WALTER STERLING SURREY MEMORIAL SERIES

Trade Blocs: A Regionally Specific Phenomenon or a Global Trend?

Richard L. Bernal

NATIONAL POLICY ASSOCIATION

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Contents

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About the Author

Richard L Bernal is Ambassador of Jamaica to the United States and Permanent Representative to the Organization of American States (OAS) He is a lead participant in bilateral and multilateral negotiations on Jamaica's behalf and presently serves as Chairman of the Working Group on Smaller Economies in the Free Trade Area of the Americas process Ambassador Bernal is also a member of the Special Trade Committee of the OAS and of the Committee on Hemispheric Financial Issues He has authored more than 75 articles on international economic issues, including the debt problem, economic adjustment in developing countries regional integration, and U S Caribbean relations Ambassador Bernal holds B S M A , and Ph D degrees in economics He also earned a Masters in International Public Policy from the School for Advanced International Studies Johns Hopkins University

Walter Sterling Surrey Memorial Series

THROUGHOUT HIS LIFE Walter Sterling Surrey, former Chair of NPA's Board of Trustees, worked tirelessly to promote international trade and commerce, particularly among nations having different cultural, economic, and political systems He strongly believed that international trade is the most equitable and efficient means to create and distribute wealth throughout the world He maintained that an open and competitive international trading system leads to greater understanding and mutual respect among countries and that lasting world peace can be achieved only after such understanding and respect are established

Mr Surrey, a prominent Washington, D C , attorney, was associated with the National Policy Association, then known as the National Planning Association, for almost 40 years He first came to NPA in the early 1950s as a member of its International Committee He joined NPA's Committee on Changing International Realities—which has since become NPA's Global Economic Council—when it was established in 1975 and remained actively involved until his death in 1989 He was elected to NPA's Board of Trustees in 1965 and served as its Chair from 1977 until 1989

Following Mr Surrey's death, NPA, with the aid of the Surrey family established the Walter Sterling Surrey Fund for International Cooperation The purpose of the Fund is to expand NPA's research in international economic, social, and political policies Previous Surrey publications have looked at emerging markets, the role of the private sector in advancing the economies of the so-called third world countries, how capital markets are changing international growth, the role of international regimes and agreements in promoting development, and the ongoing changes in the former Soviet Republics and Eastern Europe

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Foreword

FOR THE PAST FOUR YEARS the Natıonal Polıcy Assocıatıon, through ıts Aıd and Development Project, has examıned the complex and ever changıng factors that ınfluence global development Increasıngly lıberalızed trade and the contınuıng expansıon of open market regımes throughout the world have made the prıvate sector role ın promotıng economıc growth ın developıng countrıes an even more ımportant one than ever before Trade blocs, by allowıng the freer flow of goods wıthın a regıon, are one optıon that developıng natıons can pursue to ıncrease theır economıc growth Many argue that the paradıgm of development should move from the ınteractıons of a donor/recıpıent relatıonshıp to a mutually benefıcıal partnershıp through trade and ınvestment Those concerned wıth ınternatıonal devel opment ıncreasıngly emphasıze the government's role ın creatıng an ena blıng atmosphere for prıvate ınvestment by openıng markets promotıng prıvatızatıon, and developıng transparent polıcıes

Trade Blocs A Regıonally Specıfic Phenomenon or a Global Trend? analyses the ımpact of trade blocs on today's global economy The number and sıze of blocs have grown explosıvely ın recent years ın both developed and developıng countrıes Moreover, these agreements often lınk the two Thıs monograph dıscusses trade regımes from the perspectıve of Dr Rıchard L Bernal, Ambassador of Jamaıca to the Unıted States After examınıng the hıstory and current status of a range of exıstıng and emergıng trade blocs, Ambassador Bernal—who delıvered the sıxth Walter Sterlıng Surrey Memorıal Lecture ın May 1997—looks at the forces that shape these agreements

Dr Bernal also examınes the profound ımplıcatıons for developıng countrıes of the expansıon of trade blocs He cıtes the potentıally serıous consequences to economıc growth ıf these countrıes are excluded from trade blocs but recognızes the forces that often ınhıbıt theır partıcıpatıon Several approaches to ıntegrate countrıes wıth dıfferıng levels of development are proposed to enable the developıng world to share ın the benefits of thıs new trade regıme

NPA Aıd and Development Project

Marılyn Zuckerman NPA Vıce Presıdent and Project Codırector
S Dahlıa Steın NPA Senıor Fellow and Project Codırector
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NPA would lıke to thank Professor Robert M Dunn Jr for hıs revıew of thıs monograph

Introduction

TRADE BLOCS ARE an important feature of the world economy, but they are not an entirely new phenomenon Their antecedents can be traced back to the mercantilist trading systems operated by Western European powers[1] from the 16th century to colonial empires that ended in the mid-20th century It can even be argued that colonial empires constituted trade blocs After World War II, colonial empires or trade blocs were dismantled by anticolonial nationalism and the deliberate opening of these "closed" trading systems through pressure from the United States [2] This dismembering of colonial empires occurred as the Soviet Union was establishing the Council for Mutual Assistance (COMECON) Beginning in the late 1950s and continuing into the 1960s, regional trade groups and regional economic integration came into vogue By the end of the 1960s, such groups existed in Europe, Latin America, Central America, the Caribbean, and Africa But during the 1970s and early 1980s, most of these trade groups and integration schemes declined or collapsed, except the European Economic Community (EEC), COMECON, and the Caribbean Common Market (CARICOM)

The contemporary world economy, it has been suggested, is already well advanced toward being dominated by three major trade blocs—Europe, a U S -dominated North America, and a Japan-centered Asia,[3]—although some have disputed the formation of an Asian bloc or maintained that Europe is the only trade bloc [4] This so-called Triad could be involved in fierce competition, economic rivalry, and even political conflict [5] In this milieu, one of the most important questions is whether trade blocs are a systemic feature of the world economy or whether they are simply a series of regionally specific developments This report discusses this issue Part I documents existing and proposed or developing trade blocs, and Part II describes their dimensions and dispersal Part III discusses the factors that explain the occurrence of trade blocs Part IV presents the conclusion, and Part V briefly surveys some of the principal implications of trade blocs Appendix I lists some regional trading arrangements that are not designated as trade blocs because one country grants nonreciprocal market access to a group of countries

The views expressed in this monograph are those of the author and not those of the Government of Jamaica This monograph benefited from comments by Donald Mackay Ernest H Preeg and Peter Morici The author wishes to thank Colleen Rhyant for her assistance in preparing this paper

NOTES

1 These powers included England France the Netherlands Spain and Portugal See C H Haring *Trade and Navigation Between Spain and the Indies* (Cambridge Harvard University Press 1918 reprinted Peter Smith 1964) C H Haring *The Spanish Empire in America* (New York Harcourt Brace & World 1947) J H Parry *The Spanish Seaborne Empire* (London Hutchinson 1966) C R Boxer *The Portuguese Seaborne Empire 1415 1825* (London Hutchinson 1969) and D K Fieldhouse *The Colonial Empires* (London Weidenfeld and Nicolson 1966)

2 Richard N Gardner *Sterling Dollar Diplomacy in Current Perspective* (New York Columbia University Press 1980) Part I and R Palme Dutt *Britain s Crisis of Empire* (London Lawrence and Wishout 1949) Chaps 6 7

3 Ernest H Preeg *Economic Blocs and U S Foreign Policy* (Washington National Planning Association 1974) Kenichi Ohmae *Triad Power The Coming Shape of Global Competition* (New York Free Press 1985) and Robert B Reich *The Work of Nations Preparing Ourselves for 21st Century Capitalism* (New York Alfred A Knopf 1991)

4 The Triad scenario has been criticized particularly by those who argue that an Asian bloc is not forming nor is it likely to Jeffrey J Schott 'Trading Blocs and the World Trading System *The World Economy* Vol 14 No 1 (March 1991) p 5 David Henderson Putting Trade Blocs into Perspective in Vincent Cable and David Henderson (eds) *Trade Blocs? The Future of Regional Integration* (London Royal Institute of International Affairs 1994) pp 179 198 Arvind Panagariya East Asia and the New Regionalism in World Trade *The World Economy* Vol 17 No 6 (November 1994) pp 817 840 and Colin Kirkpatrick Regionalisation Regionalism and East Asian Economic Cooperation *The World Economy* Vol 17 No 2 (March 1994) pp 191 202

For a discussion of Europe as the only trade bloc see J M C Rollo 'The EC European Integration and the World Trading System in Cable and Henderson (eds) *Trade Blocs?* pp 35 58

5 Lester Thurow *Head to Head The Coming of Economic Battle Among Japan Europe and America* (New York William Morrow and Co 1992) and Jeffrey Garten *A Cold Peace America Japan Germany and the Struggle for Supremacy* (New York Times Books 1992)

Part I
Trade Blocs

DEFINITIONS OF the term "trade bloc" vary widely The Oxford Dictionary defines a bloc as "a combination of countries, parties, or groups sharing common purposes or policy " In economic terms, it has been suggested that an economic bloc is "an arrangement among certain nations but signifi cantly less than all nations, which tends to affect quantities and prices of internationally exchanged commodities or factors of production '[1] As de fined in this report, a trade bloc

(1) participates in a special trade relationship established by a formal agreement that promotes and facilitates trade within that group of countries in preference to trade with outside nations by discriminating against nonmembers,
(2) has attained or has as a stated goal the deepening of trade liberalization or integration with the objective of establishing a free trade area, customs union, or common market,
(3) strives to reach common positions in negotiations with third countries, with other trade blocs, or in multilateral forums, and
(4) attempts to coordinate national economic policies to minimize disruption to intrabloc economic transactions

Trade groups or agreements that meet some of these criteria are the European Union (EU), North American Free Trade Agreement (NAFTA), Southern Cone Common Market (MERCOSUR), CARICOM, Central American Common Market (CACM), Andean Group or Pact, Group of Three, Closer Economic Relations Trade Agreement (CER), Association of Southeast Asian Nations (ASEAN), and Asia-Pacific Economic Corporation (APEC) forum Attempts are under way to develop a Free Trade Area of the Americas (FTAA) a South American Free Trade Area (SAFTA), a Transatlantic Free Trade Agreement (TAFTA), and subregional arrangements in Africa, the Middle East, and the Indian subcontinent

In a review of trade blocs, it is useful to distinguish between functioning trade blocs and proposed or developing blocs The next two sections briefly describe these types of blocs

FUNCTIONING TRADE BLOCS

The principal functioning trade blocs are the EU, NAFTA, MERCO SUR, Andean Group, the CACM, CARICOM, Group of Three, and the CER

(1) European Union (EU)

The European Union, which was formed as the EEC with the signing of the Treaty of Rome in 1957 and became a single market in 1992, was enlarged to the European Economic Area (EEA) in 1994 The EU consists of 15 industrialized countries Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom It has a market of 373 million people and an aggregate gross domestic product (GDP) of US$8 6 trillion [2] This regional bloc comprises the world's largest trading entity and absorbs approximately 21 percent of total U S exports of goods and services, as well as more than 41 percent of total U S direct foreign investment [3]

The EU's single market reduced or eliminated internal barriers to trade to make the European market more cohesive, an important shift in the development of regional trading blocs Although it may seem that the establishment of a single market would result in increased barriers to trade, the converse is true The removal of internal barriers not only has allowed increased access for EU members, but also has fostered a more efficient allocation of investment among member states, improving their individual and collective competitiveness

(2) North American Free Trade Agreement (NAFTA)

In 1988, the United States and Canada concluded the Canada-U S Free Trade Agreement (CUSFTA), and in 1990, Mexico and the United States announced their intention to negotiate a comprehensive bilateral trade agreement Negotiations between the United States and Mexico were later expanded to include Canada and resulted in the North American Free Trade Agreement, which took effect January 1, 1994 NAFTA facilitates the freer flow of goods throughout the continent and, over a transition period of up to 15 years in some sectors, will eliminate all customs duties and nontariff barriers to trade among the three member countries This agree ment supersedes the CUSFTA and provides for wider liberalizing measures (particularly in investment, services, and intellectual property) than those of the CUSFTA

NAFTA contains provisions for enforcement of intellectual property rights, liberalization of cross border trade in energy energy services, and financial services, and making administrative procedures more transpar ent The agreement provides for stringent rules of origin to determine if traded goods qualify for the preferences enjoyed by NAFTA member coun tries NAFTA establishes rules to eradicate all discriminatory measures governing product standards and testing, investment and business services, and government procurement

NAFTA also seeks to protect countries from potential disruptions in their markets that the agreement itself might bring It establishes trans parent rules and procedures that allow any party to the agreement to provide temporary protection to industries adversely affected by import surges The agreement further seeks to ensure that the parties to the agreement are not placed at a disadvantage compared with their partners Three supplemental agreements deal with import surges (only between the United States and Mexico), cooperation on the environment, and labor standards

NAFTA represents a departure from previous trade agreements because it integrates countries at different levels of development and with widely different income and wage levels Because it goes beyond trade in goods to include services, investment, intellectual property rights, and government procurement, NAFTA is one of the most comprehensive trade agreements in existence

(3) Southern Cone Common Market (MERCOSUR)

Since the late 1930s, Argentina and Brazil have periodically sought to liberalize their trade relationship In 1990, they signed the Buenos Aires Act, providing for the creation of a common market between them On March 26, 1991, the presidents of Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asuncion to establish the customs union, Mercado Comun del Sur or the Southern Cone Common Market—commonly known by its Spanish acronym MERCOSUR—by 1994 The bloc encompasses 12 million sq km , has a population of about 190 million, and has a combined GDP of $610 billion [4] Liberalization will be phased in between January 1, 1995, and 2001 Trade within MERCOSUR grew from $6 billion in 1988[5] to $21 0 billion in 1995, an increase of 250 percent Between 1991 and 1995, intraregional exports grew at an annual rate of 29 6 percent [6] The MERCOSUR countries account for an estimated 35 percent of intra Latin American trade [7] There are, however, potentially disruptive problems arising from divergence in macroeconomic policy, differences in economic trends, trade imbalances, and political shifts [8] A number of issues are unresolved, in particular the treatment of high technology goods (mainly automobiles, computers, and telecommunications), services, and investment

(4) Andean Group or Pact[9]

Bolivia, Chile, Columbia, Ecuador, and Venezuela formed the Andean Pact in 1969, but Chile withdrew in 1976 The Andean Common Market has not functioned as well as expected, partly because member countries have pursued different economic policies In 1984, Bolivia, Columbia, Peru, and Venezuela created a free trade zone, which Ecuador entered in 1992 A number of measures have since been adopted to eliminate restrictions and to standardize various regulations A four-tier common external tariff has been agreed upon, but differences persist, with Bolivia and Ecuador enjoying certain exceptions and with Peru formally withdrawing in early 1997 Intraregional trade expanded at 29 percent per year from 1970 to 1979, but plummeted by 50 percent between 1980 and 1986 Between 1989 and 1993, the value of trade tripled from $1 billion to $2 8 billion, an average annual growth rate of 34 5 percent [10]

(5) Central American Common Market (CACM)

Work toward regional integration in Central America began as early as 1951,[11] and the Central American Common Market was established in 1961 It includes El Salvador Nicaragua, Guatemala, Honduras, and Costa Rica By 1969, intraregional trade accounted for 26 percent of total trade,[12] and nearly 95 percent of trade had been granted duty-free status During the 1970s, however the CACM declined because of economic, political, and ideological differences among the governments, and the organization continues to face problems [13] By the early 1990s, the value of intraregional exports had dropped 40 percent below the 1980 level [14] As of 1994, intraregional exports were only 2 8 percent of total exports Growth of intraregional trade has been delayed by the slow and uneven pace of adjustment among member countries Policy changes have been somewhat erratic in their timing, sequence, and calibration, and there have been important policy reversals [15] Several agreements crisscross the CACM among various subsets of member countries El Salvador, Nicaragua, Guatemala, and Honduras signed an agreement to establish a free trade zone by 1993 but Costa Rica did not sign [16]

(6) Caribbean Common Market (CARICOM)

The Caribbean Common Market, which aims to create a common market among English speaking countries in that region, is the longest continuing regional integration agreement CARICOM was established in 1973 to further integrate the economies that had previously comprised the Caribbean Free Trade Association (CARIFTA), which had been in operation since 1968 [17] The countries in CARICOM are Antigua and Barbuda, the Bahamas, Barbados, Belize, British Virgin Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname, Trinidad and Tobago, and the Turks and Caicos Islands During the 1980s, intraregional trade declined sharply due to severe economic recession in several member countries and divergent national economic strategies In 1984, however, CARICOM members agreed to establish a common external tariff, which is now partially in place [18] Trade liberalization has not been accompanied by the free movement of capital and labor, but a CARICOM Stock Exchange began in 1992 In 1995, CARICOM admitted the first non-English speaking member, Suriname,[19] and in 1997 admitted Haiti as a member Also in 1997, CARICOM took steps to move from a customs union to a single market and economy

(7) Group of Three

Mexico, Columbia, and Venezuela signed a free trade agreement in 1994 The overall objective is to create a free trade area by January 1, 2004, that includes financial services, intellectual property, public sector purchases, and investment standards as well as trade [20] Only automobiles and agricultural commodities have been excluded The phasing in of liberalization will not be simultaneous as Mexico's liberalization is proceeding faster than that of Colombia and Venezuela [21]

(8) Closer Economic Relations Trade Agreement (CER)

In an attempt to enhance and expand trade between their two countries, Australia and New Zealand established the Closer Economic Relations Trade Agreement in 1983 [22] The CER has abolished all border restrictions to trade in goods, including tariffs, quantitative restrictions, import and export prohibitions, export incentives, and export restrictions During 1990 92, intra-CER trade accounted for less than 5 percent of Australia's trade and about 20 percent of New Zealand's trade [23] The CER contains a number of special provisions to encourage the exporters of the island countries of the South Pacific, including Papua New Guinea, with whom Australia and New Zealand have a nonreciprocal preferential trade arrangement

PROPOSED OR DEVELOPING TRADE BLOCS

Several trade blocs have been proposed or are in various stages of development

(1) ASEAN Free Trade Area (AFTA)

The Association of Southeast Asian Nations was established in 1967 [24] and it now consists of Brunei Darussalam, Burma, Indonesia, Laos, Malaysia, Republic of the Philippines, Singapore, Thailand, and Vietnam, which have a combined GDP of more than $632 billion and a population of 481 million [25] Over the past 10 years, the ASEAN countries have recorded annual growth levels of up to 7 percent Intraregional trade in ASEAN expanded 41 percent between 1993 and 1994, amounting to $44 4 billion [26]

As a further step toward economic integration, the members agreed to establish the ASEAN Free Trade Area in 1992 [27] Under this agreement, tariff rates on imports of certain goods will be reduced among member countries to 5 percent or less over 15 years AFTA is expected to strengthen regional economic cooperation through increased trade facilitated by lower tariffs In 1995, the number of items to be reduced to 0-5 percent tariff by 2000 was significantly increased [28] Singapore has urged ASEAN to move quickly to remove tariff barriers or risk falling behind competitors in other parts of the world [29]

(2) Asia Pacific Economic Cooperation (APEC)

The idea of an organization encompassing all of the countries of the Asia Pacific region is not new and has gained acceptance since the 1960s[30] However, it was only with the creation of the Asia Pacific Economic Cooperation forum in 1988 that the idea received institutional form This in part, reflects apprehension about the dominance of Japan or the United States

APEC comprises 18 countries Australia, Brunei Darussalam, Canada, Chile, Hong Kong Indonesia, Japan, Malaysia Mexico, New Zealand, Papua New Guinea, Peoples Republic of China, Republic of Korea, Republic of the Philippines, Singapore, Taiwan, Thailand, and the United States A major guiding principle for APEC has been "open regionalism"[31] Several regional arrangements—including NAFTA AFTA, and the CER—coexist with APEC This coexistence shows that regional trading blocs need not be the antithesis to free trade at the multilateral level APEC has stimulated trade and investment cooperation among member countries, a growing cohesion among private sectors, and extensive dialogue among trade and investment officials

At their November 1994 summit, APEC leaders agreed to achieve free trade among member industrialized economies by 2010 and among developing economies by 2020[32] Some business groups such as the Pacific Business Forum are pressing for a shorter timetable for reducing tariffs[33] A report by the Eminent Persons Group of APEC has called for speeding up liberalization within APEC and the phase in of trade liberalization measures agreed to in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT),[34] but Japan has called for special treatment for "sensitive sectors" within APEC[35] At its most recent summit, held in 1996, APEC launched the implementation phase of its free and open trade and investment agenda[36]

(3) Free Trade Area of the Americas (FTAA)

The creation of a free trade area encompassing the democratic countries in the Western Hemisphere (excluding Cuba) was agreed upon at the Summit of the Americas in 1994 The governments resolved to begin immediately to construct the FTAA, in which barriers to trade and investment are to be progressively eliminated They agreed to conclude the negotiation no later than 2005 and committed to making concrete progress toward attaining this objective by the end of this century However, because no single path to the FTAA has been decided on, different paths are already evolving simultaneously and are likely to continue

(4) Indian Ocean Rim Association for Regional Cooperation (IORARC)

In 1995, business leaders and academics from 30 countries discussed the idea of an economic grouping of Indian Ocean nations[37] In 1996, IORARC was launched [38] The 14 founding members are Australia, India, Indonesia, Kenya, Madagascar, Malaysia, Mauritius, Mozambique, Oman, Singapore, South Africa, Sri Lanka, Tanzania, and Yemen The members were motivated by opportunities to expand trade, fear of being marginalized by the emergence of large trade blocs, and lack of membership in or exclusion from other trade blocs (for example, for many years India has tried unsuc cessfully to join APEC) The group could ultimately include more members, encompassing 1 5 billion people (one third of the world's population), two-thirds of the world's oil reserves, and one-fifth of its arable land

(5) Transatlantic Free Trade Agreement (TAFTA)

Canada has raised the idea of significant trade liberalization between NAFTA and the EU, but U S and Mexican response has been cautious [39] The EU Commission is also studying the implications of establishing a free trade agreement with Canada and Mexico or with NAFTA as a whole [40] Further, the EU has endorsed a wide-ranging cooperation pact aimed at creating closer political and economic links to the United States, including exploring the possibility of a Transatlantic Free Trade Agreement [41] The Clinton administration is considering the possibility of a TAFTA between the United States and the EU [42]

The idea of an Atlantic free trade area was first discussed in the early 1960s and seemed the natural culmination of the Atlantic Alliance of the post World War II period[43] in view not only of the possible economic benefits but also of the strength and cohesion of the North Atlantic Treaty Organization (NATO), common interests in relation to developing countries and preservation of Western culture and social values [44] However, writing in 1967, Balassa concluded that under the conditions then prevailing, estab lishing an Atlantic free trade area appeared neither feasible nor desirable The countries on both sides of the Atlantic were not ready or willing to assume the risks such an arrangement might entail, and they did not possess the degree of solidarity necessary to bring it to fruition [45]

As far back as 1989 53 percent of U S business executives believed that the United States should sign a free trade agreement (FTA) with the EU [46] According to *Business Week,* TAFTA would be a second best solution to genuine multilateralism, but may become the first choice if Asia does not refrain from creating an all Asian mercantilist bloc [47] Since 1995, business executives on both sides of the Atlantic have continued an informal dialogue, even in the absence of progress among governments [48]

Some see TAFTA as a way of preserving the standard of living of industrialized countries Goldsmith has warned that free trade creates competition among countries with different wage levels, lowering wages in industrialized countries Thus, he argues that countries with similar devel opment and wage structure should form free trade areas with mutually beneficial bilateral agreements between the various FTAs [49]

In 1995, then Canadian Trade Minister Roy MacLaren voiced support for TAFTA, suggesting that a senior level group from the private sector should help design it He further suggested that a new free trade partnership of Europe and North America could set competition in motion to reduce barriers worldwide because the high level of trade and investment flows already justified a more structured economic framework—about $250 billion in two-way trade and $460 billion in investment, reflecting a combined transatlantic output of more than $2 trillion [50] Prime Minister Jean Chretien of Canada pushed the idea, but then U S Trade Representative Mickey Kantor had only preliminary discussions with EU officials

TAFTA faces major obstacles of the kind that delayed the completion of the Uruguay Round of GATT, particularly in agriculture, trade, and market opening for air travel civil aircraft, and television broadcasting [51] By mid 1997, momentum receded as attention focused on more pragmatic initiatives

(6) South American Free Trade Area (SAFTA)

Brazil has proposed extending MERCOSUR to create a South American Free Trade Area that would include all of South America and eventually be in a position to merge with NAFTA [52] The idea of a SAFTA is not new, the Latin American Integration Association (ALADI) was started in 1980 and replaced the Latin American Free Trade Association (LAFTA) created in 1960 ALADI members include Argentina, Bolivia, Brazil, Chile Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela Support is growing for SAFTA, with six Andean countries proposing such a free trade zone in 1995 [53] Chile and Bolivia have become associate members of MERCOSUR, and after they negotiate a more formal arrangement, Ecuador, Peru, and Colombia would be likely candidates [54]

In 1995, U S Trade Representative Kantor and Brazil's Foreign Trade Minister Luiz Felipe Lampreia agreed that the two countries should "explore with the other parties to our respective sub-regional trade arrangements the possibility, which we strongly endorse, of holding an initial meeting between NAFTA and MERCOSUR "[55] Although the United States and Brazil agreed to an exploratory meeting between NAFTA and MERCOSUR, this did not happen because of objections from Mexico During a 1995 visit to Chile and the MERCOSUR countries, Canadian Prime Minister Chretien reiterated that "We see NAFTA as the foundation for eventual free trade throughout the Americas "[56] There is a possibility that MERCOSUR could become the core of a Western Hemisphere FTA or a SAFTA because of the extent of its integration and its size in relation to Latin America MERCOSUR represents almost 50 percent of Latin America's GDP, more than 40 percent of its population, and about 33 percent of its foreign trade [57]

(7) Association of Caribbean States (ACS)

The Association of Caribbean States was established in 1994, with the objective of complete economic integration, including the liberalization of trade and investment as well as programs of functional cooperation The creation of a free trade area among the 37-member countries would encom pass a population of 220 million and an annual trade flow of $5 billion [58] It is the first time in the Caribbean that this comprehensive a grouping of countries (including Cuba) has participated in a bloc Twenty five independent states have full membership in the ACS, and another 12 signatories—most of them overseas territories of the United Kingdom, France, the Netherlands, and the United States—have observer status [59]

(8) European-Mediterranean (Euro-Med) Free Trade Zone

In mid 1997, the European Union and 12 Middle Eastern and North African nations laid the foundation for a Europe Mediterranean Free Trade Zone as part of an economic and political partnership to include free trade in industrial goods and services by 2010 and increased EU funds for the region The Euro Med program follows the conclusion of bilateral association agreements between the EU and Israel and Morocco, Tunisia signed a similar accord earlier in 1997, and negotiations are under way with other Euro-Med partners The EU intends to build a trade bloc out of these bilateral agreements, underpinned by $6 2 billion in aid and a similar amount in soft loans pledged for 1995-99 [60]

(9) EU-MERCOSUR Inter-regional Association

In mid-1994, the MERCOSUR countries began consideration of an interbloc accord between MERCOSUR and the EU, and in late 1994, MERCOSUR Foreign Ministers and European officials announced plans to begin negotiations on trade liberalization [61] The EU MERCOSUR Inter-regional Framework Cooperation Agreement was signed in Madrid in 1995, with an EU MERCOSUR Inter-regional Association to be established sometime between 2000 and 2002 [62]

MERCOSUR represents roughly one-half of the EU's trade with Latin America, and Europe is the largest export market for the MERCOSUR countries In 1995, Europe accounted for 27 percent of MERCOSUR exports, compared to 20 percent for the United States [63] The EU's decision to form a bloc with MERCOSUR reflects the EU's intention to prevent the erosion of export markets in Latin America as part of a broad strategy to maintain traditional relations with Africa and the Caribbean through the Lome Convention (see Appendix I) and to enhance trade arrangements with Russia and Eastern Europe

OTHER INTERBLOC LINKS AND REGIONAL TRADE ARRANGEMENTS

Other interbloc links are emerging Russia and the EU have initiated an interim agreement, and the ratification process has been completed for the Partnership and Cooperation Treaty signed in 1994[64] The EU and Turkey have established a customs union, which became effective in 1996[65] Within the Western Hemisphere, Chile has expressed interest in linking NAFTA and MERCOSUR by being the first country to become a member of both trade blocs, and Bolivia has proposed becoming a bridge to MERCO SUR and the Andean Pact[66]

Some regional trade arrangements, actual and proposed, do not con stitute trade blocs because one country grants nonreciprocal market access to a group of countries These arrangements do not commit participating countries to the eventual goal of a free trade area, customs union, or common market, yet a number of such agreements exist (see Appendix I)

NOTES

1 Ernest H Preeg *Economic Blocs and U S Foreign Policy* (Washington National Planning Association 1974) p 8

2 European Commission European Union Key Figures (Luxembourg 1997)

3 1995 export statistics from International Monetary Fund *Direction of Trade Statistics Year Book* (Washington IMF 1996) p 445 1994 direct foreign investment statistics from U S Department of Commerce *The Statistical Abstract of the United States* (Washington U S Government Printing Office 1996) p 791

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5 Luigi Manzetti Economic Integration in the Southern Cone *North South Focus* (December 1992) p 3

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7 Ibid

8 John Barham 'Trade Imbalance Strains MERCOSUR Pact *Financial Times* November 17 1992 and Jane Bossey Trade Imbalance Threatens to Snag South America Pact *Journal of Commerce* January 15 1993

9 Paul W Moore and Rebecca K Hunt 'The Andean Pact In the Forefront of the Integration Movement *Business America* Vol 115 No 5 (May 1994) p 10 and Andean Pact Still Split on Outside Tariffs *Financial Times* May 12 1994

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Part II
Dimensions and Dispersal of Trade Blocs

DIMENSIONS OF TRADE BLOCS

Proposition 1 A large and growing share of world trade takes place within the ambit of trade blocs

DURING THE PAST DECADE there has been a resurgence of interest in regionalism and regional integration Today, trade blocs are a fundamental aspect of the world economy, both in terms of the share of the world trade they encompass and the number of countries that participate in them In 1995, 51 reciprocal, GATT-notified regional trade agreements were in force and accounted for 50 percent of world trade [1] A 1992 survey listed 23 preferential trade arrangements, encompassing 119 countries and accounting for approximately 82 percent of international trade in goods [2] Most of these arrangements seem to be moving toward becoming trade blocs, and they accounted for two-thirds of world trade in 1992 [3]

The existing trade blocs are the EU, NAFTA, MERCOSUR, Andean Group, the CACM, CARICOM, Group of Three, and the CER Table 1 shows the dimensions of the major functioning and proposed or developing trade blocs

Intraregional trade has grown rapidly throughout the world since the late 1940s and now accounts for one half of world trade, with a high of 70 percent in Western Europe (see Table 2) This trend reflects physical proximity, trade liberalization by individual governments, and regional trade arrangements Ironically, intraregional trade has grown most rapidly in Asia—in the absence of any formal integration or trade agreement This no doubt derives from the very high rates of growth of countries in the region Intraregional trade has attained significant proportions in Asia (see Table 2), despite the fact that trade blocs have only recently been established The growth of intraregional trade in East Asia has occurred because of the rapid growth in overall trade as well as unilateral nondiscriminatory trade liberalization, including reductions in "nonofficial" trade barriers,[5] and the expansion of intraregional investment, particularly in manufacturing [6] In the European arena, intraregional trade has reached a new high, as integration has deepened and membership has expanded in the EU

Trade among Latin American countries was relatively limited before the 1950s, having grown slowly in the first half of the century Exports

TABLE 1

Profile of the Principal Functioning and Proposed or Developing Trade Blocs

Trade Bloc	Population 1993 (Mill)	GNP, 1993 (US$ Bill)	GNP per Capita, 1993 (US$)	Intraregional Exports as a % of Total Exports, 1994
Andean Group	97 6	161	1 534	9 9
APEC	2 116 7	13 289 7	6 278	69 0
ASEAN	333 9	427 3	1 280	19 0
CACM	28 3	30	1 106	22 3
CARICOM	6 2	16	3 849	9 9
CER	21 1	N A	15 500	12 5
EU	344 0	6 600	17 741	61 0
Group of Three	141 2	373	2 643	3 0
MERCOSUR	197 7	1 618	3 930	19 2
NAFTA	372 6	7 287	16 390	47 7

Sources U S Department of Commerce Organization of American States Inter American Development Bank and APEC Economic Committee *1995 APEC Economic Outlook* (November 1995)

within Latin America as a percentage of total exports were 6 2 percent in 1913 and 9 3 percent in 1948 [7] By the mid-1950s, the volume of intra-Latin American trade was substantially higher than it had been before World War II, but it had grown at a lower rate than the growth of total world trade [8] Forecasts in the 1950s for the growth of Latin American exports, including those to the United States, were pessimistic and served to redirect attention to the potential of intra Latin American trade [9]

Latin American intraregional trade grew during the 1960s, declined during the 1970s, and began growing again in the 1980s [10] During the 1980s, economic integration schemes and regional trade agreements either ceased to function or existed in name only Factors leading to the contraction of trade and the collapse of regional arrangements included the perception of a polarization of benefits, policy disparities and limited policy cooperation due to widely different ideologies and economic development strategies, internal political crises, including civil wars and coups, and the adverse impact of oil prices, declining commodity prices, protectionism, external debt, and exchange rate volatility

TABLE 2

Share of Intraregional Trade (Exports Plus Imports) in Total Trade in Seven Geographic Regions, 1948 95 (Percentage of Each Region s Merchandise Trade)

	1948	1958	1963	1968	1973	1983	1993	1995
Western Europe	41 8%	52 8%	61 1%	63 0%	67 7%	64 7%	69 9%	68 9%
Central and Eastern Europe and the former USSR	46 4	61 2	71 2	63 5	58 8	57 3	19 7	18 7
North America	27 1	31 5	30 5	36 8	35 1	31 7	33 0	36 0
Latin America	20 0	16 8	16 3	18 7	27 9	17 7	19 4	20 8
Asia	38 9	41 1	47 0	36 6	41 6	43 0	49 7	50 9
Africa	8 4	8 1	7 8	9 1	7 6	4 4	8 4	10 0
Middle East	20 3	12 1	8 7	8 1	6 1	7 9	9 4	8 0
World	32 9	40 6	44 1	47 0	49 3	44 2	50 4	N A

Mexico is included in Latin America

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In the 1990s, trade within the Western Hemisphere has grown much more rapidly than trade with the rest of the world (see Table 3), with intraregional trade experiencing significant growth in recent years (see Table 4)

GLOBAL DISPERSAL OF TRADE BLOCS

Proposition 2 Trade blocs do not occur everywhere in the world but are concentrated in Western Europe, North America, South America, Central America, and the Caribbean They are notably absent in Africa and Eastern Europe and are embryonic in Asia.

Trade blocs are not evenly dispersed across the globe, but are concentrated in South America (including the Caribbean and Central America), North America, and Western Europe Since World War II, there has been persistent interest in and development of trade arrangements aimed at

TABLE 3

Average Annual Growth of Exports in the Western Hemisphere 1990 96

	Global Exports	Extraregional Exports	Intraregional Exports
Andean Group	5 1%	3 9%	23 6%
CACM	11 2	10 4	15 1
CARICOM	5 5	5 1	8 0
Group of Three	11 7	11 6	20 9
MERCOSUR	8 3	5 7	25 6
NAFTA	8 6	7 1	10 5
Latin America and the Caribbean	9 9	8 5	18 2
Western Hemisphere	8 4	6 3	10 4

Source *Integration and Trade in the Americas* (Washington Inter American Development Bank Department of Integration and Regional Programs July 1997) p 3

TABLE 4

Intraregional Exports in Latin America and the Caribbean 1990 96 (Percentage of Total Exports)

	1990	1993	1996
Andean Group	4 1%	9 4%	10 9%
CACM	16 2	21 8	19 9
CARICOM	11 7	11 4	13 1
Group of Three	1 6	3 2	2 6
MERCOSUR	8 9	18 5	21 5
NAFTA	42 9	45 5	47 5
Latin America and the Caribbean	11 9	19 0	18 4
Western Hemisphere	48 1	52 2	53 8

Source Same as Table 3

establishing trade blocs South America and Europe have had the longest established trade blocs, dating in some cases from the 1950s The extended duration of some now defunct blocs, such as COMECON and the European Free Trade Agreement (EFTA), reflect this interest

The early development of trade blocs in the 1950s and 1960s was followed by a second wave of activity in the latter half of the 1980s and the early 1990s, when MERCOSUR was formed and the European Economic Community was transformed into the European Union This resurgence and deepening of economic integration has continued into the 1990s, especially in the Western Hemisphere with the establishment of NAFTA and in the Caribbean and South America with a renewed interest in integration and regional trade arrangements [11] Regional integration has grown out of economic liberalization and the shift toward outward-looking economic development strategies The revival of regionalism has also been influenced by the transition to a world market as national economies merge into trade blocs The deepening integration in the EU and the successful implementation of NAFTA are manifestations of this trend toward the emergence of trade blocs

Functioning trade blocs are markedly absent in Africa and the Middle East, although there have been numerous attempts and brief operations While the Franc Zone has existed in French-speaking West Africa since the colonial era, there has been little progress in trade integration Apart from the Southern African Customs Union, trade blocs and integration agreements in this region have failed under the stress of daunting economic, political, and social problems [12] The Lagos Plan was intended to create a common market of sub-Saharan countries,[13] and efforts continue to bring it to completion In the Middle East, seven regional trade blocs were initiated between 1959 and 1981, none of which now function effectively The most recent attempt was the Arab Maghreb Union formed in 1989 by economies dominated by oil production and trade The region has little prospects of forming a trade bloc, especially given religious, ethnic, and political differences [14]

Trade blocs have not been prominent in Asia, but there is a long history of regional organizations and alliances motivated by security considerations, especially anticommunism Japan has studiously avoided involvement in trade blocs with its Asian neighbors, being preoccupied with global markets, particularly markets in the United States and Western Europe Japan has also refrained from deliberate policies to increase its financial and monetary influence in Asia or to promote the yen as an international currency to compete with the U S dollar [15] Japan's disinclination to form or join a trade bloc has coincided with some apprehension from its neighbors Worried by disparities in size, industrialization, and technology, many Asian countries have eschewed inviting Japan to participate in regional trade arrangements However, perhaps more important in perpetuating this attitude have been the lingering bitterness over Japanese colonialism and conduct during World War II and the memory of the Greater East Asia

Co-Prosperity Sphere [16] Further, most countries in the region practice unilateral trade liberalization and have benefited from an open multilateral trading system and do not want to jeopardize their existing access to export markets, particularly the United States [17]

Although trade blocs are not well developed in Asia, regional arrangements in economic, security, political, and other areas are firmly established and quite advanced [18] Many of the old hostilities are yielding to the economic push for increased trade and investment by increasing interaction and cooperation [19] Some type of free trade zone or arrangement linking the countries of Southeast Asia, or a grouping that includes Japan, is a distinct possibility, although some scholars argue against this [20] An Asian economic group consisting of Japan and the ASEAN countries would encompass 33 9 percent of the exports of these countries Japan and the newly industrialized countries of East Asia have a combined GDP of $3 3 trillion and a population of 607 million [21] The Muslim countries of Asia formed the Economic Coop eration Organization in 1992, and there is a proposal for an Islamic free trade area The idea of a free trade zone involving Russia, China, and North Korea has even been discussed [22]

In 1997, Muslim developing nations formed a global economic coop eration group known as the D-8 [23] Bangladesh, India, Sri Lanka, and Thailand have established the BIST EC, which will initially concentrate on infrastructure and transportation [24] The members of the South Asian Asso ciation of Regional Cooperation (SAARC)—Bangladesh, Bhutan, India, Maldives, Nepal Pakistan, and Sri Lanka—have agreed to establish a free trade area by 2001 [25] In deciding on its role in Asian regionalism, Japan must continually recalibrate the balance of relations between Asia and the West [26]

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Part III
Factors Explaining the Formation of Trade Blocs

THE OCCURRENCE of trade blocs is determined by the interaction of global and regional factors

GLOBAL FACTORS

The three factors operating at the global level are globalization, corporate integration, and U S policy toward regionalism and trade blocs Globalization and corporate integration are the economic forces pushing the formation of trade blocs, made possible because of the changed nature of U S hegemony

Proposition 3 Two major economic forces—globalization and corporate integration—encourage the formation of trade blocs as a transition from an atomistic world economy of nation-states to a world economy devoid of national barriers to international trade

Globalization

In recent years, international trade and capital flows have grown at a faster rate than world GDP [1] During 1983-93, there was a 71 percent increase in the volume of world merchandise exports, double the 35 percent growth in world output [2] This reflects the progressive globalization of production and finance,[3] which is pushing governments to minimize, harmonize, or eliminate national barriers (e g , tariffs, quotas, and exchange controls) to the international movement of goods, services, capital, and finance Efficiency in resource allocation and profit maximization on a global scale cannot be attained in a world economy that is fractured into national economies whose policies constrain the degrees of freedom Transnational corporate integration impels multicountry market integration initially in a regional context, both as ex post economic rationalization and as a defense by the nation-state against the inevitable relinquishment of the vestiges of economic sovereignty

The speed and extent of the flow of goods, services, capital, and finance throughout the global economy require a degree of freedom that is not available if there are national impediments This fundamental economic development is the impetus for the dismantling of national barriers and the movement toward regional groups where a free market exists for capital and goods The thrust toward globalization manifests itself in the formation of trade blocs and the impetus to liberalize embodied in the Uruguay Round Agreement of GATT Trade blocs are transitional mechanisms that accommodate the needs of globalization and facilitate the concentration of economic activities in these areas

The transition to a world market is taking place through the linkage of national economies and regional trade blocs For example, APEC's share of world exports increased from 38 percent in 1983 to 46 percent in 1993 Intra-APEC trade also expanded rapidly, with about 70 percent of APEC exports going to other APEC countries in 1993, compared to 61 percent in 1983 [4]

Globalization is compelling the world economy toward transnational production and economic activity Private sector-led, market-driven economic catenation, or linkages, are pushing political authorities to reduce and ultimately eliminate national barriers to the flow of goods, services, capital, and finance Although global, transnationalization is uneven in its development, in its most advanced state, it takes the form of trade blocs, primarily between highly developed, trade-oriented economies Globalization tends to manifest itself as trade blocs because regional concentrations of economic activity are outgrowing national economies yet are constrained by national political barriers No single country currently performs a hegemonic management role to ensure a genuinely multilateral system of free trade, as Britain did in the nineteenth century or the United States did from 1945 to the mid-1970s In this situation, nation states endure as politically bounded economic spheres

In some cases, trade blocs are driven by economic tendencies that may take the form of corporate integration Corporate integration sometimes develops momentum after an initial phase of government-led integration The formation of the European Union is a case where political vision, driven by security needs and a common culture and history, preceded transnational economic links Liberalization among Western European countries compounded and accelerated the transnationalization of trade and investment Eventually, corporate integration developed sufficient mass and momentum to drive the political process and consummate the long-held vision of a European economy

Trade blocs also tend to develop where intraregional trade is very important and is market induced The exponential growth of regional trade and investment in Asia emerged from market forces, extremely high rates of economic growth, and the export-oriented nature of the economic policies and structures of the economies Only recently has the complementary political will begun to coalesce around the idea of a regional economy based on the market rather than on formal legal and institutional mechanisms

Concomitant with globalization has been the marginalization of much of the developing world, whose links with the areas of dynamic growth are tentative and are being eroded by lack of technology, low productivity, and inadequate competitiveness Trade blocs have long been a phenomenon of some developing countries, reflecting their attempts to overcome their marginalization or to cooperate in their relations with the blocs of developed countries

Corporate Integration

Economic concentration—that is, the emergence of growth poles re sulting from the clustering of industries—intensifies intra-industry trade and accelerates technological innovation Corporate integration through mergers and strategic alliances have been a dominant feature of capitalism in the United States and Western Europe Corporate integration, consoli dation, and restructuring through cross-border mergers and acquisitions have become worldwide phenomena for the following reasons (1) companies strive for size, (2) to attain economies of scale, (3) market presence, (4) com petition forces consolidation and pruning, (5) easing of regulations govern ing mergers, and (6) corporations prepare for more intensive competition in the global market[5]

Corporate integration is proceeding rapidly between Argentina and Brazil, with more than 300 joint ventures in 1995[6] and such integration is pushing MERCOSUR This is a clear example of how corporate integration spurs and reenforces the formation of trade blocs In that same year, Argentina became the leading recipient of Brazilian foreign investment[7] This type of intraregional investment is the result of a larger market having been created by a trade bloc as transnational corporations decide where to locate their plants based on the capacity of a country to serve as a hub in global or regional production networks Argentina has attracted Chilean and U S investment, particularly in food processing, with major invest ments by Nabisco, Cadbury-Schweppes, Cargill, Danone, and Parmalat Chilean firms such as Chilectra, Chilgener, and Endesa have invested heavily in privatized gas and electricity utilities[8]

U S Policy Toward Trade Blocs

Proposition 4 The relative decline in U S hegemony has allowed the multilateral trading system to accommodate the emergence of trade blocs other than the EU Indeed, the United States is now pursuing a two pronged approach that binds multilateralism and regionalism and is itself a lead participant in a major trade bloc, NAFTA.

U S economic power and political hegemony in world affairs has changed in the postwar period, as was evident in the prolonged Uruguay Round of GATT[9] The emergence of trade blocs and U S participation in NAFTA partly reflects the difficulties for the United States of enforcing an open multilateral trading system, as it did immediately after World War II Although modifications in U S policy toward regional integration and trade blocs reflect the changes in U S power, the U S disposition can still significantly influence whether a bloc is formed This is clearly evident in the U S support for the FTAA and in its apprehension over and lack of acquiescence to the establishment of Asian blocs that exclude the United States Indeed, U S policy toward such trade blocs has been a factor in discouraging the formation of a trade bloc in Asia The perception of U S hostility is sufficient to deter participation in trade blocs, as many countries in the region are vulnerable to U S actions [10] In fact, Japan has had to be sensitive to the balance of relations between Asia and the West in deciding on its role in Asian regionalism

The attitude of the U S government toward regional trading arrangements and regional integration has varied with its perception of its national interest For example, the United States has supported regional integration when it regarded a region as being in need of economic development or as a safeguard against external threats, as in Western Europe in the Cold War years or in Latin America because of internal destabilization The United States has vehemently opposed regional economic arrangements that it perceived as excluding or diminishing U S exports or as making market access more difficult by protectionism, as in Latin America in the 1950s and early 1960s and in the EEC as it expanded to a single market in 1992

In the latter part of the 1980s, the United States became an advocate of regional trading arrangements, starting with the Canada-U S Free Trade Agreement In 1990, NAFTA was proposed, with the ultimate objective of becoming a Western Hemisphere Free Trade Area, reflecting the importance of markets in the hemisphere at a time when the U S economy had a large, persistent trade deficit and economic growth had become more dependent on exports [11] This shift in policy coincided with the consolidation of the EEC, uncertainty about concluding the Uruguay Round of GATT,[12] and frustration over access to the Japanese market

Before 1945, proposals to create a European union were considered detrimental to U S interests and were viewed with suspicion [13] However, in the aftermath of World War II, the United States vigorously supported Western European economic cooperation and integration because of a combination of economic, political, strategic, and security reasons [14] The establishment of the EEC and the economic recovery of its member states transformed European-U S economic relations from dependence to inter dependence [15] As early as 1962, the EEC retaliated against U S goods after the United States withdrew concessions on carpets and glass By the early 1970s, the EEC was regarded as an increasingly closed trading group that was becoming progressively exclusionary [16]

In contrast to U S support since the inception of the Marshall Plan for regional cooperation in Western Europe and the active assistance given later to the EEC, the U S attitude toward Latin American integration efforts during the years preceding the Kennedy administration was discouraging [17] U S support was conditioned by private sector fears that expanding intraregional trade would harm U S exports [18]However, by the early 1960s, there was increasing willingness to concede that regional economic integration in

Latin America was not intended to be protectionist to the detriment of U S exports or the multilateral trading system and the principles of GATT [19]

The United States has traditionally advocated and used its influence to promote free trade in the multilateral trading system, but since the mid-1970s there has been a growing willingness by the United States to resort to protectionism for selected endangered industries Bhagwati has argued that "the overall ethos favorable to protectionism came from the national psychology produced by America's relative decline in the world,"[20] what he calls the "diminished giant syndrome "[21] Justifications for protec tionism include preventing the demise of strategic industries such as iron and steel, protecting U S wages from "cheap labor" imports, maintaining jobs in sectors such as textiles and apparel, as a sanction against barriers to U S exports, as in Japan, and as a bargaining chip to open markets There has been increasing acceptance of the idea that strategic and selective application of protectionism promotes exports, reduces trade deficits, and retards deindustrialization Support for managed trade has come to be regarded not as short-sighted protectionism, but as practical, patriotic defense of the national interest

The growth of protectionist sentiment is linked to the growing recog nition that while free trade is a desirable goal, the real world diverges significantly from it The argument that free trade is the best option is based on the Ricardian-Hecksher Ohlin theory of comparative advantage, which derives from very restrictive assumptions [22] The validity of the theory has been increasingly questioned as the reality of world trade has progressively invalidated the theory's underlying assumptions This is clearly expressed by Dosi et al who state that "with increasing returns and imperfect compe tition, free trade is not necessarily and automatically the best policy Trade without barriers and government policies of promotion that distort markets may improve national welfare However government policy to strengthen the competitive position of domestic producers in world markets may generate higher levels of national welfare than would result from free trade "[23] There are also advocates of "aggressive" bilateralism or forceful" unilateralism who justify the use of sanctions such as those provided in Super 301 (a section of U S trade legislation) to lower or dismantle protec tionist barriers that hinder U S exports in several countries most notably Japan, or to deter or compensate for unfair practices not adequately regu-lated by GATT or its successor the World Trade Organization (WTO) [24] This milieu of managed trade has made it possible for a two track trade policy to emerge in the United States one supporting multilateralism and the other permitting regional trade blocs

Regional Factors

It is the effect of regional factors on the global forces that are propelling the establishment of trade blocs that determines if and where these blocs will emerge

Proposition 5 The uneven development of trade blocs—that is, their occurrence or absence and the global dispersal of trade blocs—reflects the influence of regional factors and conditions on the global forces impelling their formation Trade blocs emerge when the forces of globalization and corporate integration coincide with conducive regional conditions

Four principal factors operate at the regional level that determine whether the global impulses toward the formation of trade blocs will be translated into the reality of blocs These factors are a history or tradition of regionalism and cooperation, physical proximity, reaction to the emergence of another bloc, and divisive social, political, or ideological differences

History of Regionalism and Cooperation

Proposition 6 A history or tradition of regionalism and cooperation has been an important contributing factor in the formation of trade blocs such as those in Western Europe, Latin America, the English speaking Caribbean, and the Andean Pact

A history of regionalism and the idea of regionalism as a long-term goal have been important to the emergence, development, and consolidation of regional trade blocs For example, in Western Europe, the idea of some type of economic union or European community gained wide acceptance after World War II [25] Similarly in the English-speaking Caribbean, the idea of a Caribbean community has been significant, indeed, present economic integration was preceded by a short-lived political federation [26]

Latin America is perhaps the best example of a history of regionalism contributing to the emergence and persistence of trade blocs The idea of economic integration in Latin America dates from the First International Conference of American States in 1889, when the formation of a customs union was proposed [27] In 1941, a regional conference was convened in Montevideo at which Argentina, Bolivia, Brazil, Paraguay, and Uruguay signed a series of agreements covering a range of economic relations [28] In 1960, the Treaty of Montevideo was signed, creating a free trade area encompassing Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay and establishing the Latin American Free Trade Association (LAFTA) [29] As noted in Part II, the Central American Common Market came into existence in 1961, and the Caribbean Free Trade Association was established in 1968

MERCOSUR illustrates the importance of a history of regionalism Argentina, Brazil, Uruguay, and Paraguay have long tried to translate their shared sense of being a separate region into a formal regional arrangement In 1939, Argentina and Brazil negotiated a treaty to liberalize trade,[30] in

1940, Argentina proposed the creation of a customs union that would also encompass bordering countries,[31] and in 1941, the regional conference noted above was held [32] In 1991, this long standing idea of regionalism finally came to fruition in MERCOSUR

A history or tradition of regionalism can emerge in different ways as a response to the dominance of a country or trade bloc, as in Latin American reaction to U S dominance, in overcoming development constraints, such as small size in CARICOM or the limits of import substitution and industrialization in Latin America, from an external threat to national security, as in Western Europe and Asia, or as a carryover from colonial administration, as in Caribbean integration, which followed naturally from the British colonial practice of administering the region as a single unit

Physical Proximity and Economic Catenation

Proposition 7 Trade blocs are most likely to be formed in natural physical regions, such as Western Europe, North America, Central America, and the Southern Cone, because physical proximity facilitates the catenation of economies and corporate integration, such as Mexico-United States, Brazil Argentina, and Western Europe

Close physical proximity and adequate infrastructure transportation, and telecommunication systems facilitate economic activity through trade, investment, and corporate linkages and can be the forerunners of a trade bloc Indeed, these multistate concentrations of economic activity have been described as natural trade blocs [33] Natural blocs or regions may persist over very long periods despite the superimposition of formal trade blocs and nation states [34] In Western Europe, physical proximity promotes an ease and frequency of interaction between business and political leaders as well as cross-border travel by the average citizen, leading to the emergence of transnational networks and a greater awareness of commonalities [35]

Trade tends to be concentrated among countries or regions in close physical proximity, especially when countries in a regional trade group share a contiguous land mass This is evident, for example, among the MERCOSUR countries, the United States Canada, Taiwan Hong Kong South China,[36] and the Singapore-Johore (Malaysia)-Riau (Indonesia) growth triangle [37] Between 1991 and 1995, exports to MERCUSOR as a share of total exports increased from 16 5 percent to 32 3 percent in Argentina, 7 3 percent to 13 2 percent in Brazil, 35 2 percent to 56 8 percent in Paraguay, and 35 4 percent to 47 0 percent in Uruguay [38] As noted, since 1992, the number of joint ventures between Brazil and Argentina has tripled to 313 [39] The close link between Argentina and other MERCOSUR countries will be strengthened as infrastructure and transportation systems improve and become less expensive, 60 percent of Argentine Brazilian trade is carried by road, mainly because their railway systems use different gauges [40]

Trade blocs and formal trade agreements are not confined to regional arrangements, although these remain the most common and most economically viable. Economic interests may dominate over regional proximity, as in the Lome Convention (see Appendix I), or political interests may take precedence over physical proximity, as in the U.S.-Israeli FTA. Ethnicity may also be a basis for economic linkages. Examples include the Indian Ocean Rim Association for Regional Cooperation, the D-8 group of Muslim developing nations, the BIST-EC, and the South Asian Association of Regional Cooperation.

Exclusion and Uncertainty about Participation

Proposition 8. Blocs may be formed or strengthened as a reaction to the emergence of another bloc. For example, the transformation of the EEC into the European Union provided an important impetus to the formation of NAFTA, and the creation of NAFTA added impetus to the ACS and the proposal for a SAFTA.

Sometimes trade blocs are established or expand in response to the formation and expansion of other blocs. In the formation of the CUSFTA and NAFTA, Canada and Mexico were partly motivated by the need to secure an agreement with the United States to help avoid protectionist barriers.[41] Concern in Asia has grown over the emergence of the trade bloc in North America, the consolidation of the European trade bloc, and the "new" regionalism throughout the world, which have contributed to increasingly serious consideration of an Asian trade bloc.[42] The formation of NAFTA and the deepening of integration in the EU were factors in the creation of the ASEAN Free Trade Area and the acceleration of its schedule of implementation.[43] Developments in ASEAN were influenced by the establishment of NAFTA and its possible expansion in the Western Hemisphere. As noted in Part I, Singapore has urged ASEAN to act quickly to remove tariff barriers by warning about the risks of falling behind other regional trade groups. Japan's interest in APEC and, to a lesser extent, ASEAN was prompted by fears that NAFTA might become "Fortress North America."[44] Similarly, the choice of 2005 for completion of negotiations for the Free Trade Area of the Americas was influenced by the dates APEC announced earlier of achieving free trade among member industrialized economies by 2010 and among developing countries by 2020.

The possibility of exclusion from the EU, NAFTA, and a possible Asian trade bloc was part of the stimulus for the formation of MERCUSOR, the revitalization of the Andean Group, and Malaysian proposals for an East Asian Economic Group and later an East Asian Economic Caucus.[45] This is a particular motive in the case of the interest of the small and/or developing countries of the Caribbean and Central America in joining NAFTA and the FTAA.

Argentina is an example of a country confronted by the dilemma of weighing the pros and cons of participating in a trade bloc Although Argentina has deep and well founded concerns about participating in NAFTA dominated by the United States, it is also worried about Brazil's domination of MERCOSUR by virtue of its size and more advanced level of industrialization Brazil is a new regional power in the world economy and international politics,[46] which chafes against Argentina's long held ambitions for leadership in Western Hemispheric affairs,[47] to be an advanced industrialized economy and for greater autonomy in foreign policy [48] Meanwhile, Chile's strong interest in MERCOSUR and MERCOSUR's accord with the EU is largely a response to the U S Congress's increasingly antagonistic stance toward the expansion of NAFTA and the FTAA [49]

Discord May Prevent Bloc Formation

Proposition 9 Divisive forces such as ethnicity in the former COMECON and former Soviet Union, political turmoil in Africa, ideological differences in North Africa and the Middle East, and long standing antagonisms in Asia may counteract the market induced or policy-directed formation of a bloc

Differences exist within any group of countries Some differences can be overcome by state or market led economics or the exercise of political will, either collectively or by a hegemonic state Religious, ethnic, political, or ideological differences can be divisive, just as shared religious beliefs or shared ethnicity can help bring groups together to form trade blocs or contribute to their cohesion (as noted above)

Although Asia has experienced the highest rate of growth in intraregional trade, it has not established a fully functioning trade bloc This is a clear case of historical antagonisms frustrating the market induced impulses toward the formation of a trade bloc Japan is turning more toward Asia's economies as the result of a deliberate policy realignment, partly reflecting aggressive U S trade tactics, and the rapid growth of Asian markets Asia became Japan's largest export market in 1991, and in 1993 Japan's trade surplus with the region surpassed its surplus with the United States [50] Japan's investment in Asia is estimated at $48 billion, nearly one third of its total overseas investment Japanese direct investment in Asia quadrupled in less than a decade, increasing from $2 3 billion in 1986 to $9 3 billion in 1994 This trend is likely to continue, especially with the growth of China From 1985 to 1995 Asia's share of Japan's trade increased from 27 percent to 38 percent while the U S share dropped to 27 percent Trade is increasingly based on corporate integration Japan's imports from East Asia have doubled from 1987 to 1995 to $91 billion, "much of which come from its own plants there," according to the *Financial Times* [51]

But political frictions remain (even though Japan has apologized for its actions during World War II) as does the traditional fear of Japan's domınance, no longer polıtıcal but economıc Prıme Mınıster Mahathır bın Mohamad of Malaysıa has complaıned that Japan ıs not wıllıng to share technology, that ıt has faıled to open ıts market to developıng countrıes by removıng quotas and nontarıff barrıers, and that ıt has not supported the formatıon of the East Asıan Economıc Caucus [52]

NOTES

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Part IV
Conclusion

TRADE BLOCS ENCOMPASS a large and growing share of world trade but are concentrated in Western Europe, North America, South America, Central America, and the Caribbean They are notably absent in Africa and Eastern Europe and are embryonic in Asia Trade blocs have formed when and where there has been a favorable conjuncture of global and regional forces

Two major forces—globalization and corporate integration—encourage the formation of trade blocs as a transition from an atomistic world economy of nation-states to a world economy without national barriers to international trade and capital flows In the past decade the United States has changed its position toward regional trading arrangements and is no longer a constraint on global pressures for bloc formation

The uneven development of trade blocs reflects the influence of regional factors and conditions on the global forces impelling their formation Trade blocs emerge where the forces of globalization and corporate integration coincide with conducive regional conditions These regional factors include

(1) a history of regionalism and cooperation, which has been an important contributing factor in the formation of trade blocs in Western Europe, Latin America, the English speaking Caribbean and the Andean Pact,

(2) physical proximity, which facilitates the catenation of economies and corporate integration such as Mexico United States, Brazil Argentina and Western Europe Trade blocs are most likely to be formed in natural physical regions such as Western Europe, North America, Latin America, and the Southern Cone,

(3) a unifying force, as the military in ASEAN, cultural links, as in Western Europe and in the English speaking Caribbean, a hegemonic power treating or administering a group of countries as a single region, as in the eastern Caribbean by Britain and in Central America by the United States, or the threat of drug trafficking, as in the Andean Pact countries Divisive forces may counteract the market induced or policy-directed formation of a bloc Such forces include ethnicity, economic disorder, and inefficiencies, as in the former COMECON and former Soviet Union, political turmoil in Africa, ideological differences in North Africa and the Middle East, and long-standing antagonisms in Asia

Trade blocs therefore are a systemic feature of the world economy and not a regionally specific phenomenon

Part V
Implications

THE FORMATION OF TRADE BLOCS and the increased share of global trade encompassed within these blocs will have profound implications for all aspects of the global economy and world politics Four issues are likely to be very important (1) the impact on the nation state, (2) the nature of international relations, (3) the operation of labor markets, and (4) economic growth of developing countries

(1) Although predictions of the demise of the nation-state as a political entity are premature, countries will lose some control and influence over economic activity within their own borders and internationally This is evident now in the movement of the exchange rates of leading currencies, including the U S dollar The value of the dollar depends not only on what the U S government is doing, but also on what traders are doing in the global currency markets, what is happening in the Japanese financial system, and so on There is also a disjuncture between politics and economics at the nation-state level Both economic transnationalization and globalization are occurring and will increase, but there is also interaction between the two Although trade blocs promote economic interdependence, the continuity of the nation-state is being reinforced by the resurgence of ethnicity, nationalism, and the need to participate in a community that is manageable in size

(2) In international relations in the coming years, the individual nation-state and its foreign policy will increasingly be subsumed within regional political alliances, both as a reaction to and an outgrowth of the formation of blocs The United States, by virtue of its special position in the world economy, will be an exception to this trend to some extent But even the United States operates in certain regional settings such as the Group of 7 (G-7), NAFTA, and NATO

(3) Labor markets are being segmented Indeed, a global labor market exists in certain professions, although many occupations will continue to rely primarily on national labor markets Because business has experienced a progressive globalization in all aspects of production, management, and ownership and because trade unions and labor are still primarily nationally based, there is now a profound difference in the way that business and labor interact Ownership has increasingly become transnational even though global companies may be registered or headquartered in an individual country Nationally based institutions are increasingly interacting with globally based businesses In this environment, it will be necessary to rethink the role of trade unions and to develop a new form of labor alliance

Because workers will be changing their jobs and professions several times in a lifetime, unions will have to become organizations that people can join as lifelong members The new union organization will broaden its role from bargaining for wages and working conditions to include advising members on career changes and helping them to get training and jobs This expanded notion of labor organizations would also address the needs of the growing number of independent, home based, and part time workers

(4) The formation of trade blocs has profound implications for developing countries The dilemma for developing countries is whether to par ticipate in trade blocs or to remain outside Given that exclusion can have serious adverse implications in the form of trade diversion from nonmem bers to member states, developing countries cannot in most cases afford to be excluded [1] Most of the exports of developing countries are sold to devel oped countries, hence to maintain market access, developing countries will have to seek membership in trade blocs that include developed countries, e g , Caribbean countries' interest in NAFTA membership This will particularly be the case where special arrangements not involving membership, e g , the Lome Convention, are not available

Membership for developing countries in trade blocs involving developed countries raises the critical issue of how to address the substantial differences in levels of development This problem is well illustrated by the Free Trade Area of the Americas The Western Hemisphere encompasses countries vastly different in size and level of development [2] Size ranges from the United States (9 8 million sq km) and Brazil (8 5 million sq km) to Montserrat (102 sq km) Population varies from 258 million in the United States to 11,000 in Montserrat GNP differs between the United States with $8,291 billion to Antigua, Dominica, Grenada, Montserrat, St Kitts, St Lucia, and St Vincent, each with GNP of less than $500 million Per capita GNP ranges from $24,750 in the United States to $450 in Haiti

The integration of countries at different levels of development within trade blocs will have to be addressed by a variety of measures These include (a) special and differential treatment on a permanent basis, e g , CARICOM, or for a fixed period of time, e g , in GATT, (b) special arrangements between blocs of developed countries and nonmember developing countries e g , the Lome Convention between the EU and the African, Caribbean, and Pacific group of developing countries, (c) asymmetrically phased implementation of disciplines, that is providing longer adjustment periods for developing countries, e g , the WTO treatment of least developed countries

NOTES

1 For an overview of the adverse implications for developing countries of nonmembership in NAFTA see Richard L Bernal From NAFTA to Hemispheric Free Trade *Columbia Journal of World Business* Vol 29 No 3 (Fall 1994) pp 22 31 and Richard L Bernal and Pamela Coke Hamilton Region Seeks to Redress Apparel Issue *Hemisfile* Vol 8 No 2 (March/April 1997) pp 3 4

2 *Observations on Small Countries and Western Hemisphere Economic Integration* Organization of American States Trade Unit Background Document to the FTAA Working Group on Smaller Economies Paper No SG/TU/WG SME/Doc 2/95

Appendix I

(1) The Caribbean Basin Initiative (CBI), formed in 1983, provides one-way free trade for 90 percent of the products from Central America and the Caribbean entering the U S market The drawback to this arrangement is that many of the exports that have the best prospects for Central America and the Caribbean are excluded from the CBI, in particular garments, textiles, citrus products, and leather goods [1]

(2) The Caribbean-Canadian Trade Agreement (CARIBCAN) is a one-way free trade entry for goods from the Caribbean countries into the Canadian market Exports from CARICOM to Canada covered by CARIBCAN have not increased significantly The range remains limited, and the number of Caribbean firms exporting to the Canadian market is very small [2]

(3) The Andean Trade Preference Act (ATPA), signed in 1991 by President George Bush, provides duty-free treatment for exports from the Andean countries over a 10-year period, excluding tuna, rum, textiles, most apparel, leather goods, footwear, sugar, and petroleum The objective of the act is to reduce the dependence of these economies on illegal drug trafficking [3]

(4) The Venezuela-CARICOM agreement, signed in 1991, offers duty free treatment to imports from the Caribbean countries for five years Negotiations have begun on phased reciprocity

(5) The Colombia-CARICOM agreement, signed in 1994, took effect in 1995 The agreement permitted immediate access to the Colombian market, with reciprocity to be phased in by CARICOM over a five-year period

(6) The Lome Convention is between the European Union and former colonies in Africa, the Caribbean, and the Pacific The first Lome Convention came into effect in 1975, and Lome IV is now in place [4]

NOTES

1 *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U S Industries and Consumers Sixth Report 1990* (Washington U S International Trade Commission Publication 2432 September 1991)

2 *Canada and the Commonwealth Caribbean Evaluation of the CARIBCAN Experience Since 1986* Sisterna Economico Latino Americana SP/CL/XVIII 0/Di No 20 (1992)

3 *Guidebook to the Andean Trade Preference Act* (Washington U S Department of Commerce July 1992)

4 For the early history of the Lome Convention see John Ravenhill *Collective Clientelism The Lome Conventions and North South Relations* (New York Columbia University Press 1985) For a recent review see Anthony T Bryan *Trading Places The Caribbean Faces Europe and the Americas in the Twenty First Century* (Miami North South Center Paper No 27 June 1997)

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