

# **EXPORT MARKETING AND FINANCE**

## **WEEK 9 TRADING BLOCS AND EXPORTS**

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## **WEEK NINE**

### **TRADING BLOCS AND EXPORTS**

#### **9.1 Introduction**

Welcome to week nine lecture! We have now covered three quarters of the course and I continue to congratulate you for the deamination you have shown so far! In the last lecture we examined regulations that govern international trade and transport, the legal environment and the kinds of disputes experienced in trade. to address some of the challenges, nations have formed what is referred to as trading bloc where they agree on certain matters regarding tariffs and non-tariff issues. In this lesson we examine

#### **9.2 Intended Learning Outcomes**

At the end of this lecture, you will be able to:

- Describe a trading bloc and its purpose.
- Examine formation of trading blocs
- Evaluate objectives and advantages of trading bloc.
- Examine impact of trade bloc on export business
- Discuss examples of trading bloc

#### **9.3 Understanding a trading bloc.**

The twenty-first world is divided into markets more than political boundaries. Nations have come together to set themselves apart and see how they can compete more effectively by coming up with trade agreements. These are the basis of regional integration agreements or the so-called trading blocs. A trading bloc is a preferential economic arrangement between a group of countries which might take a variety of textbook forms (Brand, 1992). Regionalism, which is also associated with trading blocs, refers to the appearance and consolidation of various arrangements among groups of geographically proximate countries. The arrangement ranges from the simplest free trade area to full economic union; (Heywood, 2003). On his part (Maity, n.d) defines a regional trading bloc as a group of countries within a geographical region that protect themselves from imports from non-members. In general terms, regional trade blocs are associations of nations at a governmental level to promote trade within the bloc and defend its members against global competition.

From these definitions we note the following

- a) Trading blocs come with many names like, regional trade agreements, regional integration agreements.
- b) Formed by groups of countries that are close to each other geographically.
- c) formed to promote trade and economic cooperation within the region.
- d) They are formed with a both economic and political agenda.

## 9.4 Types of trading blocs

The trend on formation of trade bloc or regionalism has been on sharp increase in the last few decades with formation of bloc that are even trading with others. Generally there are four types of regional trade blocs (Maity,n.d).

- a) Preferential Trade Area – Preferential Trade Areas (PTAs), the first step towards making a full-fledged RTB, exist when countries of a particular geographical region agree to decrease or eliminate tariffs on selected goods and services imported from other members of the area. Examples of such include Generalized System of Preferences – Armenia, African Growth and Opportunity Act and Caribbean Basin Economic Recovery Act. This is the lowest level of integration. PTAs aims to facilitate trade between countries, its usually unilateral and offers benefits related to price reduction on customs as well as non price related benefits such as reduction in formalities.
- b) Free Trade Area – Free Trade Areas (FTAs) are like PTAs but in FTAs, the participating countries agree to remove or reduce barriers to trade **on all goods** coming from the participating members. In these blocs members move towards zero or near-zero tariff levels amongst them on substantially all trade Examples of EFTA (European Free Trade Association). NAFTA (North American Free Trade Agreement) and New Zealand-China Free Trade Agreement. In free trade areas there is Intellectual Property Protection, product standards set, selling to governments and fair treatment for investors among other agreements.
- c) Customs Union – A customs union has no tariff barriers between members, plus they agree to a common (unified) external tariff against non-members. Effectively, the members are allowed to negotiate as a single bloc with third parties, including other trading blocs, or with the WTO. Examples of custom unions include Andean Community (CAN), Caribbean Community (CARICOM), Central American Common Market (CACM), East African Community (EAC)
- d) Common Market – A ‘common market’ is an exclusive economic integration. The member countries trade freely all types of economic resources – not just tangible goods. All barriers to trade in goods, services, capital, and labor are removed in common markets. In addition to tariffs, non-tariff barriers are also diminished or removed in common markets. Examples include the European Union, COMESA, and The Southern Common Market (MERCOSUR).

## 9.5 Motivation for formation of trading blocs

The motivation for forming trading blocs varies from region to region, and even from country to country. The main reason behind this integration includes the following (Shiels, 1995):

- a) Economic benefits: achieved by developing a more efficient production structure (including by exploiting economies of scale through spreading fixed costs over larger

regional markets), and enhanced economic growth from foreign direct investment, learning by doing, and research and development.

- b) Non-economic benefits: Members may value noneconomic objectives, such as strengthening political ties and managing migration flows.
- c) Safe heavens: Smaller countries may seek increased security of market access by forming trading blocs with larger countries.
- d) Locking in unilateral domestic policy reforms. Members may want to improve their bargaining power in multilateral trade negotiations or express frustration with the slow pace of these negotiations (as happened during the Uruguay Round).
- e) Domino effect: As countries form new RTAs, or deepen existing ones, trade is diverted from third countries. This may tip the political balance in third countries in favor of joining the RTA, as exporters' interests begin to prevail over the interests of import-competing firms. As more countries join the RTA, excluded countries may suffer additional trade diversion and, eventually, incentives to join outweigh interests of import-competing firms—the domino effect.
- f) Regional infant industries: Members may want to promote industries that are not viable without a protected regional market. This is pegged on the idea that they would be internationally competitive if given sufficient time to develop.

## **9.6 Objectives of trading blocs**

Maity (n.d.) identifies the following as objectives of formation of trading blocs

- Reduction of trade barriers among the member countries: members hope that by coming together and adopting a common policy on trade, there would be significant reduction of trade barrier within and without the various members of the bloc.
- Maintaining better relations: countries cannot trade effectively if there is absence of peace in the region. Blocs are seen as engine of peace building within the blocs.
- Imposing barriers on nonmember countries: the country aim to secure their economic growth by developing policies that are likely to keep away nonmember countries.
- Promoting free transfer of labor, capital, and other factors of production
- Creating currency and central bank: this is one of the biggest challenges in formation and development of blocs but hoped to be achieved within a given period. The end of a bloc is to develop a political federation.
- Collective bargaining: members of a bloc have better chances of bargaining better with other countries or even blocs.
- Assisting member countries: this happens when a member is faced with crises such as natural catastrophe and even political unrests.
- Enhancing welfare of consumers: this is done by ensuring certain standards of goods and services are enhanced within a bloc.

- Generating competition: competition is healthy within a bloc as it makes industries more efficient in production. Younger industries are also given time to develop within a certain bloc.
  - Prompting higher employment: this is because of increased trade within the bloc.
- Other aims of trading bloc include (World Bank, 2000):
- Encourage RIAs to achieve trade creation and avoid trade diversion, both for the sake of members and to minimize harm to excluded countries, for instance, by setting low external tariffs.
  - Permit deep integration, including nation building, between members.
  - Preserve the effects of previous liberalization and provide credibility for any liberalization that forms part of the RIA.
  - Support a liberalizing dynamic within member countries and in the world trading system.

### **9.7 Advantages and disadvantages of trading blocs**

The following are advantages and disadvantages of trading blocs as highlighted by Maity (n.d).

#### **Advantages**

- a) Foreign Direct Investment – Foreign direct investment (FDI) surges in TRBs and it benefits the economies of participating nations.
- b) Economies of Scale – The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.
- c) Competition – Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.
- d) Trade Effects – As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.
- e) Market Efficiency – The increased consumption, the changes in demand, and a greater amount of products result in an efficient market.

#### **Disadvantages**

- a) Regionalism – Trading blocs have bias in favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.
- b) Loss of Sovereignty – A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.
- c) Concessions – The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc need to make some concessions.
- d) Interdependence – The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have an adverse effect on the economies of all participants.

## **9.8 Principles for designing regional trade agreements.**

The following are guidelines for designing effective regional trade agreements that facilitate growth of trade world-wide (Shiel, 1995).

- a) WTO compatibility. The RTAs must be designed in a way to eliminate barriers to most trade among members. This practice supports the ultimate objective of global free trade.
- b) Low Most Favored Nations tariffs. Lowering tariffs reduces the risk of trade diversion among members.
- c) Liberal accession clauses. Liberal rules are essential for inclusion of new members in the group.
- d) Liberal rules of origin. The rules should be transparent, not differ across sectors, and not be too stringent, since they protect regional input suppliers, leading to diversion of investment into the RTA. They must be designed to avoid interference from other groups.
- e) Deep integration. Deeper integration, involving liberalization of services trade, investment, and some coordination of regulations offers greater scope for economic gains from efficient resource allocation within the RTA.
- f) Limiting antidumping actions. Dumping implies exporting at prices lower than the comparable price in the home market. RTAs should prohibit use of these measures against members, and should minimize resort to antidumping duties against nonmembers.

## **9.9 Characteristics and growth of trade blocs**

There are three common characteristics of trading blocs (Brand, 1992).

- First, they are born of political fear. Fear of domination and threat of being colonized trade wise by other countries.
- Second, blocs espouse trade liberalization internally, but achieve trade protection externally.
- Third, Agriculture is treated in one of two ways. It is institutionalized as the central policy of the bloc or it is neglected purposefully

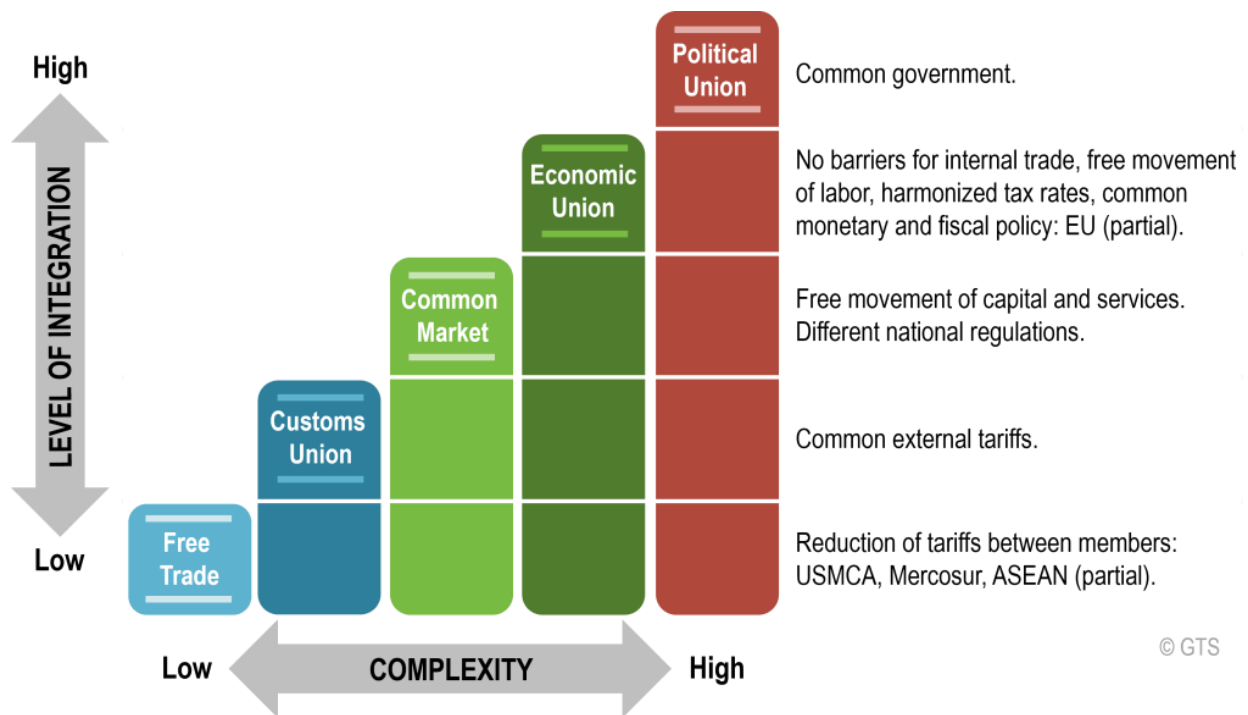
Once trade blocs have been established, they must be grown by the efforts of all members to reach their full potential. It is said that trade blocks grow from preferential trade areas to custom union as depicted in figure 9.1.

Foxley A. (2010) notes the following about growth of trade blocs.

- Regional trade agreements reach their full potential when the political and ideological differences among participating countries are minimal.
- Trade deals work best when member states coordinate monetary and fiscal policies. In fact, uncoordinated fiscal policies in the European Union framework are responsible for current financial turmoil in the region, with a negative impact on trade.
- Bottom-up approaches, in which companies develop supply chains across borders, are more effective in facilitating regional integration than are top-down approaches imposed by governments.

- Agreements on trade and investment norms—including reducing transportation costs through coordinated efforts to improve the quality of infrastructure can significantly improve trade.
- Countries must achieve better balance between fiscal stimulus and financial solvency to reinvigorate regional trade agreements. The former increases public debt to levels that might threaten financial stability. Countries also must address concerns over consistency in exchange rates policies. The coexistence of fixed exchange rates with free floating rates, as in the euro zone, creates imbalances in trade.
- Ambitious goals for trade deals are easier to achieve when negotiations proceed among countries that embrace the benefits of globalization, meaning those that have been willing to unilaterally open to trade, or have actively supported multilateral trade liberalization.

### 9.1 Stages of development of regional trading blocs



Source: *The Geography of Transport Systems FIFTH EDITION Jean-Paul Rodrigue (2020), New York: Routledge, 456 pages. ISBN 978-0-367-36463 doi.org/10.4324/9780429346323*

### 9.10 Governing principles of a trading bloc

Once a trading bloc has been established there are governing principles that helps to sustain it and support achieving of its objective. We take the example of South Asian Association for Regional Cooperation (SAARC) as demonstrated by Maity(n.d).

- Respect for sovereignty, territorial integrity, political equality and independence of all members state.

- Non-interference of internal matters is one of its objectives.
- Cooperation for mutual benefits.
- All decisions to be taken unanimously and need a quorum of all the eight members.
- All bilateral issues to be kept aside and only multilateral issues to be discussed without being prejudiced by bilateral issues.

### **9.11 Barriers to development of trade blocs**

Barriers that affect the development of regional trading groups include (Constantia A. & Nicolette S. (2006) and .

- Geographical and political fragmentation,
- Varying levels of development between member states
- Political and economic variety,
- Diversity of strategic views among member states
- Irregular sharing of gains among the member states
- Unwillingness of member states to surrender their independence to supra-national organization.
- Poor transport and communication system
- Macro-economic challenges such as unfair trading systems, debts
- Protective importation that hinders trade
- Weak institutions to implement trade agreements.
- Lack of inclusion of all players in developing of trade agreements especially the businesspeople

### **Review questions**

1. Define a trading block and explain its characteristics.
2. Discuss motivations for the development of trading blocs.
3. Why should a export marketeer learn about a trading bloc
4. Discuss the process of development of a reading bloc.
5. Elaborate on advantages and disadvantages of joining a trade bloc
6. Discuss the governing principles of a trade block

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