Chapter 8

Regional Economic Integration

International Business
Strategy, Management & the New Realities

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Learning Objectives

1. Regional integration and economic blocs
2. Types of regional integration
3. Leading economic blocs
4. Why countries pursue regional integration
5. Success factors for regional integration
6. Drawbacks and ethical dilemmas of regional integration
7. Management implications of regional integration

- **Regional economic integration**, refers to the growing economic interdependence that results when countries within a geographic region form an alliance aimed at reducing barriers to trade and investment.
- **40%** of world trade today is under some bloc preferential trade agreement.
- Premise- mutual advantages for cooperating nations within a common geography, history, culture, language, economics, and/or politics
- Free trade that results from economic integration helps nations attain higher living standards by encouraging specialization, lower prices, greater choices, increased productivity, and more efficient use of resources.

- **Economic bloc**- a geographic area that consists of two or more countries that agree to pursue economic integration by reducing tariffs and other restrictions to cross-border flow of products, services, capital, and, in more advanced stages, labor. Advantages:
- Blocs involve a smaller number of countries and are much easier to negotiate than a system of worldwide free trade.
- **1947**- the GATT the WTO have fostered economic integration on a *global* scale.
- WTO rules have been less effective in dealing with groups of countries, and the slow progress to liberalize trade, especially in agricultural products, has prompted many developing countries to seek alternatives to the trading system favored by the WTO.

Types of Regional Integration

- Regional integration is a continuum, with economic interconnectedness progressing from a low level of integration—the **free trade area**— through higher levels to the most advanced form of integration—the **political union**.
- **Synergies**- the total output of the integrated area becomes greater than that achievable by individual states.
- Five possible levels of regional integration.

Level of Integration	*Free Trade Area*	*Customs Union*	*Common Market*	*Economic and (sometimes) Monetary Union*	*Political Union*
Members agree to eliminate tariffs and non tariff trade barriers with each other but maintain their own trade barriers with non member countries. *Examples: NAFTA, EFTA, ASEAN, Australia and New Zealand Closer Economic Relations Agreement (CER)*	✔				
Common external tariffs *Example: MERCOSUR*	✔	✔			
Free movement of products, labor, and capital *Example: Pre-1992 European Economic Community*	✔	✔	✔		
Unified monetary and fiscal policy by a central authority *Example: The European Union today exhibits common trade, agricultural, and monetary policies*	✔	✔	✔	✔	
Perfect unification of all policies by a common organization; submersion of all separate national institutions *Example: Remains an ideal; yet to be achieved*	✔	✔	✔	✔	✔

Exhibit 8.1

Five Potential Levels of Regional Integration among Nations

1. **Free trade area**- is the simplest and most common arrangement, in which member countries agree to gradually eliminate formal barriers to trade in products and services within the bloc, while each member country maintains an independent international trade policy with countries outside the bloc. **E.g.,** NAFTA.
2. **Customs union-** similar to a free trade area except that the member states harmonize their trade policies toward nonmember countries -- *common* tariff and nontariff barriers on imports from nonmember countries. **E.g.,** MERCOSUR (Argentina, Brazil, Paraguay, and Uruguay)

Common Market

3. Common market (single market) - trade barriers are reduced or removed, common external barriers are established and products, services, and *factors of production* such as capital, labor, and technology are allowed to move freely among the member countries. Common trade policy with nonmember countries. **E.g.,** the EU.

Common market challenges:

- Require substantial cooperation from the member countries on labor and economic policies.
- As labor and capital can flow freely inside the bloc, benefits to individual members vary, because skilled labor may move to countries where wages are higher and investment capital may flow to countries where returns are greater.

Economic Union

4. Economic union- member countries enjoy all the advantages of early stages, but also strive to have common fiscal and monetary policies- identical tax rates, fixed exchange rates, free convertibility of currencies and the free movement of capital.

- **Example**- the EU has made great strides toward this. Thirteen EU countries have established a *monetary union* with a single currency, the euro.
- Member countries strive to eliminate border controls, harmonize product and labeling standards, and establish region-wide policies for energy, agriculture, and social services.
- Members standardize laws and regulations regarding competition, mergers, and other corporate behaviors, and harmonize licensing procedures for professionals.

Political Union

5. Political union

- Perfect unification of all policies by a common organization- submersion of all separate national institutions
- Remains an ideal, yet to be achieved.

Leading Economic Unions

- The European Union (EU)
- The world's most integrated economic bloc.
- **1957**- **Treaty of Rome-** origins of the EU - Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands- sought to promote peace and prosperity through economic and political cooperation (www.europa.eu).
- **1993-** the formal creation of the EU

Members	*Population (millions)*	*GDP (US$, billions, PPP terms)*	*GDP per capita (US$; PPP terms)*	*Exports as a percentage of GDP*
Austria	8	$299	$36,189	29%
Belgium	10	353	33,908	52
Bulgaria	8	83	10,844	16
Cyprus	1	20	23,419	7
Czech Republic	10	210	20,539	44
Denmark	5	204	37,398	26
Estonia	1	26	19,243	36
Finland	5	179	34,162	29
France	63	1,988	31,377	17
Germany	83	2,699	32,684	26
Greece	11	274	24,733	3
Hungary	10	190	18,922	42
Ireland	4	192	45,135	53
Italy	59	1,791	30,383	17
Latvia	2	34	15,062	21
Lithuania	3	57	16,756	36
Luxembourg	0.5	35	76,025	28
Malta	0.4	8	21,081	44
The Netherlands	17	550	33,079	44
Poland	38	557	14,609	24
Portugal	11	218	20,673	18
Romania	22	219	10,152	51
Slovakia	5	101	18,705	67
Slovenia	2	49	24,459	38
Spain	42	1,203	28,810	16
Sweden	9	297	32,548	30
United Kingdom	61	2,004	32,949	14
	Total: 491	Total: $13,840		

Exhibit 8.4 Key Features of the European Union Member Countries, 2007

SOURCE: International Monetary Fund at www.imf.org

The EU: Features of a Full-Fledged Economic Union

1. ***Market access***. Tariffs and most nontariff barriers have been eliminated for trade in products and services, and rules of origin favor manufacturing that uses parts and other inputs produced in the EU.
2. ***Common market***. The EU removed barriers to the cross-national movement of production factors—labor, capital, and technology.
3. ***Trade rules***. The member countries have largely eliminated customs procedures and regulations, which streamlines transportation and logistics within Europe.
4. ***Standards harmonization***. The EU is harmonizing technical standards, regulations, and enforcement procedures that relate to products, services, and commercial activities.

The EU: Features of a Full-Fledged Economic Union

5. ***Common fiscal, monetary, taxation, and social welfare policies*** in the long run. The euro (common currency since 2002):

- Simplified the process of cross-border trade and enhanced Europe's international competitiveness.
- Eliminated exchange rate risk in much of the bloc and forced member countries to improve their fiscal and monetary policies.
- Unified consumers and businesses to think of Europe as a single market
- Forced national governments to relinquish monetary power to the European Central Bank, in Luxembourg, which oversees EU monetary functions.

Four Institutions That Govern the EU

1. The **Council of the European Union** is the EU's main decision-making body. Makes decisions regarding economic policy, budgets, and foreign policy, and admission of new member countries.
2. The **European Commission** represents the interests of the EU as a whole. Proposes legislation and is responsible for implementing the decisions of the Parliament and the Council.
3. The **European Parliament** consists of elected representatives that hold joint sessions each month. Up to 732 representatives. Three main functions:
   - Form EU legislation,
   - Supervise EU institutions, and
   - Make decisions about the EU budget.
4. The **European Court of Justice** interprets and enforces EU laws and settles legal disputes between member states.

The European Union Today

- **2004-** 12 new states have joined the EU; with the recent addition of Bulgaria and Romania, the total number of member countries is 27.
- New member countries such as Poland, Hungary and the Czech Republic are important, low-cost manufacturing platforms for EU firms.
  - Peugeot and Citroën- production plant in the Czech Republic.
  - Hyundai (South Korea)- produces the Kia at a plant in Slovakia.
  - Suzuki (Japan) makes cars in Hungary.
- Most of the newest EU entrants are one-time satellites of the former Soviet Union, and have economic growth rates far higher than their 15 Western European counterparts.
- Developing economies such as Romania and Bulgaria may require decades of developmental aid to catch up.

Some Challenges Faced by the EU

- Relinquishing autonomy and combining resources across national borders are necessary - yet some EU members, e.g. Britain, are reluctant to surrender sovereignty over monetary and fiscal policies, and military defense.
- **Common Agricultural Policy** (CAP) has been long-standing fixture of the EU. CAP is a system of agricultural subsidies and programs that guarantees a minimum price to EU farmers and ranchers
- Reality- CAP has increased food prices in Europe, consumes over **40 percent** of the EU's annual budget, and complicates negotiations with the WTO.
- CAP imposes high import tariffs that unfairly affect exporters in developing economies.
- **2004**- Entry into the EU of new member countries has increased the number of bloc farmers from 7 to 11 million and increased crop production by 10–20 percent.

European Free Trade Association (EFTA)

- **1960**- established by Austria, Britain, Denmark, Norway, Portugal, Sweden, and Switzerland- EFTA is the second largest free trade area in Europe.
- Most of these countries left the EFTA to join the EU.
- Current EFTA members are Iceland, Liechtenstein, Norway, and Switzerland.
- EFTA promotes free trade and strengthens economic relations with other European countries and the world- i.e. free movement of people, products, services, and capital throughout the combined area of the EFTA and the EU.

NAFTA (Canada, Mexico, the U.S.)

- NAFTA passage (1994) was facilitated by the ***maquiladora*** program - U.S. firms locate manufacturing facilities just south of the U.S. border and access low-cost labor without having to pay significant tariffs. NAFTA has:
- Eliminated tariffs and most nontariff barriers for products/services.
- Initiated bidding for government contracts by member country firms
- Established trade rules and uniform customs procedures.
- Prohibited standards/technical regulations to be used as trade barriers.
- Instituted rules for investment and intellectual property rights.
- Provided for dispute settlement for investment, unfair pricing, labor issues, and the environment.

Exhibit 8.5 North American Free Trade Agreement (NAFTA), 2007

SOURCE: International Monetary Fund at www.imf.org

Members	*Population (millions)*	*GDP (US$ billions, PPP terms)*	*GDP per capita (US$; PPP terms)*	*Exports as a percentage of GDP*
Canada	33	$1,225	$37,321	29%
Mexico	108	1,192	10,993	18
United States	302	13,678	45,257	6
	Total: 443	Total: $16,095		

NAFTA Results

- Trade among the members has more than tripled and now exceeds $1 trillion per year.
- In the early 1980s, Mexico's tariffs averaged 100% and gradually disappeared under NAFTA.
- Member countries now trade more with each other than with former trading partners outside the NAFTA zone.
- Both Canada and Mexico now have some **80%** of their trade with, and **60%** of their FDI stocks in the United States.

NAFTA Lead to North American Restructuring

- Falling trade barriers triggered job losses in the North as factories were "exported" to Mexico to profit from its low-cost labor.
- Increased purchasing power of Mexican consumers meant that they could afford to buy from Canada and the U.S.
- Workers in the NAFTA zone gained the right to unionize.
- The accord helped to improve working conditions and compliance with labor laws.
- NAFTA also includes provisions promoting sustainable development and environmental protection.

How the Mexican Economy Benefited from NAFTA

- Mexican exports to the U.S. grew from $50 billion to over $160 billion per year.
- Access to Canada and the U.S. helped launch numerous Mexican firms in industries such as electronics, automobiles, textiles, medical products, and services.
- Annual U.S. and Canadian investment in Mexico rose from $4 billion in 1993 to nearly $20 billion by 2006.
- Mexico's per capita income rose to about $11,000 in 2007, making Mexico the wealthiest country in Latin America.
- By increasing Mexico's attractiveness as a manufacturing location, firms like Gap Inc. and Liz Claiborne moved their factories from Asia to Mexico during the 1990s.
- IBM shifted much of its production of computer parts from Singapore to Mexico.

El Mercado Comun del Sur (MERCOSUR)

- **1991**- MERCOSUR or (the Southern Common Market) has become the strongest economic bloc in South America.
- The four largest members alone—Argentina, Brazil, Paraguay, and Uruguay—account for some **80 percent** of South America's GDP.
- MERCOSUR established the free movement of products and services, a common external tariff and trade policy, and coordinated monetary and fiscal policies.
- MERCOSUR eventually aims to become an economic union.
- MERCOSUR may be integrated with NAFTA and the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) as part of the proposed Free Trade Area of the Americas (FTAA). This integration would bring free trade to the western hemisphere.

Members	*Population (millions)*	*GDP (US$ billions, PPP terms)*	*GDP per capita (US$; PPP terms)*	*Exports as a percentage of GDP*
Argentina	39	$599	$15,509	6%
Brazil	189	1,758	9,286	5
Paraguay	6	32	5,264	9
Uruguay	3	38	12,012	4
Venezuela	28	182	6,614	18
Bolivia *	10	28	2,858	7
Chile *	17	225	13,588	12
Colombia *	48	380	7,975	5
Ecuador *	14	62	4,591	13
Peru *	29	190	6,609	6
	Total: 383	Total: $3,494		

* Associate members

Exhibit 8.6 El Mercado Comun del Sur (MERCOSUR), 2007

SOURCE: International Monetary Fund at www.imf.org

Caribbean Community and Common Market (CARICOM)

- **1973**- Composed of roughly 25 member and associate member states around the Caribbean Sea.
- CARICOM was established to lower trade barriers and institute a common external tariff.
- In recent years, the bloc has made more progress toward establishing the Caribbean Single Market, a common market that allows for a greater degree of free movement for products, services, capital, and labor, and gives citizens of all CARICOM countries the right to establish businesses throughout the region.

Comunidad Andina de Naciones (CAN)

- **1969**- Long called the Andean Pact, the CAN includes Bolivia, Colombia, Ecuador, Peru, and Venezuela.
- The CAN countries have a population of 120 million and a combined GDP of $260 billion.
- CAN is expected to merge with MERCOSUR to form a new economic bloc that encompasses all of South America.
- Geography (Andes mountain range) has hindered intrabloc trading - reaching only 5 percent of bloc members’ total trade.

Association of Southeast Asian Nations (ASEAN)

- **1967**- One of the few examples of economic integration in Asia, ASEAN was created with the goal of maintaining political stability and promoting regional economic and social development.
- ASEAN created a free trade area in which many tariffs were reduced to less than 5 percent.
- Economic diversity has slowed further regional integration.
- **Example**- oil-rich Brunei has a per capita income of over $26,000, while Vietnam's is less than $4,000.
- ASEAN aims to incorporate powerhouses like Japan and China, whose membership would accelerate the development of extensive trade relationships.

Members	*Population millions*	*GDP (US$ billions, PPP terms)*	*GDP per capita (US$; PPP terms)*	*Exports as a percentage of GDP*
Brunei	0.4	$10	$26,098	52%
Cambodia	15	41	2,673	6
Indonesia	225	1,146	5,097	8
Laos	6	15	2,402	3
Malaysia	27	341	12,703	47
Myanmar (Burma)	58	105	1,814	3
Philippines	88	474	5,409	9
Singapore	5	140	31,165	130
Thailand	66	626	9,427	16
Vietnam	86	300	3,503	10
	Total: 576	Total: 3,198		

Exhibit 8.7 Association of Southeast Asian Nations (ASEAN), 2007

SOURCE: International Monetary Fund at www.imf.org

Asia Pacific Economic Cooperation (APEC)

- APEC aims for greater free trade and economic integration of the Pacific Rim countries.
- It incorporates 21 nations on both sides of the Pacific, including Australia, Canada, Chile, China, Japan, Mexico, Russia, and U.S.
- Its members account for **85%** of total regional trade, as well as **one-third** of the world's population and over **half its GDP**.
- APEC aspires to remove trade and investment barriers by 2020.
- Members have varying national economic priorities, and the composition of less affluent Asian countries alongside strong international traders like Australia, Japan, and the U.S. makes it difficult to achieve agreement on a range of issues.

Australia and New Zealand Closer Economic Relations Agreement (CER)

- **1966**- Australia and New Zealand reached a free trade agreement that removed 80% of tariffs and quotas between the two nations.
- **1983 -** the CER sought to accelerate free trade, leading to further economic integration of the two nations.
- The CER gained importance when Australia and New Zealand lost their privileged status in the British market as Britain joined the EU.
- Many believe the CER has been one of the world's most successful economic blocs.
- **2005-** the members began negotiating a free trade agreement with the ASEAN countries, a move that would further reduce Australia and New Zealand's dependence on trade with Britain.

Economic Integration in the Middle East

- **1981**- The Middle East's primary regional organization is the **Gulf Cooperation Council** (GCC).
- Established to coordinate economic (oil), social, and cultural affairs, the GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
- GCC initiatives include coordination of the petroleum industry, abolition of certain tariffs, and liberalization of investment, as well as harmonization of banking, financial, and monetary policies.
- The GCC also wants to establish an Arab common market and increase trade ties with Asia.

Other Examples of Integration in the Middle East

- **Arab Maghreb Union** (composed of Algeria, Libya, Mauritania, Morocco, and Tunisia) - still struggling to become a viable economic bloc.
- **Regional Cooperation for Development** (RCD; composed of Pakistan, Iran, and Turkey) - the RCD was dissolved in 1979 and replaced by the Economic Cooperation Organization (ECO).
- The **ECO** includes ten Middle Eastern and Asian countries, seeking to promote trade and investment.
- The Arab League is a longstanding political organization with 21 member states and a constitution that requires unanimous agreement in any decision making - relatively unsuccessful in regional economic development.

Regional Integration in Africa

- **Africa** would like better access to European and North American markets for sales of farm and textile products.
- Examples of integration: Southern African Development Community, the Economic Community of West African States, the Economic Community of Central African States, and, most recently, the African Union for Regional Cooperation.
- These groups have not had much impact on regional trade.
- Economic development in many African countries has been hindered by political instability, civil unrest and war, military dictatorships, corruption, and infectious diseases.

Why Nations Pursue Economic Integration?

1. ***Expand market size***
   - Regional integration greatly increases the scale of the marketplace for firms inside the economic bloc.
   - **Example-** Belgium has a population of just 10 million; the EU gives Belgian firms easier access to a total market of roughly 490 million.
   - Consumers also gain access to a greater selection of products and services.
2. ***Achieve scale economies and enhanced productivity***
   - Expansion of market size within an economic bloc gives member country firms the opportunity to gain economies of scale in production and marketing.
   - Internationalization inside the bloc helps firms learn to compete more effectively outside the bloc as well.
   - Labor and other inputs are allocated more efficiently among the member countries- leading to lower prices for consumers.

Why Nations Pursue Economic Integration?

3. ***Attract direct investment from outside the bloc***
   - Compared to investing in stand-alone countries, foreign firms prefer to invest in countries that are part of an economic bloc as they receive preferential treatment for exports to other member countries.
   - **Examples**- General Mills, Samsung, and Tata- have invested heavily in the EU to take advantage of Europe's economic integration.
   - By establishing operations in a single EU country, these firms gain free trade access to the entire EU market.
4. ***Acquire stronger defensive and political posture***
   - Provide member countries with a stronger defensive posture relative to other nations and world regions- this was one of the motives for the initial creation of the European Community (precursor to the EU).

What Factors Contribute to the Success of Regional Integration

1. Economic similarity

- The more similar the economies of the member countries, the more likely the economic bloc will succeed.
- Significant wage rate differences means that workers in lower-wage countries will migrate to higher wage countries.
- Significant economic instability in one member can quickly spread and harm the economies of the other members.
- Compatibility of economic characteristics is so important that the EU requires its current and prospective members to meet strict membership conditions, ideally low inflation, low unemployment, reasonable wages, and stable economic conditions.

What Factors Contribute to the Success of Regional Integration

2. Political similarity

- Similarity in political systems enhances prospects for a successful bloc.
- Countries that seek to integrate regionally should share similar aspirations and a willingness to surrender national autonomy for the broader goals of the proposed union.
- **Example-** Sweden has attempted to lower its corporate income tax rate and other taxes to improve the country's attractiveness as a place to do business in the larger EU marketplace.

What Factors Contribute to the Success of Regional Integration

3. Similarity of culture and language

- Cultural and linguistic similarity among the countries in an economic bloc provides the basis for mutual understanding and cooperation.
- This partially explains the success of the MERCOSUR bloc in Latin America, whose members share many cultural and linguistic similarities.

4. Geographic proximity

- Most economic blocs are formed by countries within the same geographic region, i.e. *regional integration.*
- Close geographic proximity of member countries facilitates transportation of products, labor, and other factors.
- Neighboring countries tend to be similar in terms of culture and language.

What Factors Contribute to the Success of Regional Integration

- While the four types of similarities enhance the potential for successful regional integration, economic interests are often the most important factor.
- This was demonstrated in the EU, whose member countries, despite strong cultural and linguistic differences, are able to achieve common goals based on pure economic interests.

Drawbacks of Regional Integration: Trade Diversion

Regional integration gives rise to both trade creation *and* trade diversion:

- ***Trade creation*** - trade is generated among the countries inside the economic bloc. This occurs because, as trade barriers fall within the bloc, each member country tends to favor trade with countries inside the bloc over trade with countries outside the bloc.
- ***Trade diversion*** - once the bloc is in place, member countries will discontinue some trade with nonmember countries.
- **Aggregate effect** - national patterns of trade are altered - more trade takes place inside the bloc and less trade takes place with countries outside the bloc.
- Policymakers worry that the EU, NAFTA, and other economic blocs could turn into economic fortresses resulting in a decline in *between* bloc trading that exceeds the gains from *within* bloc trading.

Drawbacks of Regional Integration: Reduced Global Free Trade

An economic bloc that imposes external trade barriers is moving *away* from *worldwide* free trade.

- Tariffs apply to non-member nations shield sellers inside the economic bloc from competitors outside the bloc.
- However, buyers inside the bloc are worse off because they must pay higher prices for the products they buy.
- Tariffs counteract comparative advantages and interfere with trade flows that should be dictated by national resources.
- Foreign firms sell less into a bloc that imposes restrictions.
- Overall - external trade barriers imposed by economic blocs result in a net loss to all bloc members

Drawbacks of Regional Integration: Loss of National Identity

- **Homogenizing effect**- increased cross-border contact - the members become more similar to each other and national cultural identity is diluted.
- Member countries typically retain the right to protect certain industries vital to national heritage or security.
- **Example-** Canada has restricted the ability of U.S. movie and TV producers to invest in the Canadian film market - Canada sees its film industry as a critical part of its national heritage and fears the dilution of its indigenous culture from an invasion of U.S. movie and TV entertainment programming.

Drawbacks of Regional Integration: Sacrifice of Autonomy

- Establishment of a **central authority** to manage the bloc's affairs is required at later stages of regional integration.
- Members must sacrifice some autonomy to the central authority, such as control over its own economy- loss of national sovereignty.
- In Britain, critics see the passage of many new laws and regulations by centralized EU authorities as a direct threat to British self-governance. The British have resisted joining the European Monetary Union because such a move would reduce the power that they currently hold over their own currency and economy.

Drawbacks of Regional Integration: Transfer of Power to Advantaged Firms

- Regional integration can concentrate economic power in the hands of fewer, more advantaged firms.
- Larger, foreign competitors that have stronger brands, or enjoy other advantages can overwhelm local firms in their home markets.
- Regional integration encourages mergers and acquisitions within the bloc, leading to the creation of larger rivals.
- Economic power gravitates toward the most advantaged firms in the bloc.

Drawbacks of Regional Integration: Failure of Small or Weak Firms

- With the decline of trade and investment barriers, protections are eliminated that previously shielded smaller or weaker firms from foreign competition.
- The risk can be substantial for companies in smaller bloc countries, or in industries that lack comparative advantages.

Drawbacks of Regional Integration: Corporate Restructuring and Job Loss

- Increased competitive pressures and corporate restructuring may lead to worker layoffs or re-assigning employees to distant locations- disrupting worker lives and entire communities.
- Centralization of control to regional or international headquarters- national managers may need to surrender some of their autonomy and power.
- **Example-** Following EU unification, Ford reassigned some decision-making power from country heads to its European headquarters in Dagenham, England. The company centralized product design responsibilities, brought together pan-European design teams in Dagenham, and transferred financial controls and reporting to headquarters in the U.S. Restructuring can prove difficult to managers, such as the head of Ford's subsidiary in Cologne, who resigned rather than lose power.

Implications of Integration: Internationalization by Firms Inside the Economic Bloc

- Regional integration pressures firms to internationalize into neighboring countries within the bloc.
- The elimination of trade and investment barriers presents new opportunities to source input goods from foreign suppliers within the bloc.
- Competitive advantages gained from internationalizing within the bloc may be leveraged to internationalizing *outside* the bloc.
- **Example**- following NAFTA, many U.S. companies entered Canada and gained valuable international experience that inspired them to launch ventures into Asia and Europe.

Implications of Integration: Rationalization of Operations

- Managers develop strategies and value-chain activities suited to the region as a whole, not individual countries.
- ***Rationalization*** is the process of restructuring and consolidating company operations that managers often undertake following regional integration.
- Goal - reduce costs and redundancy; increase the efficiency through scale economies.
- Rationalization becomes an attractive option because, as trade and investment barriers decline, the firm that formerly operated factories in each of several countries reaps advantages by consolidating production in one or two central locations inside the economic bloc.

An Example of Rationalization

- **Caterpillar**, the U.S. manufacturer of earth-moving equipment, undertook a massive program of modernization and rationalization at its EU plants to streamline production, reduce inventories, increase economies of scale, and lower operating costs.
- Rationalization may be applied to value chain-functions such as manufacturing, distribution, logistics, purchasing, and R&D.
- **Example**- creation of the economic bloc eliminates the need to devise separate distribution strategies for individual countries. Instead, firms are able to employ a more global approach for the larger marketplace, generating economies of scale in distribution.

Implications of Integration: Mergers and Acquisitions

- Economic blocs lead to mergers and acquisitions (M&A)- the tendency of one firm to buy another, or of two or more firms to merge and form a larger company.
- **M&S** are related to **rationalization**- the merger of two or more firms creates a new company that produces a product on a much larger scale.
- **Example**-pharmaceutical industry- Britain's Zeneca purchased Sweden's Astra to form AstraZeneca. The acquisition led to the development of blockbusters such as the ulcer drug Nexium and helped transform the new company into a leader in the gastrointestinal, cardiovascular, and respiratory areas.

Implications of Integration: Regional Products and Marketing Strategy

- ***Standardization*** of products and services- firms prefer standardized merchandise in their various markets- easier and much less costly.
- In more advanced stages of regional integration, member countries tend to harmonize product standards and commercial regulations, and eliminate trade barriers and transportation bottlenecks.
- As conditions in member countries become similar to each other, companies can standardize their products and marketing.
- **Example**- Case, a manufacturer of agricultural machinery once produced 17 versions of the Magnum; harmonization of EU product standards allowed the firm to standardize its tractor, allowing it to produce only a handful of models for the entire EU market.

Implications of Integration: Internationalization by Firms outside the Bloc

- Regional integration and large multi-country markets are attractive to firms from *outside* the bloc.
- Foreign firms tend to avoid exporting as an entry strategy because economic blocs erect trade barriers against imports from outside the bloc.
- The most effective way for a foreign firm to enter an economic bloc is to establish a physical presence via FDI.
- **Examples-** with the EU formation, Britain has become the largest recipient of FDI from the United States. U.S. firms choose Britain as the beachhead to gain access to the massive EU market. In a similar way, European firms have established factories in Mexico to access countries in the NAFTA bloc.

Implications of Integration: Collaborative Ventures

Regional integration facilitates cooperation:

- Firms from France, Germany, Spain, and the United Kingdom collaborated to establish Airbus Industries, the giant commercial aircraft manufacturer- under the EU.
- The elimination of trade and investment barriers in the EU allowed Airbus to move aircraft parts, capital, and labor among the member countries.
- Outsiders ease their entry into the bloc by entering joint ventures and other collaborative arrangements with companies inside the bloc.

Regional Economic Integration: Future Prospects

- **1990**- there were approximately **50** regional economic integration agreements worldwide. Today there are some **200**, 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.
- More nations are clamoring to join the EU, which has signed trade agreements with other economic blocs worldwide.
- The evidence suggests that regional economic integration is gradually giving way to a system of worldwide free trade.