9. Regional Economic Integration

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Read chapter 9
Learning Objectives

1. Regional integration and economic blocs
2. Levels of regional integration
3. The leading economic blocs
4. Advantages of regional integration
5. Success factors for regional integration
6. Ethical dilemmas and drawbacks of regional integration
7. Management implications of regional integration
Agenda

✧ Key Terms
✧ Economic Blocs
✧ Rationale and Drawbacks of Economic Integration
✧ Implications of Regional Integration for the Firm
Key Terms

- Economic Blocs
- Rationale and Drawbacks of Economic Integration
- Implications of Regional Integration for the Firm
Video: Pacific Alliance trade bloc aims at boosting economy

Source: CNBC 2015, “Forget Brazil. This emerging market is on the rise,” March 26.

Country Population GDP past 5 years Predicted 2014/2015

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<th>Country</th>
<th>Population</th>
<th>GDP Past 5 Years</th>
<th>Predicted 2014/2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>115 Million</td>
<td>1.90%</td>
<td>2.4%/3.5%</td>
</tr>
<tr>
<td>Colombia</td>
<td>47 Million</td>
<td>4.20%</td>
<td>4.8%/4.5%</td>
</tr>
<tr>
<td>Peru</td>
<td>30 Million</td>
<td>5.50%</td>
<td>3.6%/5.1%</td>
</tr>
<tr>
<td>Chile</td>
<td>17 Million</td>
<td>4%</td>
<td>2.0%/3.3%</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>5 Million</td>
<td>3.10%</td>
<td>3.6%/3.6%</td>
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Source: CNBC 2015, “Forget Brazil. This emerging market is on the rise,” March 26.

# Regional Economic Integration

<table>
<thead>
<tr>
<th><strong>Fact</strong></th>
<th>Over 50 percent of world trade today occurs under some form of trade agreements signed by groups of countries.</th>
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<tbody>
<tr>
<td><strong>Definition</strong></td>
<td>Nations within a geographic region form an alliance.</td>
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<tr>
<td><strong>Aim</strong></td>
<td>Reducing barriers to trade and investment</td>
</tr>
<tr>
<td><strong>Example</strong></td>
<td>European Union, NAFTA, MERCOSUR, APEC, ASEAN</td>
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</table>
| **Result** | The growing economic interdependence & Boosting individual economies  
- increased product choices, productivity, living standards  
- lower prices, and  
- more efficient resource use. |
What Factors Help
The Success of a Regional Integration?

**Economic similarity.**
Strong similarity on wage rates, economic conditions, and other factors.

**Political similarity.**
Countries should have similar political systems, share aspirations, and be willing to surrender national autonomy.

**Geographic proximity.**
Facilitates intra-bloc movement of products, labor, and other factors.

**Similarity of culture and language.**
Often, neighboring countries share a common history, culture, and language.
NAFTA: North American Free Trade Agreement
CARICOM: Caribbean Community
MERCOSUR: Common Market of the South

EFTA: European Free Trade Association

SAARC: South Asian Association for Regional Cooperation
ASEAN: Association of Southeast Asian Nations
ECOWAS: Economic Community of West African States

GCC: Gulf Cooperation Council
IGAD: Intergovernmental Authority on Development
SADC: Southern African Development Community
CEMAC: Central African Economic and Monetary Community
Five Potential Levels of Regional Integration

1. **Free Trade Area**
   - Free movement of products/services
   - Independent external tariffs
   - Ex: NAFTA, ASEAN

2. **Customs Union**
   - Free movement of products/services and factors of production
   - Common external tariffs
   - Ex: Pre-1992 European Economic Community

3. **Common Market**
   - Unified monetary and fiscal policy by a central authority. Ex: EU

4. **Economic & Monetary Union**
   - Free movement of products/services
   - Common external tariffs
   - Ex: MERCOSUR

5. **Political Union**
   - Perfect unification of all policies by a common organization, submersion of all separate national institutions. Ex: ---
(1) Free Trade Area: Example - NAFTA

✧ Members: Canada, Mexico, the United States.
✧ Established in 1994.
✧ Eliminated tariffs and most nontariff barriers for products and services.
✧ Established trade and investment rules, uniform customs procedures, and intellectual property rights.
✧ Provided procedures for settling trade disputes.
✧ Restrictions on labor and other movements remain.
✧ No common external tariffs.
Effects of NAFTA

- Trade among the members more than tripled, and now exceeds $1 trillion per year.

- Between 1994 and 2008, annual exports from...
  - Canada to Mexico and the U.S. more than doubled;
  - Mexico to the U.S. grew from $50 to $220 billion;
  - The U.S. to Mexico grew from $40 to $150 billion;
  - The U.S. to Canada grew from $120 to $260 billion.

- Both Canada and Mexico now have some 80 percent of their trade with, and 60 percent of their FDI stocks in the United States.
Members: Argentina, Brazil, Paraguay, Uruguay, Venezuela.


Free movement of products and services,

Common external tariffs up to 20% and trade policy,

Coordinated monetary and fiscal policies.

Bolivia, Chile, Colombia, Ecuador, Peru are associate members → Participate in free trade area but not customs union.
(3) Common Market: Example - Development of European Union (EU)

1951 European Coal and Steel Community
- Removed trade barriers in coal, iron, and steel

1957 European Economic Community
- Outlined and took initial steps toward common market

1967 European Community
- Expanded to other industries incl. atomic energy

1987 Single European Act
- Harmonized regulations, strived for lower barriers

1991 Maastricht Treaty
- Set single currency targets, outlined eventual political union

1994 European Union
- Final name change and reduced barriers further
Market access. Tariffs and most nontariff barriers have been eliminated.

Common market. Barriers to cross-border movement of production factors—labor, capital, and technology.

Trade rules. Cross-national customs procedures and regulations have been eliminated, which has streamlined transportation and logistics within Europe.

Standards harmonization. Technical standards, regulations, and enforcements have been harmonized.

Common fiscal, monetary, taxation, and social welfare policies is the ultimate goal over time.
<table>
<thead>
<tr>
<th>Economic Blocs</th>
<th>Countries</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caribbean Community and Common Market (CARICOM)</td>
<td>Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts &amp; Nevis, Saint Lucia, St Vincent &amp; Grenadines, Suriname, Trinidad and Tobago</td>
<td>Customs Union</td>
</tr>
<tr>
<td>Andean Community (Comunidad Andina de Naciones) (CAN)</td>
<td>Bolivia, Colombia, Ecuador, Peru</td>
<td>Customs Union</td>
</tr>
<tr>
<td>Association of Southeast Asian Nations (ASEAN)</td>
<td>Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam</td>
<td>Free Trade Area</td>
</tr>
<tr>
<td>Asia Pacific Economic Cooperation (APEC)</td>
<td>Pacific Rim countries: Australia, Canada, Chile, China, Japan, Mexico, Russia, the U.S.</td>
<td>Free Trade Area</td>
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<tr>
<td>Closer Economic Relations Agreement (CER)</td>
<td>Australia and New Zealand</td>
<td>Free Trade Area</td>
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Video: By the Numbers - World's Trading Blocs
Source: Bloomberg TV 2015, April

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<th><strong>Free Trade Area</strong></th>
<th>Removes all barriers to trade among members with each nation determining its own barriers against nonmembers</th>
<th>NAFTA, ASEAN, APEC, CER</th>
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<tr>
<td><strong>Customs Union</strong></td>
<td>Adds the requirement that all members set a common trade policy against nonmembers</td>
<td>CARICOM, CAN, MERCOSUR</td>
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<td><strong>Common Market</strong></td>
<td>Adds the free movement of labor and capital and sets a common trade policy against nonmembers</td>
<td>European Economic Community (Pre-1992)</td>
</tr>
<tr>
<td><strong>Economic Union</strong></td>
<td>Requires members to harmonize their tax, monetary, and fiscal policies, create a common currency, and concede some sovereignty to the larger organization</td>
<td>EU</td>
</tr>
<tr>
<td><strong>Political Union</strong></td>
<td>Requires members to coordinate their economic and political policies against nonmembers, with a few exceptions</td>
<td>-----------</td>
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Agenda

✧ Key Terms
✧ Economic Blocs

Rationale and Drawbacks of Economic Integration

✧ Implications of Regional Integration for the Firm
Why Do Nations Pursue Economic Integration?

- Expand market size for firms inside the economic bloc (e.g., when NAFTA was formed, Canadian firms gained access to the much larger markets of Mexico and the United States)

- Enhance productivity and economies of scale

- Attract investment from outside the bloc (e.g., by establishing operations in a single EU country, these firms gain free trade access to the entire EU market.)

- Acquire stronger defensive and political posture (bargaining and political power in world affairs)
Example: Attract investment from outside the bloc

- The U.S. completed a deal that commits five African countries, Burundi, Kenya, Rwanda, Tanzania and Uganda, to reducing trade barriers in a plan.

- Under the deal, the U.S. will also help the trade bloc meet the technical and sanitary standards for food exports to the U.S.

- Exports from the bloc to the U.S. have primarily consisted of apparel, while the top U.S. exports to the bloc include aircraft and heavy machinery.

- African exporters say the goal is a free-trade pact with the U.S. that would eliminate barriers to trade for African and U.S. exports.

- It’s opened the U.S. market for more African products, for example chocolates from Tanzania in Whole Foods.

Drawbacks of Regional Integration (1/2)

**Economic fortress.** More within-bloc trade and less between-bloc trade, which can reduce global free trade.

- *Trade creation* – As barriers fall, trade is generated inside the bloc.
- *Trade diversion* – As within-bloc trade becomes more attractive, member countries discontinue some trade with nonmember countries.
- *Aggregate effect* – National trade patterns are altered. More trade occurs inside bloc; less trade occurs with countries outside the bloc.
Drawbacks of Regional Integration (2/2)

**Loss of national identity.** Increased cross-border contact makes members more similar to each other.

**Sacrifice of autonomy.** Members must sacrifice some autonomy to the central authority, such as control over their own economy.

**Transfer of power to advantaged firms.** Integration can concentrate economic power in the hands of fewer, larger firms, often in the most advantaged member countries.

**Failure of small or weak firms.** As barriers fall, protections are eliminated that previously shielded smaller or weaker firms from foreign competition.

**Corporate restructuring and job loss.** Layoffs or re-assigning employees to distant locations, disrupting workers and entire communities.
Being a member of a customs union:

- The Customs Union has recently issued a ban on synthetic lace lingerie which will outlaw any underwear containing less than 6% cotton from being imported, made, or sold in Russia, Belarus and Kazakhstan.
- The ban is aimed at protecting customers from cheap materials that could have a negative health impact.

Some facts about the trade bloc:

- A Moscow-initiated trade bloc, launched in 2010
- The first step towards forming a broader EU-type economic alliance of former Soviet states.

The drawbacks of the trade bloc:

- The Customs Union has attracted criticism and skepticism from the domestic producers and businessmen in Kazakhstan and Belarus particularly.
- President of Kazakhstan criticized the union, which has "brought more disadvantages than advantages to Kazakhstan.
- The view has tended towards seeing this as a way for Russia flexing its economic power.


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Agenda

- Key Terms
- Economic Blocs
- Rationale and Drawbacks of Economic Integration

Implications of Regional Integration for the Firm
Implications for the Firm (1/2)

Internationalization by firms inside the economic bloc.

- Regional integration facilitates company internationalization.

- Example: Home Depot expanded in Mexico following passage of the North American Free Trade Agreement. Expansion into neighboring countries provides valuable experience, prompting internationalization to other markets worldwide.

Internationalization by firms from outside the bloc.

- Because external trade barriers mainly affect exporting, many foreign firms prefer to enter a bloc through FDI.

- Example: After formation of the EU, Britain became the largest recipient of FDI from the United States.
Rationalization of operations.

- By restructuring and consolidating company operations, managers can develop strategies and value-chain activities suited to the region as a whole, not just individual countries.

- Goal is to cut costs and redundancy, and increase efficiencies via scale economies.

- Firms centralize production and marketing, instead of decentralizing them to individual countries.

- Developing regional products and marketing strategy to cut costs by standardizing products and services.

Mergers and acquisitions (M&A).
Economic blocs lead to M&A, the tendency of one firm to buy another, or of two or more firms to merge and form a larger firm.
Future Prospects

• In 1990, there were about 50 regional economic integration agreements worldwide. Today there are some 400, in various stages of development.

• Governments continue to liberalize trade policies, encourage imports, and restructure regulatory regimes, largely via regional cooperation.

• Many nations belong to several free trade agreements.

• The evidence suggests regional economic integration will gradually give way to a system of global free trade worldwide.
Russia Forms Eurasian Economic Union With Former Soviet Republics
Trade Bloc Is Part of Putin's Aim to Reintegrate Former Soviet Economies as Counterweight to EU

May 29, 2014

Russia and Japan have finally agreed to a free trade deal.

This new arrangement will mean billions of dollars to the economy as Australian exports of dairy, beef, wine, and a range of services are freed up.

On the other side, Japanese cars, cameras, televisions and other high-tech goods will be cheaper for consumers here as Australia eases tariffs.

Trade Minister Andrew Robb said it had been tough getting the deal done.

"After seven long years of negotiation, this historic agreement has been concluded," he said in Tokyo, according to Fairfax Media.

"It is an agreement which is a historic one in its extent of liberalisation that Japan has concede to. It will benefit greatly Australian businesses, Australian jobs and Australian consumers, with cuts in car prices of up to $1300 on the average car.

"I don't want to pre-empt the formal conclusion of this negotiation by our two prime ministers in a short while, but just want to say what an honour it is to be involved in this historic agreement."
### Key Takeaways: CH 9-Part 2

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#### Implications for the firm

- Internationalization
- Rationalization
- Mergers and acquisitions
- Lower costs through standardization
Key Takeaways: Ch 9 – In General

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