



REGIONAL ECONOMIC INTEGRATION

Chapter 7 text book = Chapter 9 on Connect

HOUSEHOLD ITEMS:

- This Thursday class will be an exam review (Dr. Z.'s version of a study guide for the Mid-Term exam).
- The Mid-Term exam will be on-line on Connect only.
- You can access it during class time on Tuesday, March 3, 12:30 p.m. – 1:45 p.m.
- Once you start the exam, you have only ONE attempt of 75 minutes to complete the exam.
- All students that have official facilitations from SDS, send me an e-mail – and I will make changes to your individual exam.



REGIONAL ECONOMIC INTEGRATION

Chapter 7 text book = Chapter 9 on Connect

REGIONAL ECONOMIC INTEGRATION

- Closely connected with our discussions on:
 - Trade Theories (specifically relative advantage)
 - Free Trade
 - Government Intervention with international trade

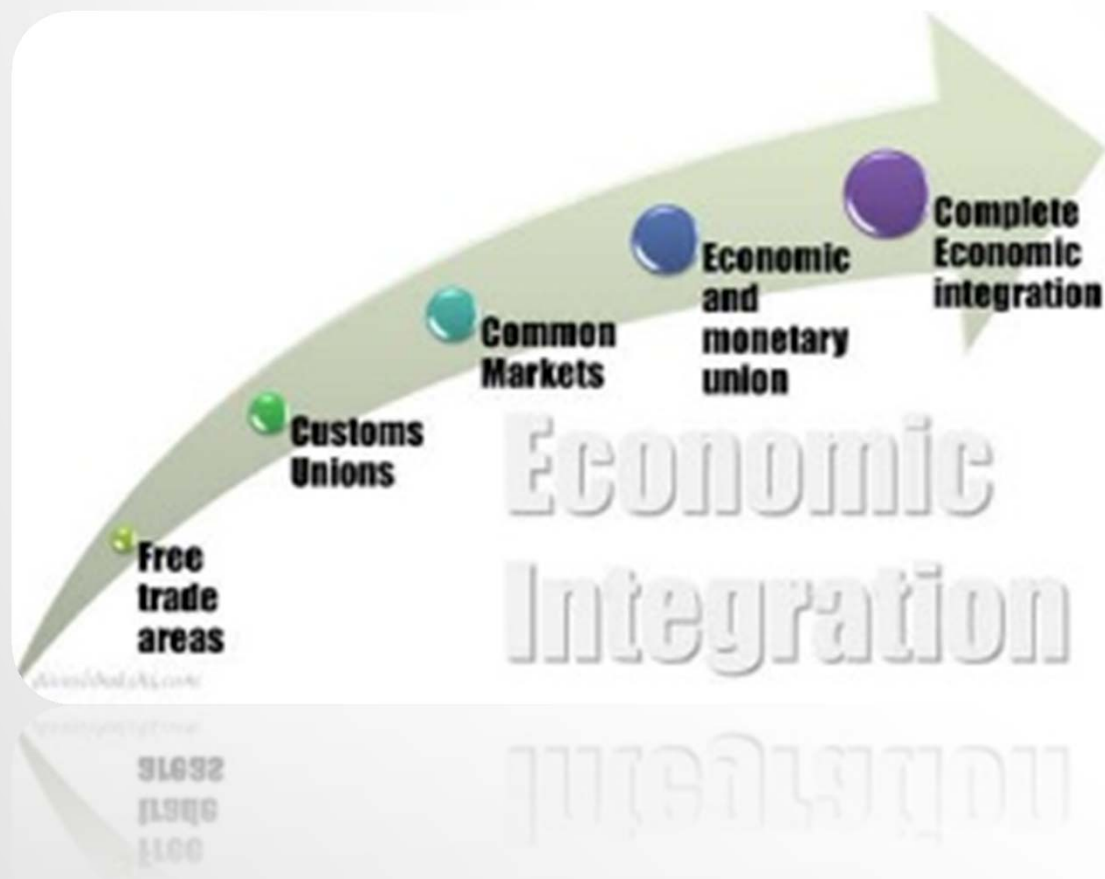
REGIONAL ECONOMIC INTEGRATION

- Closely connected with our discussions on:
 - Trade Theories (specifically relative advantage)
 - Free Trade
 - Government Intervention with international trade
- According to the WTO (know what this acronym stands for), there are over 500 regional trade agreements in place in the world today.

REGIONAL ECONOMIC INTEGRATION

- Agreement between countries to reduce tariff and non-tariff trade barriers.
- This is a free-form agreement; meaning that there is no specified format to this agreement.



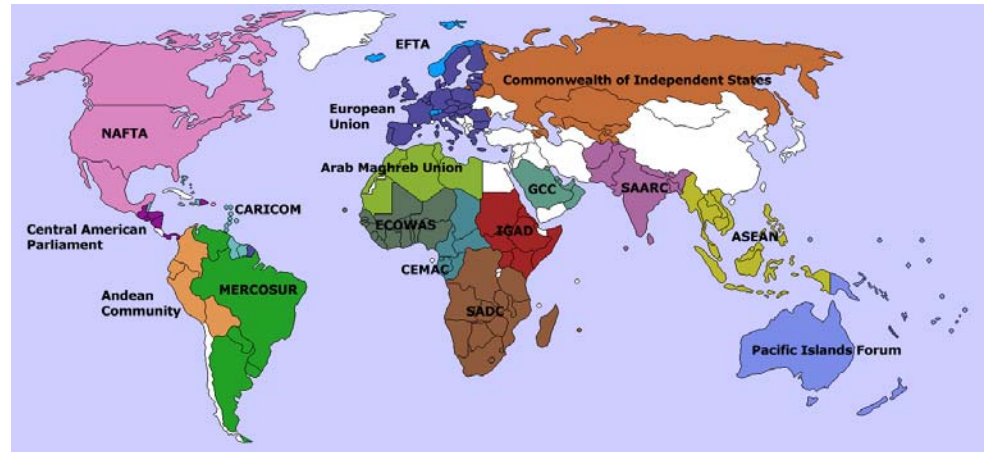


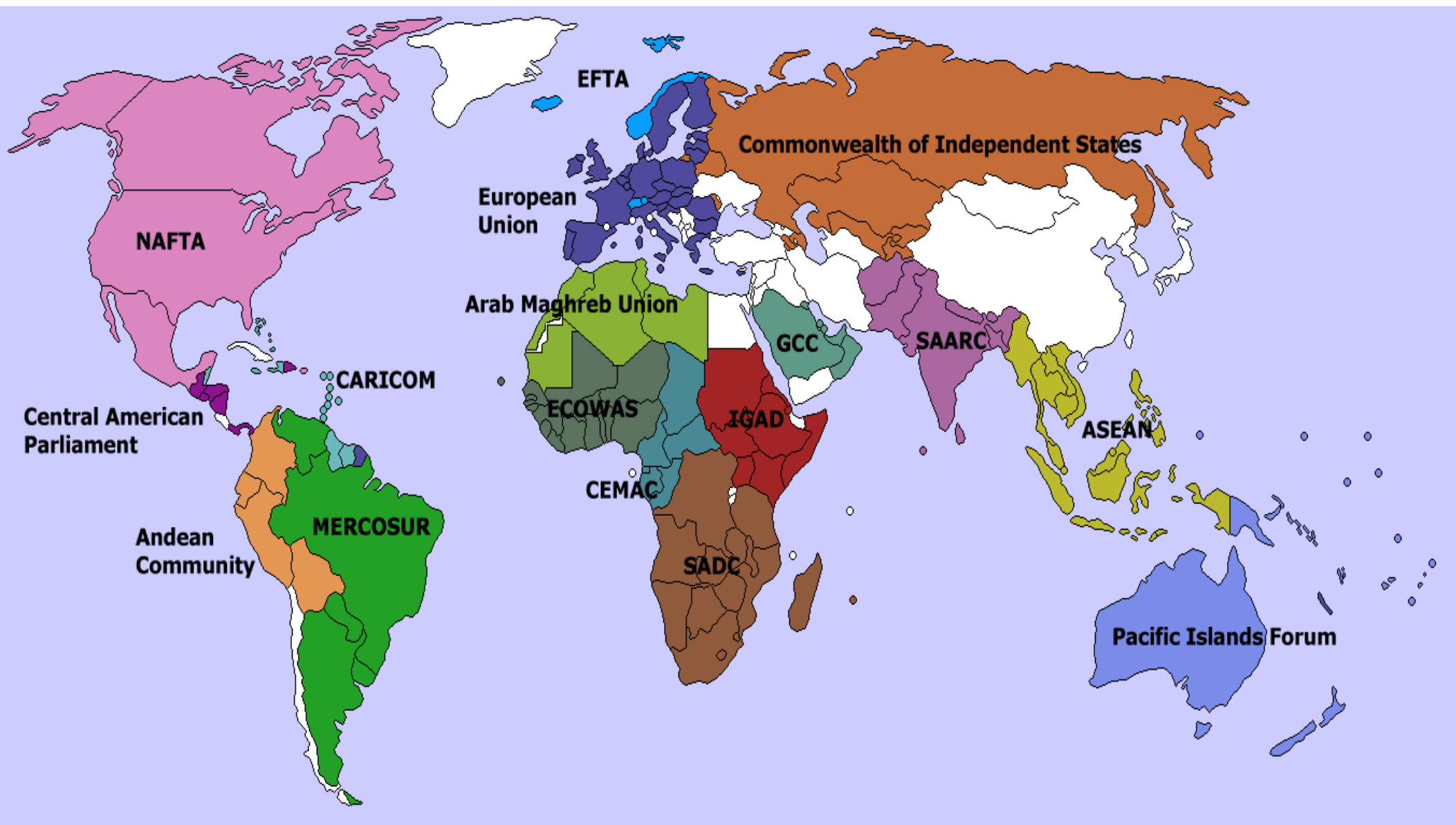
Regional Economic Integration Question

DOES REI PROMOTE FREE TRADE?

IN THEORY REI
PROMOTE FREE
TRADE...

BUT...





Definitions

LEVELS OF ECONOMIC INTEGRATION



Level of Economic Integration

Political Union: one country

Economic Union: integrate member economies, harmonized tax rates, and common currency

Common Market: free flow on factor of production (capital&labor) MERCOSUR in the near future (Brazil, Argentina, Paraguay, and Uruguay)

Customs Union: FTA + common trade policies with non members: ANDEAN Pact (Bolivia, Columbia, Ecuador, and Peru)

Free trade area: remove all barriers, each member has its own trade policy with nonmembers: ASEAN, NAFTA

LEVELS OF REI

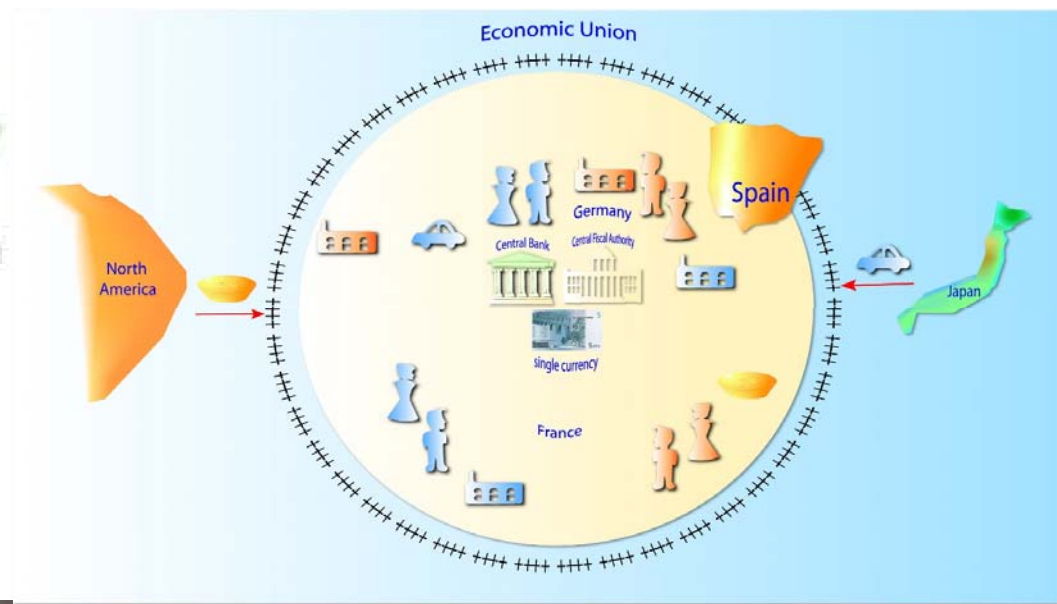
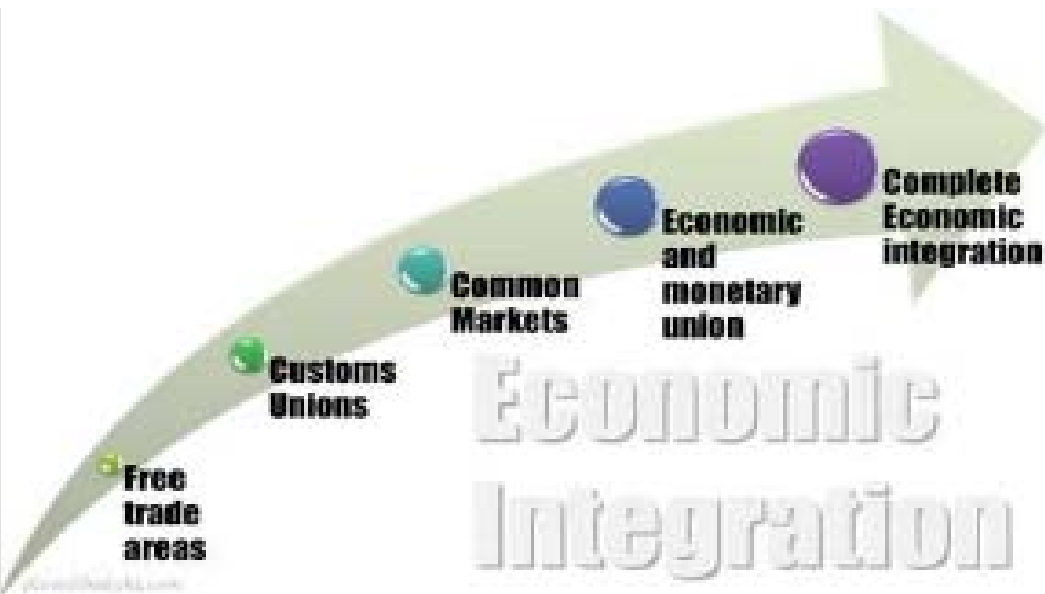
1. A **free trade area** eliminates all barriers to the trade of goods and services among member countries
 - **European Free Trade Association (EFTA)** - Norway, Iceland, Liechtenstein, and Switzerland
 - **North American Free Trade Agreement (NAFTA)** - U.S., Canada, and Mexico

LEVELS OF REI

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)

LEVELS OF REI

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



Obvious Question:

WHY DO COUNTRIES PURSUE REI?

WHY REI

- **Gains from free trade and investment**
 - REI as an attempt to exploit free trade and investment
- **Creating dependency between member countries**
 - Incentives for political cooperation; reduces likelihood of violent conflict
 - Greater political clout when dealing with other nations



WHAT LIMITS REI

- Economic integration can be difficult
 - Nation as a whole may benefit, but certain groups may lose
 - 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

EXAMPLE: EU

- 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

Growing Belief that National Economy Weakened by Economic Integration of Europe

% Saying overall economy weakened by economic integration of Europe

	2009	2010	2012	09-12 Change
	%	%	%	
Czech Rep.	37	--	59	+22
Italy	41	--	61	+20
Spain	32	41	50	+18
France	55	63	63	+8
Britain	54	57	61	+7
Poland	28	16	29	+1
Germany	43	48	39	-4
Greece	--	--	70	--

PEW RESEARCH CENTER Q35.





WHAT IS THE EU

- 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

- The **Single European Act** (1987)
- EC countries to work toward establishment of a single market by December 31, 1992
- 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

- 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

- 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

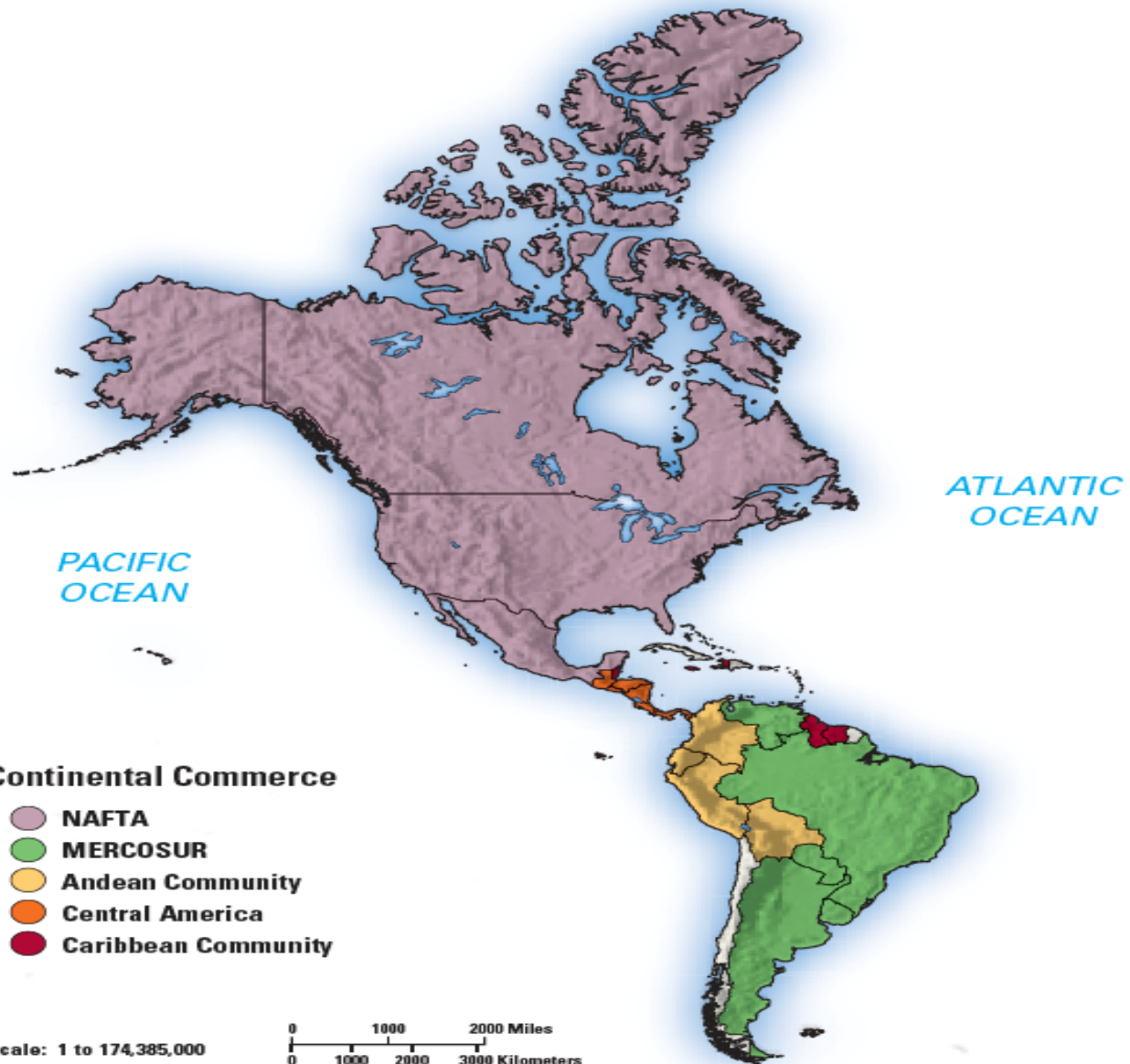
- savings from having to handle one currency, rather than many
- it is easier to compare prices across Europe, so firms are forced to be more competitive
- gives a strong boost to the development of highly liquid pan-European capital market
- increases the range of investment options open both to individuals and institutions

➤ Costs of the euro

- loss of control over national monetary policy
- EU is not an optimal currency area

- 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 NAFTA

- 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

BENEFITS?

- 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**
 - 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

CRITICS CLAIM THAT NAFTA...

- Jobs would be lost and wage levels decrease
- Pollution would increase – Mexico lax enviro laws
- Mexico as one large “sweatshop”



REALITY CHECK

- 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





MERCOSUR

- Mercosur
 - 1988 free trade pact between Brazil and Argentina
 - Expanded in 1990 to include Paraguay and Uruguay and in 2005 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

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

FTAA

- 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



ASIAN REI

- 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)

The ASEAN Integration

One Vision. One Identity. One Community.

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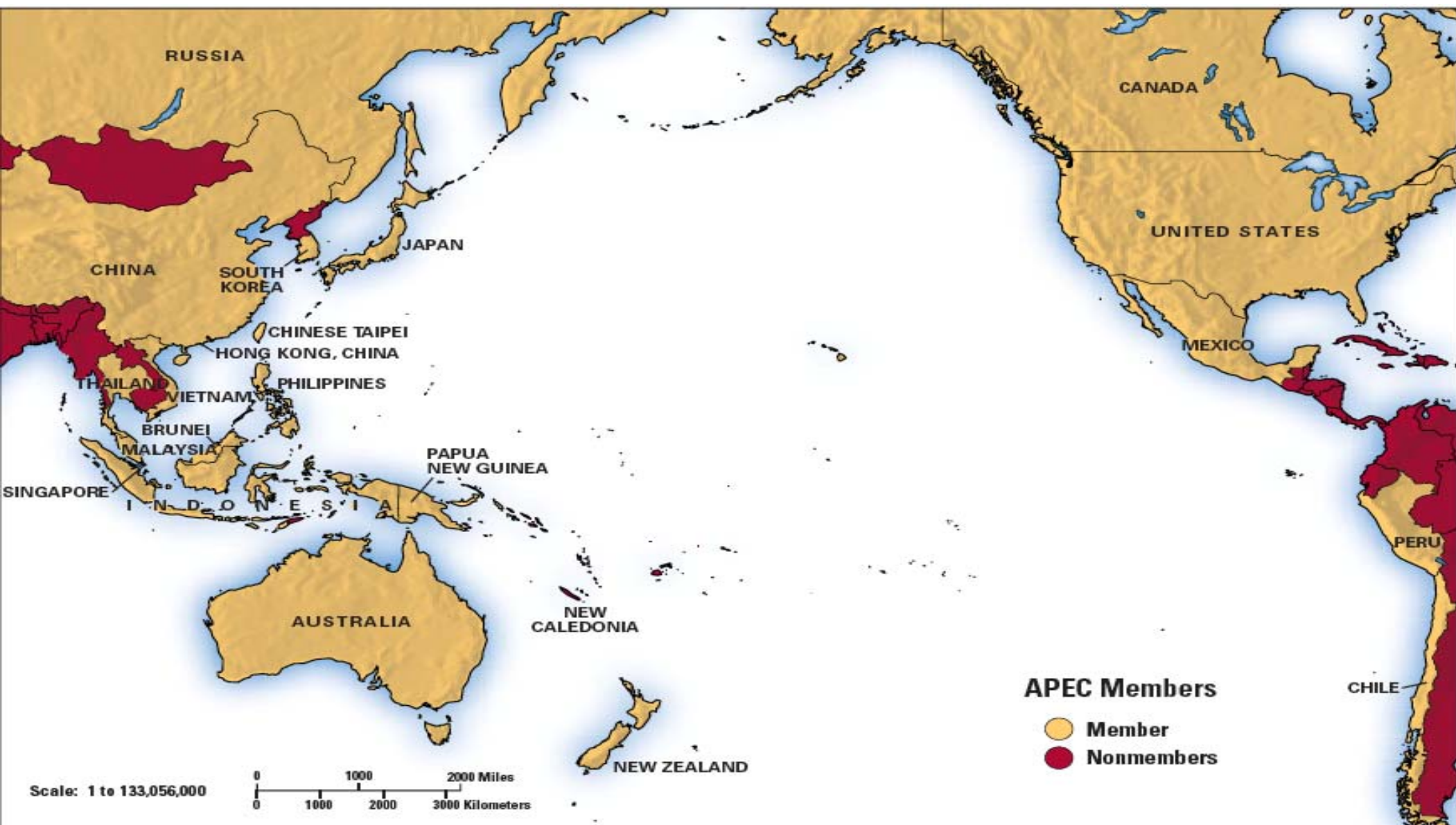


Asia-Pacific Economic Cooperation

ASEAN

- 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





WHY DO WE CARE AS 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”

