
- 3/ Recomputed based on IMF WEO Database April 2009 estimates and the latest actual country data
- 4/ 2008, preliminary data with Cambodia being estimated using trade growth as used in World Bank : World Bank Economic update for the East Asia and Pacific Region, April 2009
- 5/ Unless otherwise indicated, figures include equity, reinvested earnings and inter-company loans. Singapore data for 2008 covers only equity and reinvested earnings.

Main regional blocs: Africa



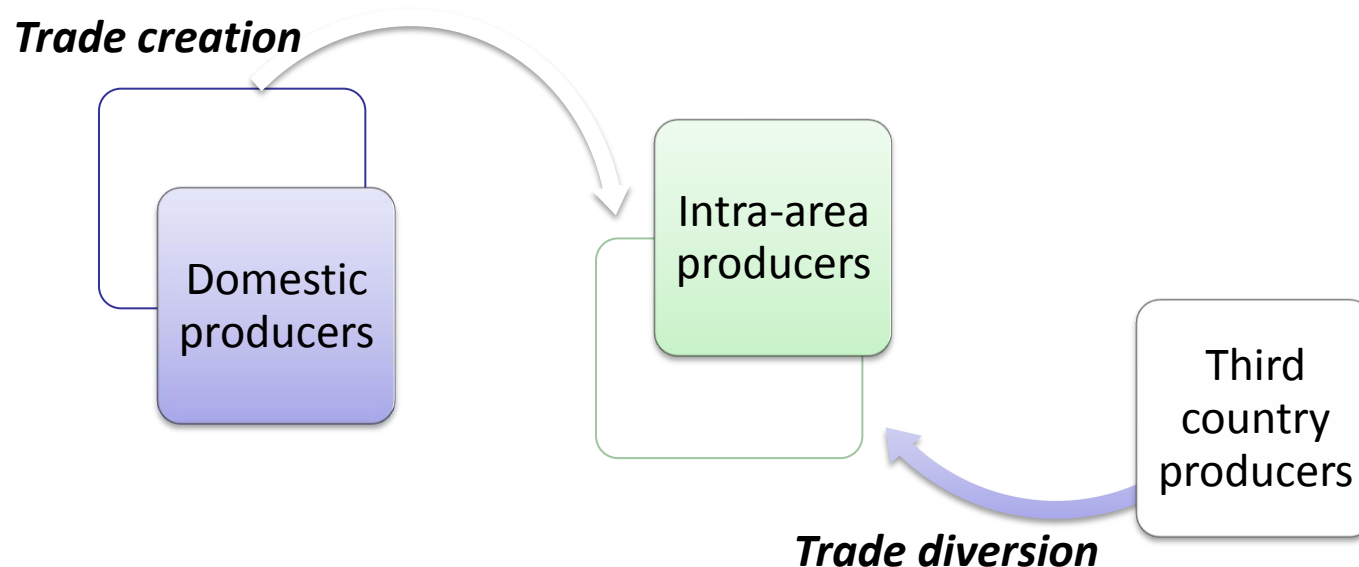
- Southern African Development Community (SADC),
- Southern African Customs Union (SACU) and Common Monetary Area (CMA),
- Preferential Trade Area for Eastern and Southern African States (PTA) and Common Market for Eastern and Southern Africa (COMESA),
- Economic Community of West African States (ECOWAS),
- *Union Douanière et Economique de l'Afrique Centrale* (UDEAC) (Customs and Economic Union of Central Africa),
- East African Community
- ...

The case for regional trade blocs

- **Political arguments**
 - ▶ **Creating incentives for political cooperation and reduces the likelihood of violent conflict**
 - ▶ **Giving individual countries greater political influence when dealing with other nations**
- **Economic arguments**
 - ▶ **Removing tariffs and promoting competition among member states, leading to lower prices, more and better products**
 - ▶ **Fostering intra-regional trade/specialisation, making it possible to generate economies of scale and take advantage from various countries' factor endowments**
 - ▶ **Protecting the regional economy from competition from other national economies or regional blocs**

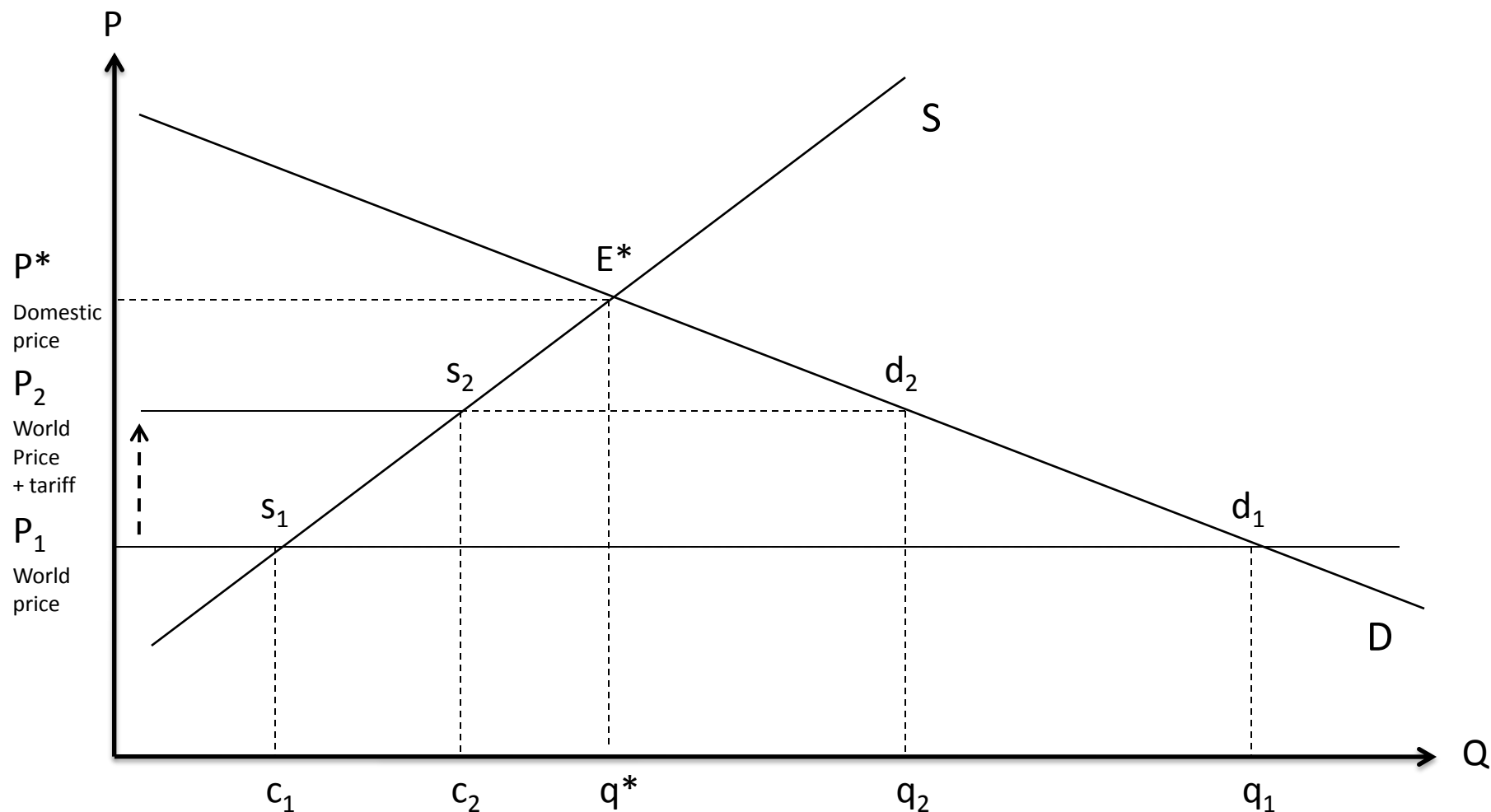
The limits of regional trade blocs

- Regional economic integration is only beneficial if trade creation exceeds trade diversion
- ▶ 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



Trade creation/diversion: an economic analysis

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Assessing the costs / benefits of the NAFTA

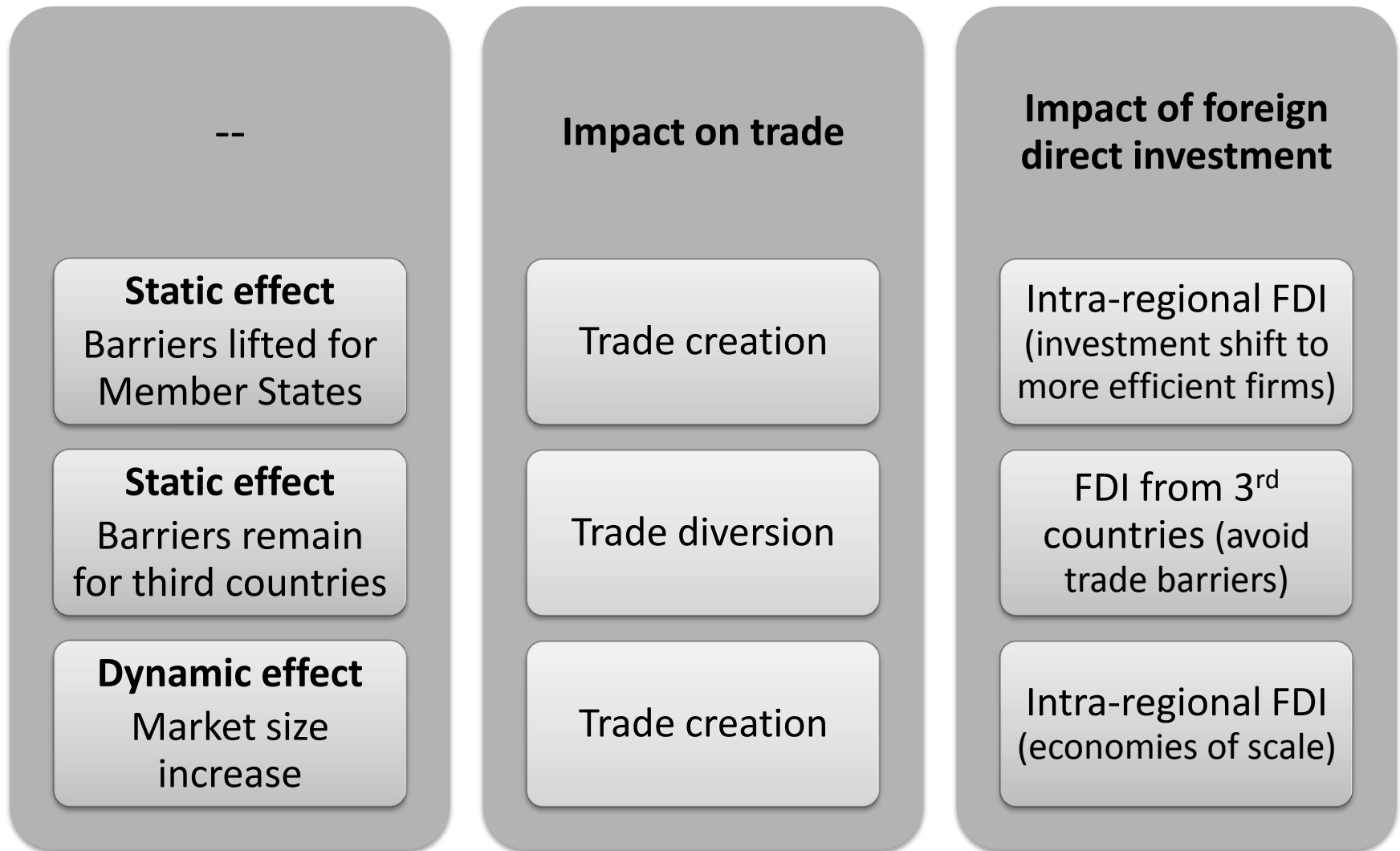
The celebrations of NAFTA's 10th anniversary are far more muted than those involved in its creation might have hoped. In the United States, the North American Free Trade Agreement has failed to fulfill the most dire warnings of its opponents and the most fervent expectations of its supporters. [...]

There is some good news. In America, the "giant sucking sound of jobs being pulled out of this country" that Ross Perot predicted never quite materialized. The first six years of NAFTA saw unemployment in the United States fall to new lows. [...] NAFTA has brought some benefits to Mexico as well; it was trade with America, fueled by NAFTA [...] that was responsible for Mexico's quick recovery after the financial crisis of December 1994.

But while Mexico benefited in the early days, especially with exports from factories near the United States border, those benefits have waned, both with the weakening of the American economy and intense competition from China. Meanwhile, poor Mexican corn farmers face an uphill battle competing with highly subsidized American corn, while relatively better-off Mexican city dwellers benefit from lower corn prices.

By JOSEPH E. STIGLITZ, New York Times, January 6, 2004

Regional trade blocs: business implications [1]



Regional trade blocs: business implications [2]

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- Internationalisation
 - ▶ **New opportunities for firms inside the bloc**
 - ▶ **Attractive market for firms outside the bloc**
- Rationalisation
 - ▶ **Restructuring and consolidation at regional level**
 - ▶ **Mergers and acquisitions**
- Standardisation
 - ▶ **Product standardisation**
 - ▶ **Marketing strategy standardisation**
- Cooperation
 - ▶ **Collaborative ventures among firms within the trade bloc**

?

Provided that regional trade blocs do not meet key WTO principles such as the "most favoured nation clause", why are they nonetheless accepted

?

Trade blocs vs. free trade

- + Domino effect (Baldwin, 1993):
 - **Outsiders want to become insiders increasing the incentives to add members to the integration bloc.**
 - **This enlarges the market causing other countries to be pulled in as well.**
- Competing trade blocs (regional protectionism)
- "Spaghetti bowl" phenomenon
 - ▶ **Overlapping / complex systems of trade concessions**
 - ▶ **Complicated trading environment, web of incoherent rules, and intricate rules of origin**
 - ▶ **Trade distortions**





Section 2

THE CASE OF THE EUROPEAN UNION



European integration: means and objectives



Political objectives :
Prevent another war – Contain Soviet expansion



Economic objectives :
Rebuild Western European economies and improve living standards, avoid protectionist policies



Economic means :
Integration of European economies, remove obstacles to exchange and design common policies



A tool : the rule of law
Enforcement of a common legal body ("Community acquis")



Unter der Linden, 1945

Key dates in European integration

- 1951:** A European [Coal and Steel Community](#) (ECSC) is established (6 members)
- 1957:** The Treaty of Rome establishes a, [European Economic Community](#) (EEC) with the aim of achieving a [Common Market](#) by 1970
- 1968:** The Common Market is officially achieved
- 1986:** The [Single European Act](#) aims at achieving a [Single European Market](#)
- 1993:** The Single European Market is officially achieved; The Treaty of Maastricht establishes the European Union (EU) and initiates [European monetary integration](#)
- 1999:** The [Single European Currency](#) comes into force (Euro notes and coins are introduced in 2002)
- 2000:** Launching of the [Lisbon Agenda](#).
- 2007:** The [Treaty of Lisbon](#) aims to simplify EU's institutional settings

Milestones [1]: the Single Market

The internal market of the European Union is a single market in which the free movement of goods, services, capital and persons is ensured and in which European citizens are free to live, work, study and do business.

Since it was created in 1993, the single market has opened more to competition, created new jobs, defined more affordable prices for consumers and enabled businesses and citizens to benefit from a wide choice of goods and services

http://europa.eu/legislation_summaries/internal_market/index_en.htm



Milestones [2]: the European Monetary Union

■ Objectives

- ▶ Reap the benefits of the Single European Market
- ▶ Create a stable macroeconomic framework
- ▶ Boost political integration
- ▶ Strengthen Europe's role in the world



■ Stages

- ▶ July 1, 1990: achievement of the Single European Market for capital, coordination among Member States' economic policies and central banks
- ▶ December 31, 1993: convergence among Member States' economic and monetary policies (Maastricht criteria)
- ▶ January 1, 1999: establishment of the European Central Bank, fixed exchange rates among Eurozone currencies, enforcement of the single currency
- ▶ January 1, 2002: circulation of euro notes and coins

The Eurozone today



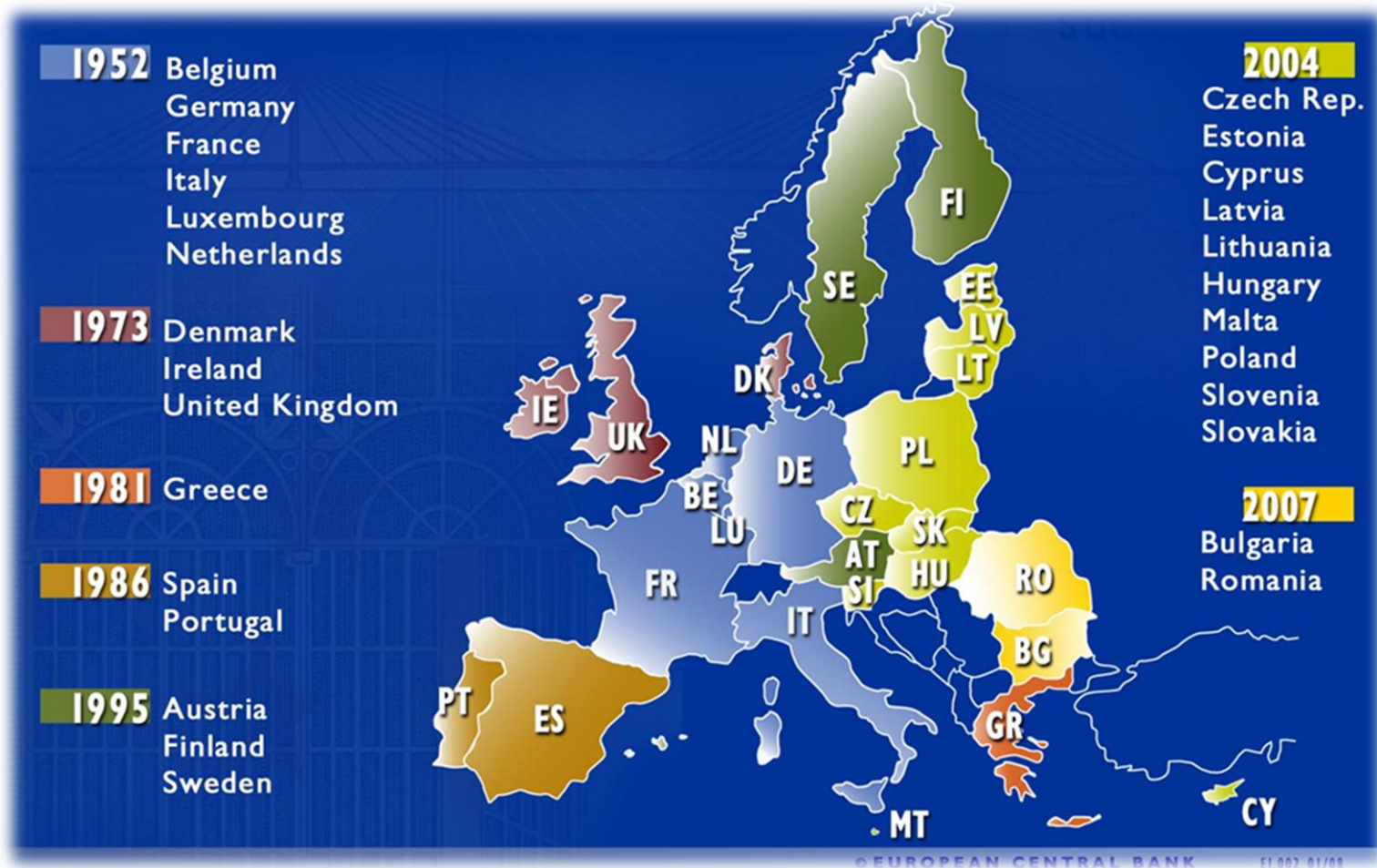
Slovakia joined on January 1, 2009

The euro is the official currency in Kosovo and Montenegro

Malta and Cyprus joined on January 1 2008

An enlarging community

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The EU today: an inclusive legislative body

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- The "Community acquis" is the body of common rights and obligations shared by EU Member States
- It includes:
 - **Primary Legislation**: Treaties and other agreements having similar status.
 - **Secondary Legislation**: Based on the Treaties, implies a variety of procedures defined in different articles thereof.
 - **Case-law**: rulings of the European Court of Justice and of the European Court of First Instance, Response to referrals from the Commission, national courts of the Member States or individuals
 - **Other acts**: Statements and declarations, unwritten laws, "soft law" agreements between Member States, international agreements, ...

The EU today: a complex institutional machinery







The EU today: achievements

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- Preserving peace, spreading stability democracy over Europe
 - Peace and cooperation between West Germany and the rest of Western Europe in the 1950s
 - Support to German unification after the fall of the Berlin Wall in 1989
 - Enlargement to former Soviet countries in Central Europe
 - Stabilization in the Balkans
 - ...
- Increasing European population's living standards
- Driving convergence through integration of European economies (Common/Single Market, Single Currency, regional policy)

A global economic player?

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Population (millions)	319	495	302	128
GDP (PPP, € trillions)	8.9	12.6	12.0	3.7
GDP per capita (PPP, € thousands)	27.8	25.4	39.6	29.0
Share of world GDP (PPP, %)	16.1	22.7	21.3	6.6
Exports (goods and services, % of GDP) **	22.6	14.2	11.8	18.4
Gross fixed capital formation (% of GDP)	21.7	21.2	18.7	23.3
Gross saving (% of GDP)	22.5	20.8	13.4	29.6

* 2007 ** The figure for the euro area excludes Cyprus and Malta
 Sources: for euro area and EU: ECB, Eurostat, national data, IMF and ECB calculations; for the United States and Japan: national sources, IMF.

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A transformed business environment



Mergers and acquisitions in Europe [in 2006] were worth \$1.59 trillion, overtaking the value of deals in America (at \$1.54 trillion), according to Dealogic, a data firm. Of the top ten deals launched worldwide in 2006, five were European, and of those two were cross-border e.ON of Germany bidding for Endesa of Spain and Dutch based Mittal for Arcelor of Luxembourg. [...]

With full liberalisation of Europe's energy market looming later this year, electricity and gas companies are seeking to become stronger before facing more competition.

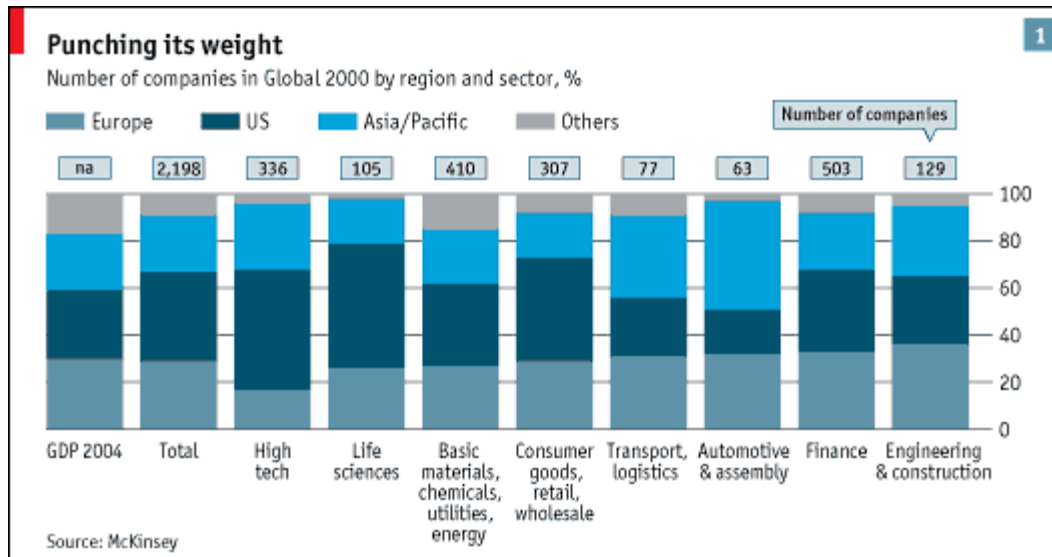
By contrast, consolidation in banking and telecoms has been relatively slow.

The Economist, February 8, 2007

European business: on the move



Feb 8th 2007, The Economist



In the big league 3

World's top companies, by revenue, 2005*, \$bn

	Revenue	Profit/loss
Exxon Mobil	339.9	36.1
Wal-Mart Stores	315.7	11.2
Royal Dutch Shell	306.7	25.3
BP	267.6	22.3
General Motors	192.6	-10.6
Chevron	189.5	14.1
DaimlerChrysler	186.1	3.5
Toyota Motor	185.8	12.1
Ford Motor	177.2	2.0
ConocoPhillips	166.7	13.5
General Electric	157.2	16.4
Total	152.4	15.3
ING Group	138.2	9.0
Citigroup	131.0	24.6
AXA	129.8	5.2
Allianz	121.4	5.4
Volkswagen	118.4	1.4
Fortis	112.4	4.9
Crédit Agricole	110.8	7.4
AIG	108.9	10.5
Assicurazioni Generali	101.4	2.4
Siemens	100.1	2.9
Sinopec	98.8	2.7
NTT	94.9	4.4
Carrefour	94.5	1.8
HSBC	93.5	15.9
ENI	92.6	10.9
Aviva	92.6	3.2
IBM	91.1	7.9
McKesson	88.1	0.8

Source: Fortune

*Or years ending early 2006

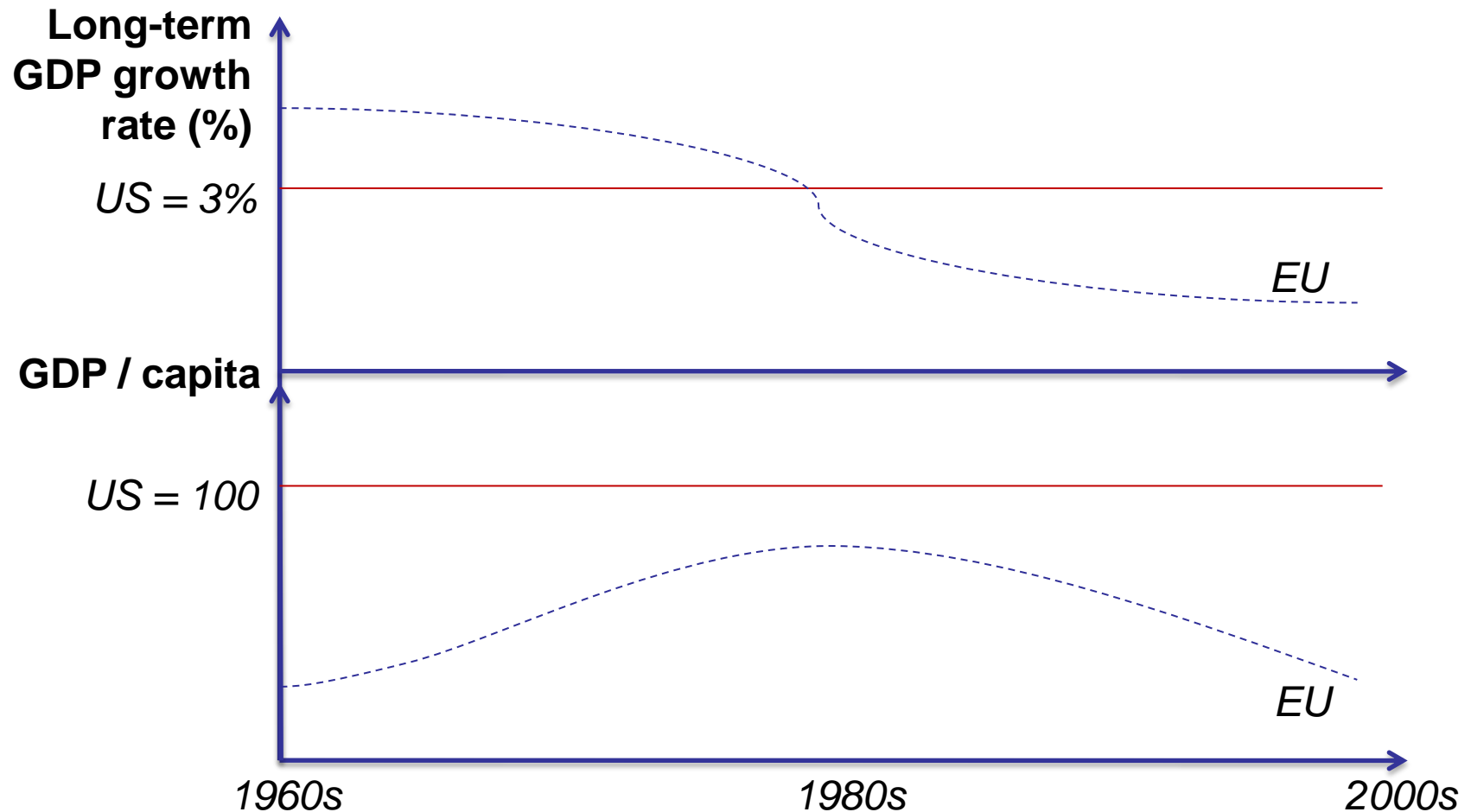
The EU today: shortcomings

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- Over the last 20 years, the European Union has failed to address core economic issues, and its legitimacy is being questioned
 - ▶ **A poor economic performance of the EU as a whole (GDP growth rate, innovation, unemployment), despite the Lisbon Agenda**
 - ▶ **An increasing divergence among Member States' positions**
- The final goal of the process - political union - is still out of reach
 - ▶ **Member States are reluctant to give up sovereignty (fiscal policy, home and foreign affairs, justice) and room for manoeuvre**
 - ▶ **People are reluctant to accept what is seen as a business-driven technocratic / non-democratic process that has failed to solve their problems**

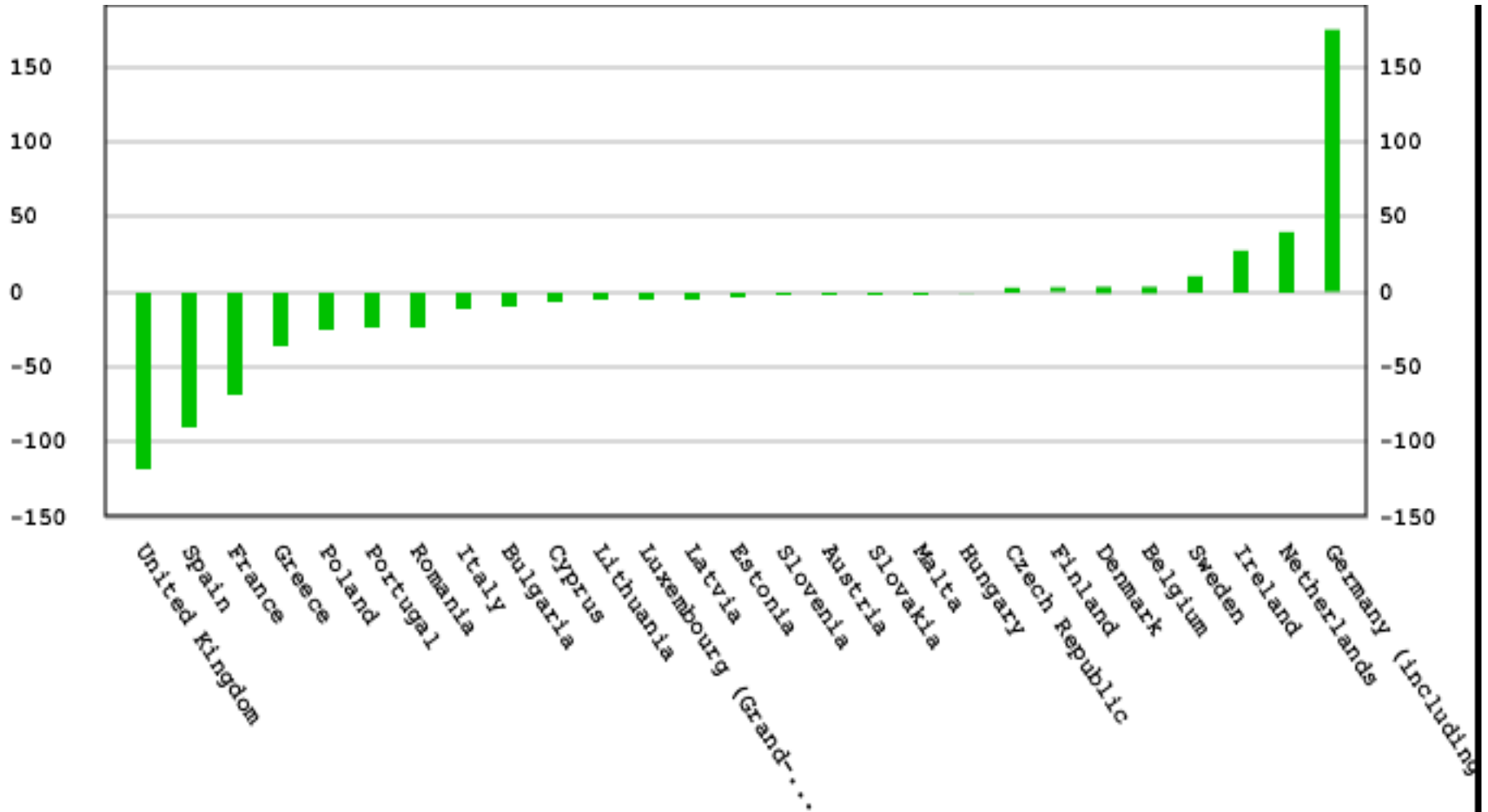
A poor economic performance

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Diverging economies

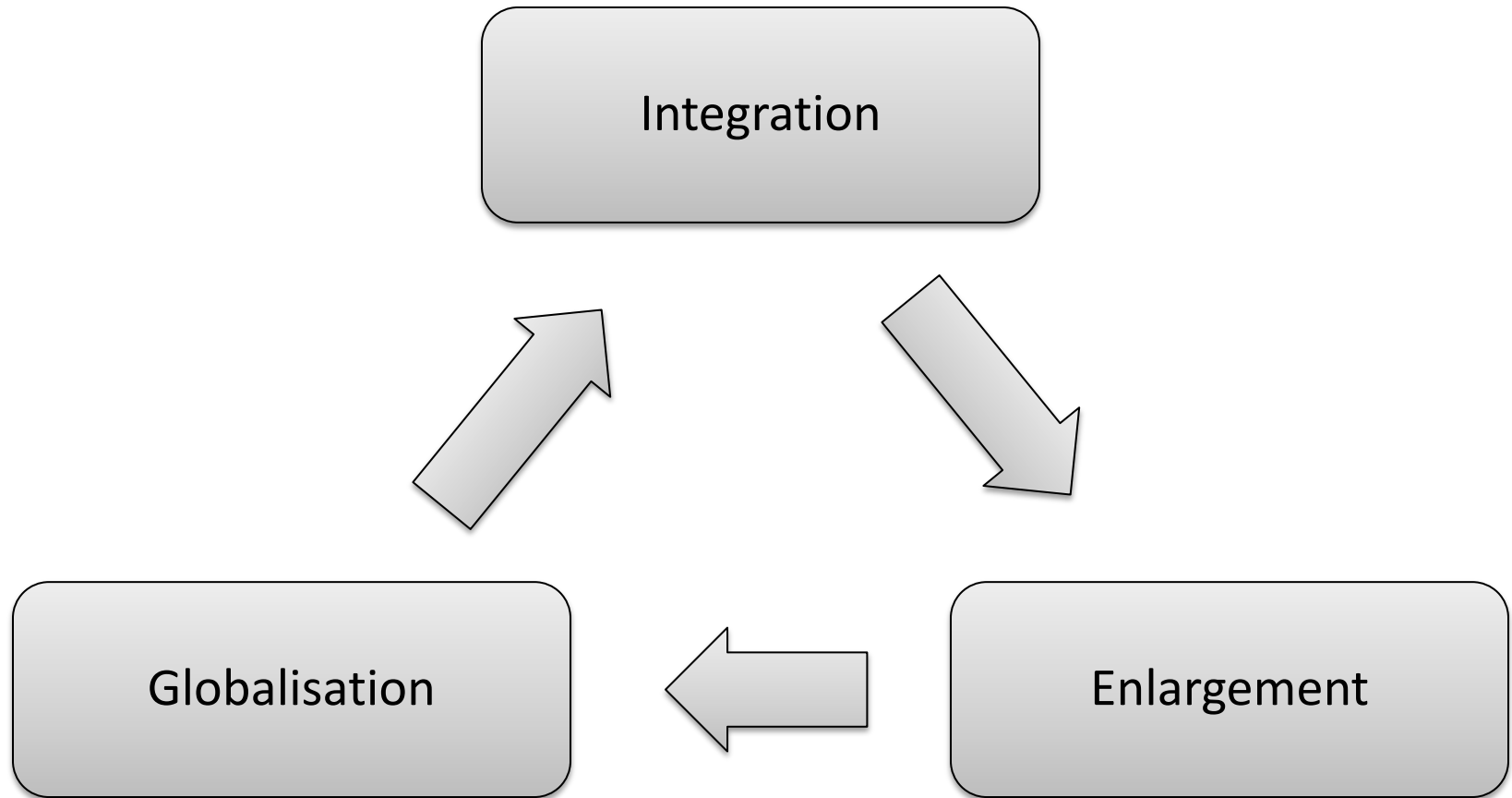
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Trade balance 2008 (Bn €, Eurostat data)

Challenges ahead

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The integration challenge

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"The clear and present danger to Europe right now comes from [...] the Continent's failure to respond effectively to the financial crisis. Europe has fallen short in terms of both fiscal and monetary policy: it's facing at least as severe a slump as the United States, yet it's doing far less to combat the downturn. [...] Why is Europe falling short? Poor leadership is part of the story. [...]"

But there's a deeper problem: Europe's economic and monetary integration has run too far ahead of its political institutions. The economies of Europe's many nations are almost as tightly linked as the economies of America's many states and most of Europe shares a common currency. But unlike America, Europe doesn't have the kind of continent-wide institutions needed to deal with a continent-wide crisis."



Paul Krugman, *New York Times*, Monday, March 16, 2009

The enlargement challenge

" [...] The single market means different things to different people. To the British, it is about removing non-tariff barriers to trade so as to create a market in which companies can compete. Theirs is a classic free-market position; it stresses deregulation and economic efficiency.

But it is not the only view. To many continental Europeans, the single market is not about free but about “fair” trade. Indeed, it is not primarily about trade at all, but rather about regulation and integration. Historically, the single market was pushed forward most in the 1980s by Jacques Delors, a French socialist, who saw it mainly as a step towards closer political union."

The Economist, Nov 9th 2006



Upcoming enlargement rounds



The globalisation challenge

[...] Europe is becoming ever more integrated into the global economy, with emerging countries such as Brazil and India adding to the inward investment into the continent that has traditionally come from America and Japan. Next it will be the Chinese investing in Europe as they set up distribution and marketing networks for their own products.

European manufacturing companies too have begun to overhaul themselves. In addition to the radical reshaping at companies such as Philips and Siemens, the car industry has recast itself from a regional into a global mould, led by BMW, Mercedes and Audi. Renault became global through its partnership with Nissan and might yet be the saviour of Ford. Volkswagen is a leader in the Chinese market.

Japanese and South Korean investment in Europe is forcing local firms to match the incomers' productivity and quality. Katsuaki Watanabe, chief executive of Toyota, the world's best car company, has acknowledged that even his firm has to try harder to keep up with these new rivals. It is globalisation in action.

The Economist, Feb 8th 2007