Learning Objectives

1. **Explain the importance of the GATT and the WTO to international businesses**
2. **Contrast the different forms of economic integration among cooperating countries**
3. **Analyze the opportunities for international businesses created by completion of the EU’s internal market**
4. **Describe the other major trading blocs in today’s world economy**
Opening Case: Trade and Prosperity: The Case of Mexico

Mexico

- 1917-1982: import substitution policy
- The last four Mexican presidents have reversed these policies
  - by lowering tariffs, privatization, encouraging FDI, and joining the GATT and WTO.
- Mexico's participation in NAFTA and recent agreement with the EU further opened its economy to the outside world.
- Many industries in Mexico are now booming.
- China's joining the WTO (and increasing attractiveness to foreign investors) and a slowdown in the U.S. economy in 2001 slowed Mexico's export surge.
- Mexico's officials recognize the need to increase labor productivity.
International Cooperation Among Nations

- The General Agreements on Tariffs and Trade (GATT) & the World Trade Organization (WTO)
- Regional Economic Integration (REI)
- The European Union (EU)
- Other Regional Trading Blocs
Development of the World Trading System

- Lack of trust between the nations
  - Governments are hesitant to remove/lower trade barriers for fear that the other might not follow
  - Negotiating and having the set of rules to govern cross-border trade and lower trade barriers
  - BUT who is to monitor? Who is to impose sanction?
  - An independent body to monitor and impose sanctions: GATT & WTO

- From Smith to the Great Depression
  - The first official free trade as a government policy by the GB in 1846
    - Removed the Corn Laws (high tariffs)
    - The GB was the world’s dominant trading powers
    - Pushed the case for trade liberalization but no other countries followed; GB had more to lose
    - The Great Depression in the 1930s made it worse
    - The US passed the Smooth-Hawley Act ("made-to-order" tariff) in 1930
      - Reaction from the US stock market collapse
      - Made the economy worse resulted the Great Depression
A) The General Agreements on Tariffs and Trade (GATT) and the World Trade Organization (WTO)

- **International Trade Organization**
  - Created when the representatives of the leading trading nations met in Havana, Cuba in 1947
  - Mission: to promote international trade
  - Never came into being
    - Controversy over how extensive its power should be

- **General Agreement on Tariffs and Trade (GATT)**
  - Developed as part of the preparations for the Havana conference
    - Established in 1947 (1947-1994)
    - A multilateral agreement whose objective was to liberalize trade by removing trade barriers
    - Membership: 19-120 nations
    - Trade reduction was spread over 8 rounds
    - The Uruguay Round (the 8th round): launched in 1986 and completed in Dec 1994
      - Agreed not to raise tariff rates above negotiated rates
      - Created the World Trade Organization (GATT was replaced by WTO)
    - Enforced by a mutual monitoring mechanism
      - In case of violation, the Geneva-based bureaucracy investigate
    - GATT successful in the early years
a) The role of the General Agreement on Tariffs and Trade (GATT)

- **GATT**
  - Sought to ensure that international trade was conducted on a nondiscriminatory basis

- **Most Favored Nation (MFN) principle**
  - Requires that any preferential treatment granted to one country must be extended to all countries
  - All members were required to utilize the MFN principle in dealing with other members
  - Against bilateral trade negotiations; multilateral trade negotiations were encouraged

- **Exceptions to the MFN principle**
  1. To assist poorer countries in their economic development effort
     - Generalized system of preferences (GSP): Reduced tariff rates offered to developing countries
  2. Comprehensive trade agreements that promote economic integration
     - E.g. the EU
a) The General Agreement on Tariffs and Trade (GATT)

- **1947-1979: GATT, Trade Liberalization and Economic Growth**
  - The US: gained economical power after WWII
  - GATT successful in the early years

- **1980-1993: Protectionist Trends**
  - GATT came under strain
    - Move towards greater protectionism
  - The reasons
    - The economic success of Japan during that time strained the world trading system
      - Japanese markets were closed to imports and investments
    - Strained by persistent trade deficit in the US
    - Many nations found the way around GATT regulations
      - Bilateral voluntary export restraints (VERs), circumvent GATT agreements (no nations complain)
The Uruguay Round and the World Trade Organization

- **GATT**
  - Permits countries to protect their domestic industries on nondiscriminatory basis
  - Many countries are in compliance with the GATT (in terms of tariffs) yet use nontariff quotas and use it in discriminatory basis & less transparent

- **In response to the rising pressures for protectionism**
  - 1986 GATT: the 8th round
  - The most ambitious and the most difficult
  - Stronger monitoring

- **Services and Intellectual Property**
  - Tried to cover trade in service, subsidy for agricultural products, intellectual property rights
b) The World Trade Organization (WTO)

- **The World Trade Organization**
  - The clarification & strengthening of GATT rules → the creation of the WTO
  - Acts as an umbrella organization
  - Encompasses the GATT (incl. service + intellectual property)
    - General Agreement on Trade in Service (GATS), Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
  - Responsible for arbitrating trade disputes & monitoring the trade policies of member states

- **The status of WTO**
  - 2011: 153 member states of WTO
    - Account for 97% of world trade
    - Another 25 countries (incl. Russia): negotiating for the membership
  - Forefront of efforts to promote global free trade
WTO: Experience to Date

The WTO in Seattle: A Watershed?

- WTO meeting 1999 in Seattle
- The millennium round aimed at further reducing barriers to trade and investments
- The talks ended in Dec 1999 with no agreement
  - The US vs. the EU on agricultural industry
  - The US to write “basic labor rights”
    - The US wanted to impose tariff from the countries that did not abide by ‘fair’ (from the US’s view) labor practice
    - Legal way of restricting imports from poorer nations
- Significant amount of people protested outside the meeting
  - the environmentalists & human rights activists
  - Violent protest with 600 demonstrators
- Poorer nations fear that rich countries will use environmental, human rights and labor-related issues to erect barriers to the products of the developing world
A New Round of Talks: Doha in 2001

- Member states of the WTO agreed to launch a new round of talks to further liberalizing the trade & investments

- Originally scheduled for 3 years but has gone longer and is still going on
  - Cutting tariffs on industrial good & services, phasing out subsidies to agricultural producers, reduce barriers to international investment, limiting the use of antidumping laws
    - EU with agriculture, US with antidumping, EU stepped back with the environmental issue (developing nations)
  - Pharmaceutical firms:
    - Acquiesced to demands from African, Asian and Latin American nations on the issue of drug patents

- The talk still going on
  - Several attempts in 2003, 2004 and 2011 still going on
The Future of the WTO: Unresolved Issues and the Doha Round

- **Antidumping Actions**
  - Many countries are exploiting the antidumping actions to pursue protectionism
  - 1995~mid-2010: 3,752 antidumping actions to the WTO
    - Basic metal, chemicals, plastics and machinery & electrical equipment
    - Intense competition, excess productive capacity, low price & profits

- **Protectionism in Agriculture**
  - High level of tariffs & subsidies in the agricultural sector
    - Canada 4.2% (21.2%), EU 3.8%(15.9%), Japan 3.9%(18.6%), the US 4.4%(10.3%)
  - The OECD nations spend more than $300 billion p.a. in subsidies to agricultural producers

- **WTO**
  - Removing tariff barriers and subsidies could significantly boost the overall level of trade, lower prices to consumers, and raise global economic growth by freeing consumption

- **Developed nations vs. developing nations**
i) The General Agreement on Trade in Services (GATS)

- **Expanding Trade Agreements**
  - Extension to service industries
    - Global telecom & financial services industries
    - Liberalization of telecom & financial service industries
      - Full liberalization by developed nations in 1998
      - Liberalize cross-border trade in financial services in 1999
      - 102 countries
  
- **Nondiscriminatory approach**
  - National Treatment
    - A country treats foreign firms the same way it treats domestic firms

- **Very few progress**
  - Diverse service industry
  - Few concrete agreements regarding specific service industries were included in the Uruguay Round
ii) Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS)

- Protecting Intellectual Property
  - The 1995 Uruguay round established TRIPS
    - Obliged WTO members to grant and enforce patents lasting 20 years and copyrights lasting 50 years
    - Rich nations: comply within a year; poor nations within 5 years; the poorest within 10 years
  - The protection of intellectual property is an essential element of the international trading system
  - Inadequate protections for intellectual property reduce the incentive for innovation
    - E.g. Pharmaceutical industry in India
      - 1970 the Indian govt did not recognize patent rights
      - making copies of patented drugs
    - India adopted the international drug patent regime in 2005
iii) Trade-related Investment Measures Agreement (TRIMS)

- **International Investment**
  - Approx. 1/3 of the $15.9 trillion of annual trade in goods and services is between subsidiaries of a parent organization

- **TRIMS**
  - A modest start toward eliminating national regulations on FDI
    - Trade balancing rules
      - No limit on foreign investors’ imports of inputs up to the amount equal to their exports of local production
    - Foreign-exchange access
      - May not restrict foreign investors’ access to foreign exchange
    - Domestic sales requirements
      - May not require the investors to sell a percentage of a factory’s output in the local market
iv) Enforcement of WTO Decisions

- WTO as Global Police
  - A country failing to live up to the agreement may have a complaint filed against it
    - If a WTO panel finds the country in violation of rules,
      - The panel may ask the country to eliminate the trade barrier
      - If they refuse, the WTO will allow the complaining country to impose trade barriers on the offending country equal to the damage caused by the trade barrier
      - The offending country is not allowed to counter-retaliate
  - The WTO may authorize sanctions
  - 1995~2010: more than 400 trade disputes were brought to the WTO
    - ¾ have been resolved by informal consultations between the disputing nations
    - ¼ went through formal procedures
    - Most nations have adopted WTO recommendations
B) Regional Economic Integration (REI)

- **Regional Economic Integration**
  - Agreements among countries in a geographic region to reduce (remove) tariff and nontariff barriers to the free flow of goods, services, and factors of production between each other.
  - Gain for consumers but challenges for some producers.
a) Forms of Economic Integration

- **Free Trade Area**
  - All barriers to the trade of goods and services among member countries are removed.
  - No discriminatory tariffs, quotas, subsidies or administrative impediments are allowed to distort trade between members.
  - Allowed to determine its own trade policies with regard to nonmembers.
    - E.g. NAFTA, European Free Trade Association (EFTA): established in 1960s.
    - Norway, Iceland, Liechtenstein and Switzerland.
      - Austria, Finland and Sweden joined the EU in 1996.
    - Founded by the Western European countries that initially decided not to be part of the European Community (the forerunner of the EU).
  - **Trade deflection**
    - Nonmembers deflect their exports to the member nation with the lowest external trade barriers.
      - E.g. NAFTA – Canada may use high tariffs or quotas to discourage imports but the US impose few restrictions on non-members.
      - Non-members may deflect their Canada-destined exports by first shipping the good to the US and then re-export it from the US to Canada.
  - **Rules of Origin**
    - Detailed conditions of the classification of good as a member good or a non-member good.
a) Forms of Economic Integration

- **Customs Union**
  - Eliminates trade barriers and adopts a **common external trade policy** among the member states.
  - Avoids the trade deflection problem.
  - Necessitates significant administrative machinery to oversee trade relations with non-members.
    - **Andean Community (Andean Pact)**
      - Bolivia, Colombia, Ecuador, and Peru
      - Free trade between member countries.
      - Imposes a common tariff on products imported from outside.
        - 5~20% tariff.
    - **Mercosur**
      - Argentina, Brazil, Paraguay, Uruguay, and Venezuela
      - Formed to reduce barriers to trade among the countries.

- **Common Market**
  - No barriers to trade, a common external trade policy, and allows **factors of production** to move freely between members.
  - Labor, technology, & capital are free to move.
    - No restrictions on immigration, emigration, or cross-border flows of capital between member countries.
    - Significant degree of harmony & cooperation on fiscal, monetary and employment policies.
a) Forms of Economic Integration

- **Economic Union**
  - Common market + Co-ordination of economic policies (a common currency, harmonization of members’ tax rates, and a common monetary and fiscal policy)
  - A high degree of integration, a coordinating bureaucracy
  - The *sacrifice* of *significant amount of national sovereignty* to that bureaucracy
  - The EU
    - an imperfect economic union
    - Not all members of the EU have adopted the euro
    - Differences in tax rates and regulations across countries still remain, some markets are not fully deregulated

- **Political Union**
  - A complete political as well as economic integration
    - A central political apparatus coordinates the economic, social, and foreign policy of the member states
b) The Impact of Economic Integration on Firms

- **Positive impact**
  - Opens the markets of member countries
  - Firms may enjoy economies of scale lowering cost of production and distribution
  - Help the firms compete internationally outside the trading bloc
  - May attract FDI from non-member countries

- **Negative impact**
  - Exposes a firm’s home market to competition from firms from the member countries
  - Increases the risk of doing business due to more competition
  - Possibility of trade diversion
The Case for Regional Integration

The Economic Case for Integration
- In theory, free trade & investments are beneficial and ideal
- Purely “free trade & investment” is impossible
  - Very difficult to get all countries to agree to a common set of rules
- REI can be seen as an attempt to achieve additional gains from the free flow of trade and investment between countries
  - REI motivated by a desire to exploit the gains from free trade & investment

The Political Case for Integration
- Linking neighboring economies and making them increasingly dependent on each other
  - Incentives for political cooperation between the neighboring states and reduces the potential for violent conflict
  - The countries (as a whole) can enhance their political weight in the world
- The European Community (EC): 1957
  - WWI & WWII
  - The European nation-states were no longer large enough to hold their own world markets and politics
    Against the US and former Soviet Union
The Case Against Regional Integration

- Impediments to Integration
  - Costs that is involved with the integration
    - Certain groups may lose
    - May involve painful adjustments
      - NAFTA: loss of low-cost, low-skilled jobs in the US and Canada
  - Significant loss of national sovereignty
    - E.g. NAFTA: Mexico’s concern about maintaining control of its oil interests
    - Close economic integration demands that countries give up some degree of control
      - Monetary, fiscal and trade policy
    - E.g. Euro & the UK
      - It would require relinquishing control of the country’s monetary policy to the EU
The Case Against Regional Integration

- **Trade creation**
  - Occurs when high-cost domestic producers are replaced by low-cost producers within the free trade area

- **Trade diversion**
  - Occurs when lower-cost external suppliers are replaced by higher-cost suppliers within the free trade area

- **The case against REI**
  - The benefits of REI have been **oversold**
    - The **costs** have often been **ignored**
  - REI will only benefit the world only if
    - the amount of trade it **creates > it diverts**
    - Otherwise it is a change for the worse
  - Regional trade blocs could emerge whose markets are protected from outside competition by high non-tariff barriers
Evolution of the European Union

- Europe: the EU (28) & the EFTA (European Free Trade Association; 4)
- The European Union (EU)
  - The reasons for the creation
    - The desire for a lasting peace (motivated from two world wars)
    - The desire to hold their own on the world’s political and economic stage
  - History
    - 1951: the European Coal and Steel Community
      - Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands
      - To remove barriers to intragroup shipments of coal, iron, steel and scrap metal
    - 1957: The European Economic Community (ECC) was established (the Treaty of Rome)
      - Provided for the creation of a common market
      - The elimination of internal trade barriers & the creation of a common external tariff, the free movement of factors of production, harmonization of the member states’ law
      - Common policies in agriculture and transportation
Evolution of the European Union

The European Union (EU)

History

- The 1970s: the UK, Denmark, Ireland joined the ECC
  ECC  The European Community (EC)
- The 1980s: Greece, Portugal, Spain entered the EC
- 1993: the EC became the EU (the Maastricht Treaty)
- 1995: Austria, Finland, Sweden
- 2004 (1st of May): 10 countries
  - 8 East Europe + Malta and Cyprus (Mediterranean nations)
  - Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia
- 2007: Bulgaria and Romania
- 2013: Croatia

Total EU members: 28 member countries
a) Governing the European Union

- The EU
  - Intergovernmental government
    - A government of national governments
  - Supranational government
    - Exercises power above the national level

- The Governing Body of the EU
  - The European Council
  - The Council of the European Union
  - The European Commission
  - The European Parliament
  - The European Court of Justice
a) Governing the European Union

The European Commission

- Administrative ranch of EU & manages EU’s annual budget
- Responsible for **proposing EU legislation**, **implementation** and **monitoring** compliance with EU laws by member states
  - 5-year renewable terms; 28 commissioners (one from each nation)
- Competition policy
  - Ensure that no one enterprise uses its market power to derive out competitors or monopolize markets
  - Reviews proposed M&As
  - E.g. Music recording business
    - Time Warner (the US) & EMI (the UK)
    - The merger would reduce number of major record companies & play a dominant player in the global music industry
  - Telecom business
    - WorldCom & Sprint
    - Concern for the market domination
a) Governing the European Union

The European Council
- The head of government of each member states (28), the President of the European Council, and the President of European Commission
- The EU’s High Representative of the Union for Foreign Affairs and Security Policy participates in the meeting

The Council of the European Union
- Previously the Council of Ministers
- Represents the interests of member states
  - One representative from the government of each member states (28)
- Draft legislation created by the commission can become the EU law only if the council agrees
  - The ultimate controlling authority within the EU
- The EU’s most powerful Decision-making body
  - Before 1987: all council issues had to be decided by unanimous agreement
  - The Single European Act: majority voting rules on issues “which have as their object the establishment and functioning of a single market”
  - Tax regulations & immigration: unanimous agreement required
a) Governing the European Union

The European Parliament

- 736 members: Directly elected by the population of the member states (5 year terms)
  - Seats allocated in rough proportion to a country’s population
- A consultative (rather than legislative) body
- Debates legislation proposed by the commission and forward to it by the council
- Has the right to vote on the appointment of commissioners & veto (accept or reject) some laws
  - Whether the council or the parliament should ultimately be the most powerful body in the EU?
- The Treaty of Lisbon (Dec, 2007)
  - The power of the European Parliament increased
  - New position: a president of the European Council
    - 30-month terms, represents the nation-states that make up the EU
  - Took effect in Dec 2009
a) Governing the European Union

- The European Court of Justice
  - One judge from each country
    - 28 judges who serve six-year terms
  - Supreme appeals court for EU law
  - Interprets EU law and ensures that members follow EU regulations and policies
  - The judges are required to act as independent officials rather than as representatives of national interest (just as commissioners)
    - Cases, issues or conflicts that fail to meet treaty obligation
b) The Struggle to Create a Common Market

- **Struggle of the EU**
  - The first 35 years was ineffective
  - Each EU member had to agree to change thousands of its national laws, product standards, and regulations
  - Conflicting national regulations hindered trade & the completion of the common market
    - E.g. keyboards sold in Spain: required to contain a “tilde” key. No other EU country prescribed such regulations
  - EU producers spent an estimated US$1988 annually to comply with different national regulations

- **The process of “harmonization”**
  - To eliminate conflicts
  - The EU encouraged its members to voluntarily adopt common, EU-wide regulations affecting intra-EU trade

- **Cassis de Dijon case in 1979**
  - Rewe Zentral AG, a German wholesaler wished to import Cassis de Dijon, a French liqueur made from black currants, into Germany
  - It failed Germany’s regulatory standards – its alcohol content was too low
  - Rewe Zentral sued German government arguing that the government violated its obligations under the Treat of Rome (which promote the free movement of goods)
  - The European Court of Justice found for Rewe Zentral
    - Created the concept “mutual recognition”
b) The Struggle to Create a Common Market

- Mutual recognition
  - If one member state determines that a product is appropriate for sale, then all other EU members are also obliged to do so under the provision of the Treaty of Rome
    - *Cassis de Dijon* case  Germany was obligated to allow its sale
  - Conflicting product standards would no longer serve as barriers to trade among EU members
  - At that time, many EU leaders were more concerned about the EU’s competitiveness in the world

- White Paper on Completing the Internal Market
  - Issued by the European Commission in 1985
  - Called for accelerated progress on ending all trade barriers and restrictions on the free movement of goods, services, and labor among members
  - The Single European Act: in 1986
    - 279 broad regulatory changes
The Single European Act

- The Single European Act (since 1986)
  - Independently ratified by the parliaments of each member states & became EC law in 1987

- The Objectives of the Act
  - Remove all frontier controls between EC countries
  - Apply the principle of “mutual recognition” to product standards
    - Should be accepted in another, provided it meets basic requirements (health and safety)
  - Open public procurement to non-national suppliers
  - Lift barriers to competition in the retailing and insurance businesses
  - Remove all restrictions on foreign exchange transactions between members
  - Abolish restrictions on cabotage
    - The right of foreign truckers to pick up and deliver goods within member state’s borders
Impact

- Provided the motivation for the restructuring of substantial sections of European industry
- Many firms shifted from national to pan-European production and distribution systems
  - Faster economic growth
- 20 years later the formation of a single market
  - The reality falls short of the ideal
  - E.g. broadcasting example (the opening case)
  - A single market in Financial Services
    - Embarked in 1999, by 2005
    - Anticipated benefits
      - Greater competition; Greater consumer benefit; Lowering cost, increased liquidity of a large capital market (easier for firms to borrow money);

Difficulty

- Language barriers, different EU member states have historically been segmented from each other & has its own regulatory framework (tax, oversight, accounting information, cross-border takeovers)

By 2011

- Significant progress
- More than 40 measures designed to create a single market in financial services had become EU law

Significant setbacks

- Legislation designed to make it easier for firms to make hostile cross-border acquisitions was defeated
- National governments have still reserved the right to block even friendly cross-border mergers between financial service firms
c) From Common Market to European Union

- The finalization of the Single European Act
  - The end of Cold War
    - The Soviet Union dissolved, the East European & Central European countries abandoned communism and the threat of nuclear war diminished
    - The US stood alone as the world's superpower
  - The leaders of EU
    - Believed that Europe should reassert itself on the world's stage & free itself from US's domination
    - EU firms remained at a competitive disadvantage in regard to Asia and North America
      - Risk of doing business in so many different currencies

- Treaty on European Union - the Maastricht Treaty in 1991
  - To discuss the EU's economic & political future
  - A new treaty that amended the Treaty of Rome
  - The three pillars
    1. A new agreement to create common foreign and defense policies among members
    2. A new agreement to cooperate on police, judicial, and public safety matters
    3. The old familiar European Community, with new provisions to create an economic and monetary union among member states
  - Granted citizens the right to live, work, vote, and run for election anywhere within the EU
  - Strengthened the powers of the EU's legislative body, the European Parliament in budgetary, trade, cultural matters

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the Maastricht Treaty

- Created a new cohesion fund
  - A means of funnelling economic development aid to countries whose per capita GDP is less than 90% of the EU average
  - The initial recipients of cohesion funds
    Spain, Portugal, Greece, and Ireland

- Euro
  - Established the Economic and Monetary Union (EMU)
    - To create a single currency: the Euro
    - To adopt a common currency (€) by Jan 1st, 1999
      - Three year transition period
        - € was not issued until 2002; meanwhile the currencies for the member states were circulated across the member nations
    - Used by 17 of 28 member states (Eurozone)
      - 330 million euro citizens; incl. Germany & France
    - The East European and the two countries that joined the EU in 2004 & 2007 will use € when they fulfill certain economic criteria
      - High degree of price stability; a sound fiscal situation; stale exchange rate; converged long-term interest rates
    - Member countries
      - Give up their own currency
      - Give up their control over monetary policy
    - € became the second largest traded currency
the Maastricht Treaty

- **Euro**
  - Any EU member wishing to adopt the euro has to meet five convergence criteria:
    1. Inflation rate must be no more than 1.5 percentage points higher than the av. of the three EU countries with the lowest inflation rates
    2. Long-term interest rates must be no more than 2 percentage points higher than the av. of the three EU countries with the lowest long-term interest rates
    3. A country must have been a member of the EU’s revised exchange-rate mechanism for two years
    4. Budget deficit must be no more than 3% of its GDP
    5. Outstanding government debt must be trending toward no more than 60% of its GDP

- **Benefits of the Euro**
  - Businesses & individuals will realize significant savings from having to handle one currency, rather than many
    - Lower foreign exchange and hedging costs
    - E.g. travelling from Germany to France
  - Makes it easier to compare prices across Europe
  - European producers have been forced to look for ways to reduce their production costs to maintain their profit margins
  - A boost to the development of a highly liquid pan-European capital market
    - Lower costs of capital, increase in both the level of investment and the efficiency
  - Increase the range of investment options open to both individuals and institutions
    - Easier for European investors to diversify their risk
The Establishment of the Euro

Costs of the Euro
- National authorizes have lost control over monetary policy
- European Central Bank (ECB)
  - Reserve bank for the Eurozone
  - Meant to be independent from political pressure but not
  - Meant to keep inflation under tight control
- Optimal currency area
  - Similarities in the underplaying structure of economic activity
  - Feasible to adopt a single currency and use a single exchange rate as an instrument of macro-economic policy
- Dissimilarities between many of the Eurozone nations
  - E.g. different wage rates, tax regimes, business cycles, react differently to external economic shocks
  - A change in the euro exchange rate may help Finland and may hurt Portugal

Pressure towards political union
- The € will lead to lower economic growth and higher inflation within Europe

The Experience to Date
- Volatile trading history against the US dollar
  - 1999: €1=US$1.17  2000: €1=US$0.83
  - Investors were investing money in booming US stocks and bonds
  - Investors were selling € to but US$ to invest in the US
  - 2001: the value of € increased as US$ weakened
  - 2011: €1=US$1.36
Other treaties

- **Treaty of Amsterdam in 1997**
  - A strong commitment to attack the EU’s chronic high levels unemployment
  - A plan to strengthen the role of the European Parliament
  - Establishment of a two-track system
    - Allowing groups of members to proceed with economic and political integration faster than the EU as a whole

- **Treaty of Nice**
  - Became effective in 2003
  - Making modest adjustments in the EU’s governance arrangements
    - E.g. Unanimous decision qualified majority in European Council’s judgment
  - Strengthened the powers the Commission (represents Europe as a whole)
  - Weakened the powers of the Council (represents each member nation)

- **The Convention**
  - Began its deliberations in 2002
  - Drafted a proposed Constitution – endorsed by the leaders of the EU member states in 2004

- **Treaty of Lisbon (Reform Treaty)**
  - Adopted many of the governance changes proposed by the Constitutional Convention
  - Entered into force in 2009
  - Grants national legislatures the formal right to voice concerns about proposed EU legislation
Future EU Challenges

- National government protection in time of crisis
  - Many governments are unwilling to let domestic firms go bankrupt
  - Global recession
    - National governments have tried to protect their domestic corporations from unwanted takeovers by firms headquartered in other EU nations
  - Against EU rules
    - National governments may not provide subsidies to firms that “distort” competition
  - EU’s Common Agricultural Policy
    - France and the UK continue to squabble
- Paucity of democracy and lack of accountability within the EU
- Economic crisis / European Debt Crisis
  - Domino effect
  - Ireland, Greece, Portugal, Spain, Cyprus
  - E.g. Greek economy in numbers (BBC, May 12, 2015)
    - Unemployment rate: 25% (youth unemployment almost 50%)
    - Economy has shrunk by 25% since the start of the Eurozone crisis
    - Country’s debt: 175% of its GDP
D) Other Regional Trading Blocs

- **Free Trade Agreements in the Americas**
  - The North American Free Trade Agreement (NAFTA)
  - The Caribbean Basin Initiative (CBI)
  - The Central America-Dominican Republic Free Trade Agreement (CAFTA-DR)
  - The Mercosur Accord
  - ANDEAN Community

- **Trade Arrangements in the Asia-Pacific Region**
  - The Australia-New Zealand Closer Economic Relations Trade Agreement (CER)
  - Association of Southeast Asian Nations (ASEAN)
  - The Asia-Pacific Economic Cooperation Initiative (APEC)

- **African Initiatives**
a) Free Trade Agreements in the Americas

- The North American Free Trade Agreement (NAFTA)
- The Caribbean Basin Initiative (CBI)
- The Central America-Dominican Republic Free Trade Agreement (CAFTA-DR)
- The Mercosur Accord
- ANDEAN Community
The North American Free Trade Agreement (NAFTA)

- Free trade (FTA) between Canada & the US in 1988
  - Took effect Jan 1, 1989
  - To eliminate all tariffs on bilateral trade between the US & Canada by 1998

- NAFTA in 1991~1992
  - The agreement became law Jan 1, 1994

- NAFTA’s Contents
  - Abolition of tariffs on 99% of goods traded between the three by 2004
  - Removal of most barriers on cross-border flows of services by 2000
  - Protection of intellectual property rights
  - Removal of most restrictions on FDI between the three
  - Application of national environmental standards
  - Establishment of two commissions with the power to impose fines and remove trade privileges when environmental standards
The North American Free Trade Agreement (NAFTA)

The Case for NAFTA
- An opportunity to create an enlarged and more efficient productive base for the entire region
- Some US & Canadian firms would move production to Mexico to take advantage of low cost production
- More FDI toward Mexico
- Increased income of Mexicans will increase imports of Mexico
- Consumers benefit for lower prices & diversity

The Case against NAFTA
- Mass exodus of jobs from the US and Canada into Mexico
  - Up to 5.9 million US jobs would be lost to Mexico after NAFTA
  - Net creation of 170,000 jobs in the US, an increase of $15 billion Mexican & the US joint GDP p.a. & a net loss of 490,000 jobs
- Trade deflection
  - Possibility of the non-member states to exploit the opportunity
  - Screwdriver plant
    - A factory in which very little transformation of a product is undertaken
- The influence of NAFTA
  - Very small for the US & Canada
  - Big for Mexico

NAFTA: The Results
- NAFTA’s overall impact has been small but positive
- 1993–2005
  - Trade between NAFTA’s partners grew by 250%
  - Canada & Mexico: among the top three trading partners of the US
    - 1990: ¼ of total US trade  2005: 1/3 of total US trade
  - All three countries experienced significant productivity growth

Enlargement
- A number of other Latin American countries indicated their desire to join
- The US & Canada: wait-and-see attitude
- Chile – opposed by the US congress
- US & Chile made FTA in 2002
Other Free Trade Agreements in the Americas

- **The Caribbean Basin Initiative (CBI)**
  - Established in 1983 to facilitate the economic development of the countries of Central America and the Caribbean Sea
  - Overlaps two regional free trade areas
    - Central American Common Market & the Caribbean Community and Common Market
  - Acts as a unidirectional FTA
    - Permits duty-free import into the US of a wide range of goods originated in Caribbean Basin countries

- **The Central America-Dominican Republic Free Trade Agreement (CAFTA-DR)**
  - Agreement among the US, five Central American countries, and the Dominican Republic
    - Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua
  - Signed in 2004
  - Calls for the reduction of tariffs, nontariff barriers, and investment barriers among its members
    - Approx. 80% of US exports to and imports from these countries will immediately be duty-free
    - The remaining tariffs are to be phased out over a 10-year period
MERCOSUR

- In 1988: free trade pact between Brazil & Argentina
  - Modest reductions in tariffs and quotas
  - 80% increase in trade between the two in the late 1980s
- In March, 1990: Paraguay and Uruguay joined
- 1991: the Mercosur accord
- Later: Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela joined
- Initial aim
  - To establish a full free trade area by the end of 1994
  - An agreement to create a customs union among themselves
- Dec, 1995 full implementation of customs union
  - Five-year program: hoped to perfect their free trade area & move towards full customs union

Positive progress
- Trade between the 4 core members quadrupled between 1990~1998
- The combined GDP of the 4 members grew at an average rate of 3.5% p.a. between 1990~1996

Critics
- Alexander Yeats: trade diversion effects
- Intra-Mercosur trade
  - Cars, buses, agricultural equipment
- Insulated from outside competition by tariffs that run as high as 70%

1998
- Member states suffered recession & intra-bloc trade slumped
- Progress toward establishing a full customs union stopped
- Little progress

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The Andean Community

- **The Andean Pact in 1969**
  - Bolivia, Chile, Ecuador, Colombia and Peru
  - Based on the EU model but less successful
  - Internal tariff reduction, a common external tariff, a transportation policy, a common industrial policy and special concessions for the smallest members, Bolivia and Ecuador

- **Mid-1980s**
  - Collapsed
  - No tariff-free trade, no common external tariff, no harmonization of economic policies
  - Political & economic problems
  - Low economic growth, hyperinflation, high unemployment, political unrest, crushing debt burdens

- **1991: Andean Community (renamed in 1997)**
  - To adopt free market economic policies
  - Bolivia, Ecuador, Peru, Colombia, and Venezuela
  - Free trade area by 1992; a customs union by 1994; a common market by 1995

- **2005:**
  - A customs union implemented in 1995 (now they are customs union)

- **2006:**
  - Negotiated a cooperative agreement with Mercosur
  - Argentina, Brazil, Paraguay, and Uruguay joined

- **2009:**
  - Venezuela withdrew from the Andean Community to join Mercosur
  - To protest against Colombia and Peru’s signing trade promotion agreements with the US

- **2009:**
  - About 8% of members’ $78 billion merchandise exports were purchased by other Andean Community members

- **Struggle**
  - Creation of a common external tariff was stalled by political squabbling over the appropriate tariff level and structure
b) Trade Arrangements in the Asia-Pacific Region

- The Australia-New Zealand Closer Economic Relations Trade Agreement (CER)
- Association of Southeast Asian Nations (ASEAN)
- The Asia-Pacific Economic Cooperation Initiative (APEC)
The Australia-New Zealand Closer Economic Relations Trade Agreement (CER)

- **NZ & AU’s relationship with the UK**
  - Commonwealth members
  - Enjoyed preferential access to the UK
  - Lost their privileged status in the British market when the UK joined the EU
    - Poor performance in economy in the 1970s

- **The Australia-New Zealand Closer Economic Relations Trade Agreement (CER)**
  - Took effect on January 1, 1983
  - Eliminated tariffs and non-tariff barriers between the two
  - Strengthened and fostered links and co-operations in fields in investment, marketing, movement of people, tourism, and transport
Association of Southeast Asian Nations (ASEAN)

- Formed in 1967
  - Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
  - Laos, Myanmar, Vietnam and Cambodia joined recently
    - 500 million people; combined GDP of $740 billion
- Objective
  - To foster freer trade between member countries
  - To achieve cooperation in their industrial policies
- Limited progress
  - Only 5% of intra-ASEAN trade consisted of goods whose tariffs had been reduced

**ASEAN Free Trade Area (AFTA)**

- Established in 1993
  - AFTA between six original members came into full effect by 2003 on most manufactured goods (on all goods by 2010)
  - Cut tariffs on manufacturing and agricultural products to less than 5%
- Motivation
  - To decrease in government control of national economies & attract FDI
  - Defensive response to the growth of other regional trading blocs
- Intra-ASEAN trade: represents about 25% of the group’s merchandise trade
- 2003: FTA with China
Asia-Pacific Economic Cooperation (APEC)

- Founded in 1989
  - In response to growing economic interdependence of the Asia Pacific region
- 21 member states
  - 55% of the world’s GNP, 49% of world trade
- Aim
  - To increase multilateral cooperation in view of the economic rise of the Pacific nations
  - Growing interdependence within the region
- 1993 in Seattle
  - First meeting by the heads of the member states
  - Commitment to the ultimate formation of a free trade area
    - World’s largest free trade area
- APEC meeting did not work effectively
  - No more than vague commitments from member states
- 2009
  - Merchandise exports from APEC members $6.8 trillion (55% of the world’s total exports)
c) African Initiatives

- South African Development Community (SADC)
- The Economic and Monetary Community of Central Africa (CEMAC)
- The Economic Community of West African States (ECOWAS)

- These groups were established during the 1970s and early 1980s
- Have not had a major impact on regional trade
  - Inadequate interregional transportation facilities
  - The failure of most domestic governments to create economic and political systems that encourages significant regional trade
  - Intra-Africa trade: accounts for less than 12% of the continent’s total exports
Homework #17 – due next Friday

- Read the case “The New Conquistador”
- Answer the first four case discussion questions
- Do not spend more than 2 pages answering the questions
- You may use bullet points
- Keep your answers brief but think!
- Type your answers

Due date: Friday, 22nd of May by 11 a.m.
Group discussion Report #8 (due next Friday)

- With your group members discuss;
  - About Chapter 10
  - About Chapter 10 case study
  - And discuss based on case discussion questions

- Discuss following statement
  “Should international business promote or fight the creation of regional trading blocs?”

- Report due date: Friday, 22nd of May by 11 a.m.
- Group report / Individual Report (sheets are downloadable from the website http://ecampus.cbnu.ac.kr)
Case Study
Green Energy and Free Trade

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Discussion Question
Discussion Question

“Should international business promote or fight the creation of regional trading blocs?”
Case Study Discussion

The New Conquistador
The New Conquistador

- the policy changes that have been initiated in South America, and focuses on how these changes have impacted the telecommunications industry
- Telefónica S.A.
  - The most aggressive firm in the telecommunications industry and market us Telefónica S.A.
  - Based in Spain and faced with increasing competition from the EU,
  - Invested in new equipment and technologies to maintain and grow their business.
- The evaluated expanding into other EU countries, and a decision was made against European expansion because of significant competition.
- Telefónica then noticed that the South American countries were privatizing the state owned telephone monopolies.
  - Because of linguistic and cultural ties to South America, a decision was made to enter these markets.
- The company initiated entrance in 1990 into the market with an acquisition in Chile, followed by Argentina, Brazil, Peru, Mexico and Colombia.
  - They have been criticized by many because of the aggressive approach to control the market and many of the business policies.
  - After conquering Spain and Latin America, they turned their attention back to Europe, making an initial acquisition in the Czech Republic followed by Italy, the United Kingdom and Germany.
How important was the EU’s directive eliminating national telecommunications monopolies by 1998 in shaping Telefonica’s strategy? What would the company look like today if Spain were not a member of the EU?
The New Conquistador

- How important were cultural ties in determining Telefonica’s success in Latin America?
Why did Telefonica initially choose to enter the Czech market, rather than the larger French or German markets?
The New Conquistador

- Considering Telefonica’s large and persistent share of the Spanish telecommunications market, how successful has the EU’s directive been in promoting competition within the European telecommunication industry?
Homework #16 – due next Wednesday

- Read Chapter 11 – International Strategic Management
- Answer the following questions
  1. What is international strategic management?
  2. What are the three sources of competitive advantage available to international businesses that are not available to purely domestic businesses?
  3. Why is it difficult for firms to exploit these three competitive advantages simultaneously?
  4. What are the four basic philosophies that guide strategic management in most MNCs?
  5. How do international strategy formulation and international strategy implementation differ?
  6. What are the steps in international strategy formulation? Are these likely to vary among firms?
  7. Identify the four components of an international strategy.
  8. Describe the role and importance of distinctive competence in international strategy formulation.
  9. What are the three levels of international strategy? Why is it important to distinguish among the levels?
 10. Identify and distinguish among the three common approaches to corporate strategy.
 11. Identify and distinguish among the three common approaches to business strategy.
 12. What are the basic types of functional strategies most firms use? Is it likely that some firms have different functional strategies?

- Do not spend more than 2 pages (Type your answers)
- Try and keep your answers brief
- Due date: Wednesday, 27th of May by 10 a.m.

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Homework #17 – due next Friday

- Read the case “Global Success of SM Entertainment”
- Answer the three case discussion questions
- Do not spend more than 2 pages answering the questions
- You may use bullet points
- Keep your answers brief but think!
- Type your answers

- Due date: Friday, 29th of May by 11 a.m.
Group discussion Report #8 (due next Friday)

- With your group members discuss;
  - About Chapter 11
  - About Chapter 11 case study
  - And discuss based on case discussion questions

- Discuss following statement
  “Should the same managers be involved in both formulating and implementing international strategy, or should each part of the process be handled by different managers? Why?”

- Report due date: Friday, 29th of May by 11 a.m.
- Group report / Individual Report (sheets are downloadable from the website http://ecampus.cbnu.ac.kr)