



## Chapter 9

# Regional Economic Integration

# 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

# 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

# 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** (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, and Uruguay)

# 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

# What Are The Levels Of Regional Economic Integration?

Levels of Economic Integration



# 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

# 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

# What Is The Status Of Regional Economic Integration In Europe?

- Europe has two trade blocs
  1. The European Union (EU) with 27 members
  2. The European Free Trade Area (EFTA) with 4 members
- The EU is seen as the world's next economic and political superpower

# What Is The Status Of Regional Economic Integration In Europe?

Member States of The European Union in 2012



# 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

# 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

# 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

# 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 17 of the 27 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

# 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**

# Should The EU Continue To Expand?

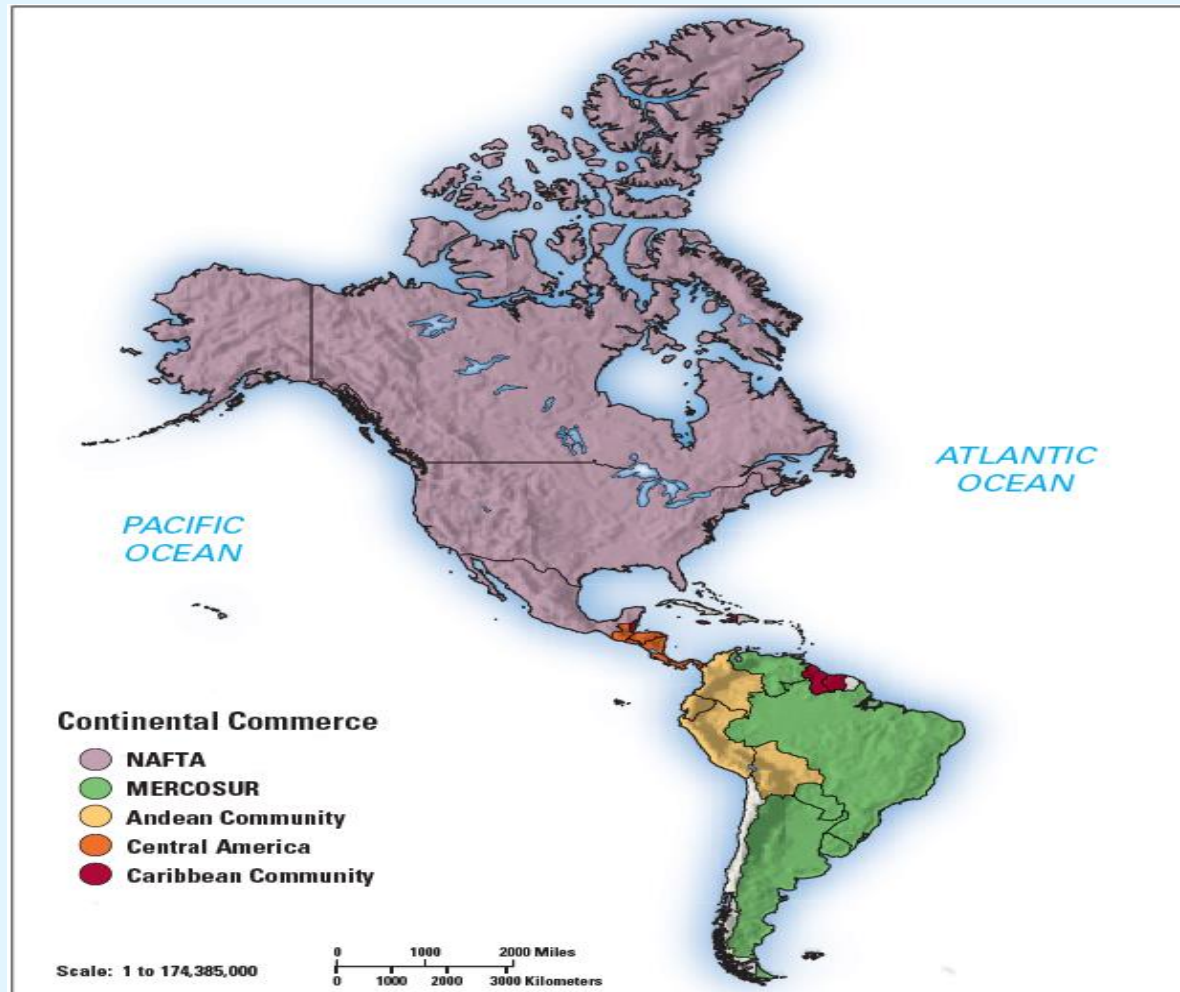
- Many countries have applied for EU membership
- Ten countries joined in 2004 expanding the EU to 25 states
- In 2007, Bulgaria and Romania joined bringing membership to 27 countries
- Turkey has been denied full membership because of concerns over human rights

# 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

# What Is The Status Of Economic Integration In The Americas?

## Economic Integration in the Americas



# What Is The North American Free Trade Agreement?

- The **North American Free Trade Area** includes the United States, Canada, and Mexico
  - abolished tariffs on 99% of the goods traded between members
  - removed barriers on the cross-border flow of services
  - protects intellectual property rights
  - removes most restrictions on FDI between members
  - allows each country to apply its own environmental standards
  - 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

# Is The North American Free Trade Area Beneficial?

- Supporters of NAFTA claimed that
- Mexico would benefit
  - from increased jobs as low cost production moves south and will see more rapid economic growth as a result
- the U.S. and Canada would benefit from
  - access to a large and increasingly prosperous market
  - the lower prices for consumers from goods produced in Mexico
  - low cost labor and the ability to be more competitive on world markets
  - increased imports by Mexico

# 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

# 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

# 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

# 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

# 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

# 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

# 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)

# 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
  - ASEAN and AFTA are moving towards establishing a free trade zone

# What Is The Association Of Southeast Asian Nations?

ASEAN Countries

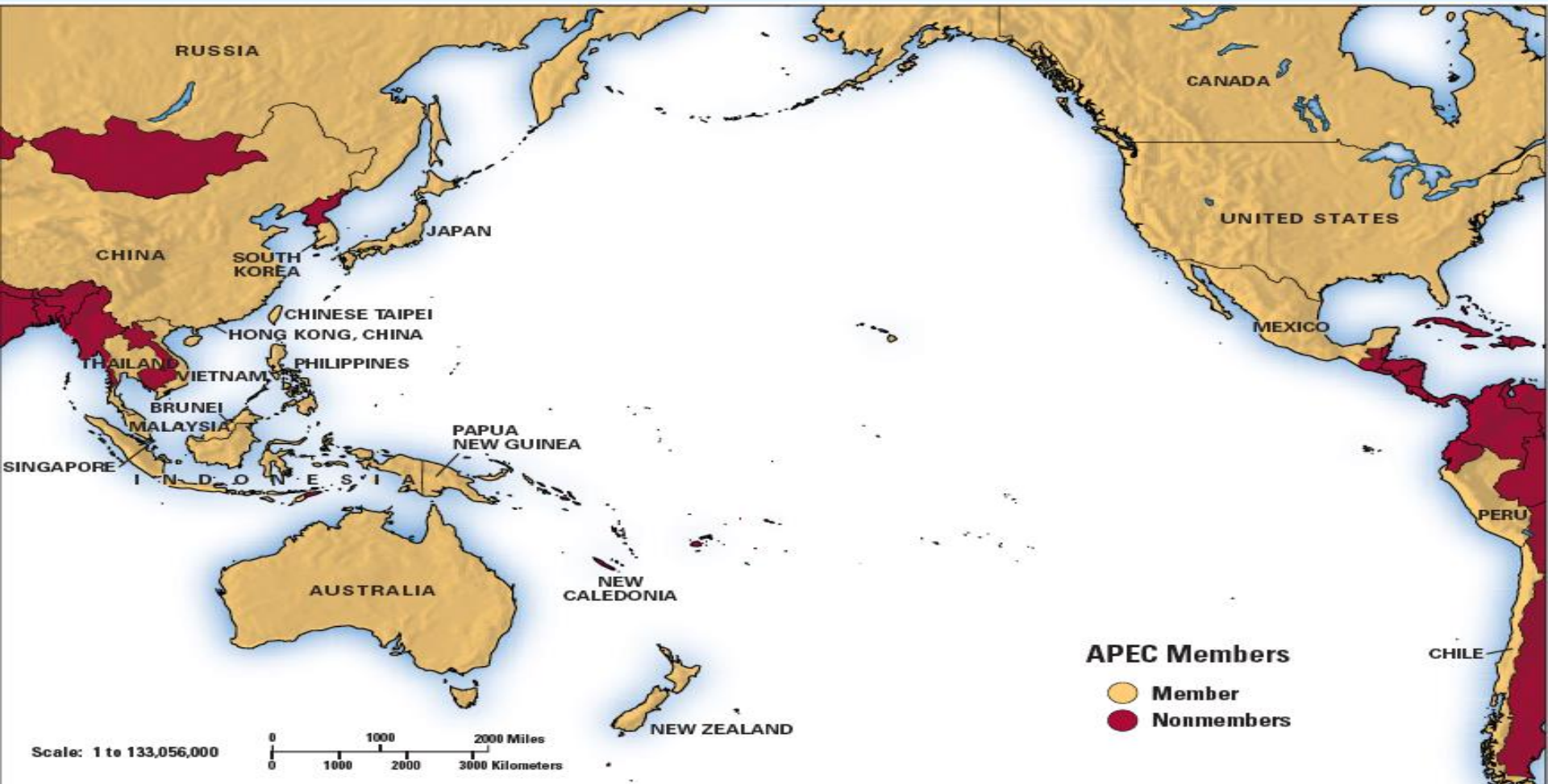


# What Is The Asia-Pacific Economic Cooperation?

- 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

# What Is The Asia-Pacific Economic Cooperation?

APEC Members



# What Is The Status Of Economic Integration In Africa?

- Many countries are members of more than one of the nine blocs 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

# 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”