

# Cross-National Cooperation and Agreements

Chapter 8

# Economic Integration

*Economic integration*: an agreement between or amongst nations within an *economic bloc* to reduce and ultimately remove tariff and nontariff barriers to the free flow of products, capital, and labor across the bloc

Approaches to *economic integration* include:

- *global integration* via the World Trade Organization
- *bilateral integration* between two countries
- *regional integration* via an *economic bloc*

*Neighboring countries tend to ally with one another because of their proximity, their somewhat similar tastes, the relative ease of establishing channels of distribution, and a willingness to cooperate with one another for the greater benefit of all parties.*

# The General Agreement on Tariffs and Trade (GATT)

*General Agreement on Tariffs and Trade (GATT):* established by twenty-three signatory nations in 1947 as a multilateral agreement whose objective is to liberalize world trade, by reducing tariffs and abolishing quotas

- *Most-favored nation* clause (MFN): the fundamental principle of “trade without discrimination,” i.e., each member nation must open its markets equally to every other member nation
- Eight major rounds of negotiations from 1947 to 1994 led to a wide variety of multilateral reductions in both tariff and nontariff barriers such as industrial standards, government procurement, subsidies, licensing and customs valuation.
- The World Trade Organization was created in 1995 with 125 members for the purpose of institutionalizing the GATT, 160 members in 2014.

# The World Trade Organization (WTO)

*World Trade Organization (WTO):* a permanent body founded in 1995 to (i) facilitate the development of a free and open international trading system according to the GATT and (ii) adjudicate trade disputes between or amongst member nations

- ❑ *included trade in services, investment, intellectual property, agriculture, textiles*
- ❑ *continued with the MFN clause that prohibits any sort of trade discrimination*

Exceptions:

- *preferential treatment* for products of emerging economies
- Barriers can be raised against countries that indulge in unfair trade practices
- *concessions* maybe granted to members of an economic bloc
- ❑ *dispute resolution:* a clearly defined mechanism for the settlement of dispute
- ❑ Doha round focused on giving a boost to developing nations – attempts to solve the problem of lowering tariffs on industrial goods in return for a reduction of agricultural barriers (india) were not successful

# Rise of bilateral agreements

- ▶ [http://www.brookings.edu/global/ipf/lawrence\\_chadha.pdf](http://www.brookings.edu/global/ipf/lawrence_chadha.pdf)
- ▶ <http://www.theguardian.com/global-development/2012/sep/03/doha-round-trade-talks-explainer>
- ▶ <http://www.theguardian.com/business/2014/nov/13/wto-food-security-us-india-trade-talks-doha-round>

# Rise of bilateral agreements

- ▶ Bilateral agreements may be between two individual countries or may involve one country dealing with a group of other countries
- ▶ Example: an agreement between US and Australia EU and Brazil, as the EU negotiates as one trading bloc
- ▶ Going beyond bilateral agreements is the regional approach called regional trade agreements or RTAs.
- ▶ It is logical that most trade groups contain countries in the same areas of the world.
- ▶ Neighboring countries tend to ally for several reasons:
  - The distances that goods need to travel are short
  - Similar consumer tastes and easy to establish distribution channels
  - Common histories and interests and more willing to coordinate their policies than non-neighboring countries

# Types of Regional Trade Agreements

The major reason to establish regional trade groups is to increase market size.

There are two major ways of regional economic integration from the stand point of tariffs:

- *free trade agreements*: economic blocs in which all barriers to trade, i.e., tariff and nontariff barriers, are abolished amongst member nations, but each member determines its own external trade barriers beyond the bloc
- *customs unions*: economic blocs in which all barriers to trade, i.e., tariff and nontariff barriers, are abolished amongst member nations, and common external barriers are levied against non-member countries

A more extensive type of *regional trade agreement* :

- *common market*: beyond tariff and non-tariff barriers countries can enhance their cooperation by permitting the free flow of capital and labor (like the EU)

# The Effects of Economic Integration

***Static effects:*** the shifting of resources from inefficient to efficient firms as trade barriers fall

Static effects develop when either of the two conditions occur:

*-trade creation:* Trade barriers drop for member countries and production shifts from less efficient domestic producers to more efficient producers (leading to FDI)

*-trade diversion:* Trade barriers remain high for non-member countries, trade shifts from more efficient external sources to less efficient suppliers within the bloc, following the imposition of common external barriers

***Dynamic effects:*** the gains from overall market growth, the expansion of production, the realization of greater economies of scale, and the increasingly competitive nature of the market

# The European Union (EU)

- represents the most advanced regional trade and investment bloc in the world today
- evolved from the *European Coal and Steel Community* to the *European Economic Community (EEC)* to the *European Community (EC)* to the *European Union (EU)*
- has grown from six members in 1951 to twenty-seven member nations in 2007
- has been moving toward a single market since the passage of the Single European Act of 1987. This has eliminated different certification procedures, rates of VAT, Excise duties. 16 member countries have adopted Euro

# Countries that have adopted euro

- ▶ 1) Andorra
- 2) Austria
- 3) Belgium
- 4) Cyprus
- 5) Estonia
- 6) Finland
- 7) France
- 8) Germany
- 9) Greece
- 10) Ireland
- 11) Italy
- 12) Kosovo
- 13) Latvia
- 14) Luxembourg
- 15) Malta
- 16) Monaco
- 17) Montenegro
- 18) Netherlands
- 19) Portugal
- 20) San Marino
- 21) Slovakia
- 22) Slovenia
- 23) Spain
- 24) Vatican City
- ▶ 25) Lithuania

# How to do business with the EU: Corporate strategy

- ▶ Determining where to produce products – central Europe has the highest manufacturing costs
- ▶ Determining whether to grow through new investments, through expanding existing investments or through joint ventures and mergers – US companies buying European companies
- ▶ Balancing common denominators with national differences – Ireland and Belgium have been shielded from economic risks while Germany and France have suffered from stagnant growth and unemployment

# The North American Free Trade Agreement (NAFTA)

- was preceded by the Canada–U.S. Free Trade Agreement of 1989
- incorporates Canada, Mexico, and the United States into a regional trade bloc
- became effective on January 1, 1994
- addresses free trade in good and services and investment rules
- claims a total GNI that is greater than that of the 27–member EU
- All tariffs phased out over a period of 15 years



# Static and dynamic effects

- ▶ Canada and US consumers benefit from lower cost agricultural products from Mexico – a static effect
- ▶ US producers benefit from large and growing Mexican market – dynamic effect
- ▶ Trade diversion – Mexico a good option for establishing manufacturing facilities (IBM shifted to Mexico from Singapore)
- ▶ Non-NAFTA countries to take advantage of FTA – Sony has mfg facilities in Tijuana – shipping to US saves time and costs
- ▶ Rule of origin: goods must originate in NA to get lower tariffs (EU is customs union rather than just FTA)

# Regional Economic Integration in the Americas: Central America

The two major blocs in Central America are:

- *Caribbean Community and Common Market (CARICOM)*

[9 countries but 60% of population is from Jamaica and Trinidad & Tobago]

- *Central American Common Market (CACM)* [Comprised of 14 member nations]

*The post-WWII strategy of using import substitution to resolve balance-of-payments problems was doomed in many Latin American nations because of the small size of many of their national markets. Economic cooperation is needed to enlarge potential market size.*

# Regional Economic Integration in the Americas: South America

The two major blocs in South America are:

- *Southern Common Market (MERCOSUR)*  
[Comprised of Brazil, Argentina, Paraguay, and Uruguay, *MERCOSUR* generates 80 percent of South America's GNI and has signed free trade agreements with Bolivia and Chile.]
- *Andean Community (CAN)*  
[Bolivia, Columbia, Ecuador, Peru, Venezuela]

The 12-member *Latin American Integration Association (LAIA)* encompasses the countries of *MERCOSUR* and the *Andean Community* plus Mexico and Cuba.

*Regional integration in Latin America has not been particularly successful because many countries rely more on the U.S. for trade than on members of their own groups.*

# Regional Economic Integration in Asia: ASEAN

## *The Association of Southeast Asian Nations (ASEAN)*

- was first organized in 1967
- is now comprised of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam
- formed the *ASEAN Free Trade Area (AFTA)* on January 1, 1993, for the purpose of cutting tariffs on inter-regional trade to a maximum of 5% by 2008

*ASEAN holds great promise for market and investment opportunities because of its large market size.*

# Regional Economic Integration in Asia: APEC

## *Asia Pacific Economic Cooperation (APEC):*

- was founded in 1989 to promote multilateral economic cooperation in trade and investment amongst 21 countries bordering the Pacific Rim on either the east or the west
- is committed to achieving free and open trade in the region by 2010 for the industrial nations and by 2020 for the remaining member countries
- includes more than half of the world's population and approximately 60 percent of the world's GNI

*APEC's progress is hampered by the number of members, the geographic distances between nations, and its lack of a binding treaty.*

# Regional Economic Integration in Africa

Regional trade groups in Africa that are registered with the WTO include:

- ▶ *Southern Africa Development Community (SADC)*
- ▶ *Common Market for Eastern and Southern Africa (COMESA)*
- ▶ *Economic and Monetary Community of Central Africa*
- ▶ *West African Economic and Monetary Union (WAEMU)*

*With the notable exception of South Africa, markets are small, and many nations rely more on trade links with former colonial powers than with each other.*

# Implications / Conclusions

- ▶ The effects of regional economic integration can be economic, cultural, and/or political in nature.
- ▶ Regional (as opposed to global) economic integration occurs because of the greater ease of promoting cooperation on a smaller scale.
- ▶ Member states must determine the degree of national sovereignty they are willing to surrender in order to capture the benefits of economic integration.
- ▶ A common market goes further than free trade areas and customs unions by permitting the free flow of capital and labor and possibly harmonizing commercial, monetary, and fiscal policies and establishing a common currency plus a supranational political structure dedicated to dealing with common economic issues.
- ▶ Commodity agreements exist to help developing countries stabilize prices, supplies, and hence their export earnings.